

**Centre for Utility Consumer Law
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**Ofwat's future strategy for customer charges for water and
sewerage services: response to consultation**

We welcome the opportunity to respond to this consultation. However, we have serious reservations about the proposals. Many of the proposed policies set out in the consultation document effectively assume a relationship between cost reflectivity, tariff structures, enabling competition, and the promotion of metering. There is an undue emphasis on enabling competition and insufficient examination of the implications for domestic consumers of the proposals.

The references to the need for charges to be as affordable as possible for all consumers are welcome. It would be helpful if Ofwat could elucidate further on what is meant by affordability and indeed develop some criteria. The document also refers to the needs of 'vulnerable customers'. This term is frequently used quite narrowly in ways that tend to stereotype groups of customers and exclude many people who are in vulnerable circumstances in relation to these services. Consequently, we recommend that Ofwat should develop its approach to what is meant by the term 'vulnerable customers' and provide guidance to the companies in relation to the complex issues that place consumers at a disadvantage.

The consultation document makes various assertions about metering and the need for tariff trials that can provide strong evidence to inform the development and refinement of tariffs. Although Ofwat is requiring the companies to include tariff trials in an approved scheme of charges before they can be put into effect, it does not appear that Ofwat is providing guidance for the companies beyond the requirement that the tariffs do not contravene condition E of their appointment. Given the importance of these matters for domestic consumers, it is essential that the trials are independently monitored and evaluated, and the results and underlying data made publicly available. Domestic consumers in England and Wales will continue to be supplied with water and sewerage services on a monopoly basis for the foreseeable future. As a result, there is no justification for the results of these trials to be kept from the public domain under the cloak of commercial confidentiality.

A fundamental point of concern is the inadequacy of the interim impact assessment that has been published to accompany the consultation document. Consequently it is vital that Ofwat carries out a far more rigorous and informative impact assessment before taking decisions on these issues.

Main recommendations

- Ofwat should publish and consult on a robust impact assessment regarding the implications of these proposals for domestic consumers in general and for groups of consumers before taking final decisions.
- Ofwat should publish guidance to the companies to ensure that the interests of domestic consumers are fully protected in any forthcoming tariff trials, particularly the interests of consumers with high levels of essential need for water use.
- Ofwat should ensure that the results and data of tariff trials are independently evaluated and made publicly available.
- Before proceeding with promoting the further spread of metering, Ofwat should publish an up-to-date evaluation of available evidence on the costs and benefits of metering for different groups of domestic consumers.
- Protection of consumers' interests, particularly those of domestic consumers, should be at the heart of Ofwat's policies; policies to enable competition should only proceed if it can be guaranteed that they will not damage domestic consumers' interest regarding these essential services.

Charging principles (section 2)

Charges should be fair and equitable

We agree with the above principle but there is a need for greater clarity about how it will be applied in practice. For instance, whilst the basis for charges should be transparent, it is not clear how cost-reflectivity sits alongside the need for charges to be as affordable as possible for all consumers, which is the second of Ofwat's principles.

In addition, it is difficult to comment on fairness and equity of charges without taking into account broader issues relating to corporate behaviour, especially in relation to the timing and costs of investment which have an impact on the companies' costs and on consumer charges.

Another concern is that the consultation document conflates fair and equitable charging with metering through assuming that a volumetric-related approach is the core or key basis for charging. However, the relative importance in terms of corporate costs and investment programmes depends greatly on the circumstances in which individual companies operate. For instance, metering

may be inappropriate in areas that are not under stress in terms of water resources. Moreover, some of the larger investment programmes of some companies may be more concerned with pollution, water quality issues and cleaning up beaches than with the costs of delivering water supply.

The case for metering is based upon old empirical studies and unpublished research. Robust and up-to-date research is needed to provide a firmer evidential basis, which should be made public and used as a basis for consultation before proceeding further with the promotion of metering.

Many people have high levels of essential need for water and sewerage services because of personal circumstances, and many of them are on low incomes and are facing increasing difficulty in affording above-inflation water and sewerage bills. The problem of water affordability for many people in these circumstances is likely to become severe if they are moved onto a metered tariff. Existing means of helping such households with their water bills is totally inadequate, and relies on the flawed Vulnerable Groups Regulations and discretionary charitable assistance.

Charges should be as affordable as possible for all customers

We agree and welcome Ofwat's recognition of the need for affordability. However, it would be helpful if Ofwat could provide further information as to how it defines affordability in this context.

The consultation document states that Ofwat's policies will expect companies to take account of the needs of vulnerable customers. It would be helpful if Ofwat could expound on its interpretation of this term and provide guidance to the companies in this regard. All too frequently, the term 'vulnerable customer' is construed far too narrowly. In reality, many people can be placed in vulnerable circumstances and are at a disadvantage in relation to these essential services because of a range of factors which may be short or long-term, episodic or fluctuating.

Incentives to consumers and companies should be improved

The consultation document states that Ofwat wants the companies to deliver the right level of service at the right price. The crucial factor here is whether the price controls are set correctly to ensure that customers are charged fairly and that companies do not enjoy excess profits.

