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Mandy Jones
Customer Charges Team
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

1 Queen Anne's Gate
London SW1H 9BT
Telephone 020 7344 1844
Fax 020 7344 1866
e-mail contact@water.org.uk
website www.water.org.uk

Pamela Taylor
Chief Executive

Dear Mandy

Thank you for inviting Water UK to comment on Ofwat's future strategy for customer charges for water and sewerage services. Generally, as we have done in the past, we support the broad principles proposed by Ofwat but we sometimes consider they lead to different implications for companies' specific charging methods. Charging for services, at the moment, is at the core of the relationship between water companies and their customers. As a consequence, each water company has developed – or would like to develop – specific charging strategies designed for its own environment. The value of Ofwat's charging strategy depends on the extent to which it supports different but legitimate company approaches to charging and still provides relevant guidance.

As Ofwat's proposed strategy affects our members in different ways, they are responding to the consultation individually with their specific views. Our response reflects Water UK's own position on general charging principles as well as, where possible, recording our members' different perspectives.

Customers and consumers

We are pleased to note Ofwat's emphasis on its duty to customers and consumers. We think that they should be the focus of Ofwat's charging strategy and this focus should inform the way Ofwat fulfils its other duties such as that of sustainable development.

We think that it is useful to refer to competition in the context of Ofwat's charging strategy, since competition is driven by customers, but we think that Ofwat's charging strategy should include an explicit discussion of the links between charging and competition.

We would like to contribute to this work but we cannot do so usefully at the moment as Ofwat's considerations are not set out. We believe that they would be interesting if they were. Indeed, Ofwat's 'Outcomes' document on its review of competition, published in April 2007, included some well-argued paragraphs linking competition and charging, including average charging. Ofwat might like to include some of that thinking in the development of its charging strategy.

Ofwat's charging strategy might also benefit from distinguishing business customers from household ones. Household charging, at the moment, seems to be the main topic of its strategy.

While legislation stays as it is, there is a case for considering whether charging for the sector potentially or actually eligible for competition should be the object of a distinct strategy from that applicable to the non-eligible sector, namely household customers. Clearly, Ofwat needs a charging strategy that covers all types of customers.

Developments since MD152 and Defra charging strategy

We agree with Ofwat that the context of its charging strategy has changed since it issued MD152 in September 1999 and that it is time to review it. As Defra has announced in its 'Future Water' strategy document that it will conduct a charging review, we believe that Ofwat's charging strategy may need to be reviewed further in light of Defra's work. We will be pleased to contribute to Defra's and Ofwat's continuing work.

Ofwat also refers to the research project in which the water industry has been engaged with Defra, Ofwat, and CCWater, which investigates how tariffs designed to achieve various policy objectives put the burden of paying for water services on various classes of customers. When this research project produces its results, we believe that they are likely to influence Ofwat's charging strategy as well as Defra's review. We will work with relevant parties to ensure that the greatest benefit is obtained from the research work.

Strategic themes

Ofwat identifies a number of strategic themes which, we agree, are important in the context of a charging strategy:

- Ofwat wishes to encourage innovative tariffs – we think that this is an important objective but we are disappointed that Ofwat does not discuss – or suggest for discussion – what it can do beyond setting conditions that tariff trials need to satisfy (Section 3.5). We are pleased to note that Ofwat has already allowed some tariff trials to

go ahead. These will give greater experience of the