In terms of tariff structures, Ofwat wishes to encourage innovation and alternative tariffs which can increase customer choice and cost-reflective charging. However, Ofwat should not assume that an expansion in the range of tariffs offered is going to be in consumers' interests. On the contrary such a move is

likely to increase consumer confusion and it is risky to embark on this policy in a sector that provides essential services for health and well-being.

Companies should be clear about how overall customers' bills are made up and what customers can do to influence them

We agree with the principle. However, it should not be assumed that an expansion of the range of tariffs is automatically in consumers' interests (see comments below under 'Customer choice').

In putting this principle into effect, Ofwat should focus on ensuring that the information about the make-up of bills is as clear as possible for consumers. It is a matter of concern that the consultation document emphasises aspirations about the potential development of competition in this regard.

Charging policies (section 3)

Unmetered charges

There is an urgent need for finding ways of ensuring that water charges are affordable for all customers – unmetered as well as metered.

It is disturbing that Ofwat appears to be allowing companies to increase so-called 'RV modifiers', that is standing charges, in order to encourage customers to opt for metering. Although Ofwat states it will look critically on company proposals in this respect, it is nevertheless allowing the practice to continue as long as companies make alternative tariffs or mechanisms available to protect vulnerable or low income customers. However, it is by no means clear that such tariffs or mechanisms will be effective. Ofwat will need to ensure that any changes in this regard are cost-reflective and that sufficient consumer protection is put in place before changes are made.

Metering

'Paying for what you use' might appear to be fair but it does not take account of a wide range of circumstances outside consumers' control regarding their use of water. Furthermore, the volumetric aspect is only one of several factors that influence customers' charges, as we have stated above.

Although Ofwat accepts the importance of tariffs and mechanisms to protect low income and other vulnerable consumers, it is nevertheless promoting the spread of metering before effective systems are in place. By doing so, Ofwat is in danger of undermining its duties regarding the interests of low income consumers and disabled people.

It appears likely that average household bills will rise by more than they would otherwise have done if metering spreads. This makes it crucially important that protection for consumers in vulnerable circumstances is in place before metering spreads further.

The document asserts that metering will reduce water consumption and, by doing so, will reduce energy use in the home and by the companies. Whilst of course we support moves to cut carbon emissions and to conserve water, it is poorer consumers who are most likely to cut down on water consumption because of metered charges. In this respect, the proposals appear to be regressive. We comment below on whether tariff structures could offer sufficient protection for low income and other vulnerable consumers.

Ofwat's argument that metering should facilitate the development of competition raises concerns about cherry-picking by new entrants. Indeed Ofwat seems to be encouraging this practice by stating that improved price signals can also reveal where entry would be most profitable and sustainable. Instead Ofwat should be seeking to guard against such practices which could have adverse effects for domestic consumers.

The document asks what other evidence and issues should be considered to gain a better understanding of the costs and benefits of accelerating the uptake of metering. Most urgently we need robust and independently-evaluated research evidence on the short and long-term consequences for different groups of customers of metering. This should include evidence about consumption patterns, what uses consumers cut back upon, and any effects for health and well-being.

In addition, there are a number of technical issues that need investigating and consulted upon, including the viability of metering properties such as blocks of flats, sheltered accommodation units, and homes of multiple occupation. There are also issues that need to be resolved about the location of meters – most notably external meters are difficult or impossible for most customers to read easily. An associated point is whether smart meters or other devices can be developed in ways that will provide easy-to-access consumer information without putting further upward pressures on costs and customer charges.

Metering standing charge

Ofwat is proposing to consider again how metered standing charges should be structured. But the consultation document provides little or no relevant information about the existing structure of these charges. It is necessary to take issue with the question posed in the document: how these charges should ideally be structured to accurately reflect the customer and volume-driven costs while also enabling competition. First we need to know the justification for how these charges are currently structured. Secondly, Ofwat should explain whether the

current structure and charges are ineffective or inappropriate and, if so why, and if not, why not.

The consultation document does not explain in what way volume-driven costs are related to these standing charges given, for instance, many companies include in these charges the costs of surface water drainage and highway drainage. Neither of these has any obvious relationship with volumes of water consumed by customers. And again Ofwat conflates the appropriateness of standing charges with enabling competition. Altering the structure on this basis alone could well contradict the policy of cost-reflective pricing.

Cost reflectivity and tariffs

The most striking feature of the consultation document on this important subject is the lack of an evidence base. Instead there are assertions and exhortations to the companies to develop seasonal, innovative, rising block, and social tariffs. Without a robust evidence base, Ofwat appears to have decided that in order to achieve various objectives – water conservation, protection of ‘vulnerable’ customers, and enabling competition – the main lever is that of tariff structures. Ofwat has decided on a policy but is relying on trials to provide the evidence. However, it may be that tariff structures alone cannot accomplish these policy objectives, which is at least one theoretical outcome of the trials.

We recognise the consultation is about Ofwat’s strategy on customer charges but we would have expected to see at least some references to other levers, such as how customers can be helped to cut down on water consumption through water efficient devices and equipment and that these would also be trialled.

Seasonal tariffs

The case for seasonal tariffs is not as straightforward as it would appear. For instance, some ‘discretionary’ use of water fits with public policy objectives, such as people using water to grow their own vegetables which helps to reduce carbon emissions by reducing the costs of transporting food.

Rising block tariffs

The size of the initial block of water for ‘essential’ use is critical. Yet Ofwat is proposing to leave decisions about this to individual companies, which is a matter of concern. Neither the consultation document nor the accompanying interim impact assessment show any recognition of the potential effect of rising block tariffs for people who have high levels of essential use of water and sewerage services. For Ofwat to meet its stated objectives, the price differentials between different blocks will have to be significant. This will penalise those with high essential usage due to household size, disability or medical condition.

This apparent lack of knowledge about households that require relatively high water use is disturbing. The potential effects should have been set out in the impact assessment. For example, there are many people with skin conditions, arthritis, bladder or bowel problems, or other conditions which mean that their health and well-being may well be damaged if they have to make substantial reductions in their use of water. In addition a number of these conditions are fluctuating or episodic and it is consequently difficult to construct tariffs that would protect people sufficiently in these circumstances. If disabled people with high levels of essential need for water are effectively penalised through rising block tariffs, a question arises as to whether this would be discriminatory on the grounds of disability. In addition, rising block tariffs appear to be regressive as the effects of each step change will affect poorer households more than better off households, especially those with high essential needs.

Social tariffs

We agree that it is the Government's role to protect low income and other consumers in vulnerable situations with regard to the affordability of water charges through the tax and benefits system.

Whilst the notion of social tariffs may be superficially attractive, in reality they can only play a minor role in tackling the affordability of water charges. Ofwat is also seriously under-estimating the potential numbers of consumers who may face difficulties with water affordability. The consultation document asserts that these tariffs can be developed without unduly increasing the burden on other customers through cross-subsidy and claims that this can be done where the number of customers helped may be small. Therefore Ofwat is assuming that the application of such tariffs will, in practice, be extremely restrictive. Once again there is no assessment or recognition of the extent of potential need or of the number of consumers who may face problems with affordability of water bills.

It would be invidious to leave it to private companies to decide on the criteria for social tariffs as this is a matter of broader public policy. Moreover, the effectiveness and viability of social tariffs are being questioned in the energy sector. There is an extremely low level of take-up of tariffs offered under the Vulnerable Groups Regulation in water and, unless Ofwat ensures that any social tariffs are more effective, little or nothing is likely to be achieved. In addition, as far as we are aware, no evaluation has been carried out about whether the tariffs offered through the Vulnerable Groups Regulations make any significant difference to the affordability of water bills for the small number of consumers who currently claim them.

It is disturbing that the consultation document refers to the ban on household disconnection and the possible use of pre-payment or trickle flow devices with the implication that the ban could be lifted. There is no mention of the profoundly important public and personal health issues involved with such moves – Ofwat

should clarify that it has no intention of making recommendations to lift the disconnection ban or that the use of such meters or devices should be permitted.

Customer choice

The consultation document appears to assume that increased choice of tariffs would automatically be in consumers' interests. This is not necessarily the case as demonstrated by other markets which have a confusing array of tariffs and deals, such as mobile phone tariffs. There is also no obvious recognition of the need for clear and trustworthy information so that customers can make informed decisions about tariffs that reflect their own situation. Neither is it clear whether consumers in general wish to be confronted with yet another set of choices – this time about the most essential of services. There are also many people, for instance those with basic skills difficulties or in stressful situations, who might not welcome having to choose between a range of tariffs. This, and other critical issues, are not mentioned in the interim impact assessment.

On 'green tariffs', which Ofwat puts forward as one of the possible optional tariffs, there are lessons to be learnt from energy where concerns have been raised about the justification for higher charges associated with these tariffs, and to what extent they are based on 'green' energy sources. It is surprising that the consultation document makes no reference to current debates about the validity of 'green' tariffs.

Impact assessment

The interim impact assessment that accompanies this document is grossly inadequate. It does not contain any meaningful attempt to evaluate the possible consequences of the proposals for groups of domestic consumers. In particular, the assessment does not examine the implications for the potentially large number of consumers who have high essential needs for consumption of water and sewerage services because of disability, medical condition, size of household or other personal circumstances.

A recent report by the National Audit Office on impact assessments by the economic regulators concluded that regulators are not routinely producing good quality, proportionate analyses of costs and benefits.¹ The report covered Ofwat amongst the other economic regulators. It highlighted two common weaknesses in the impact assessments reviewed: a lack of meaningful comparisons between alternatives or an appropriate level of quantitative analysis. These weaknesses are reflected in the interim impact assessment.

The NAO report remarked that there are a number of circumstances where a regulator will be unable to perform quantitative analysis without creating

¹ *A Review of Economic Regulators' Impact Assessments – for the House of Lords Select Committee of Regulators*, National Audit Office, 2007.

misleading certainty and in these circumstances qualitative analysis has an important role. Ofwat's interim impact assessment is seriously deficient in terms of both quantitative and qualitative analysis.

April 2008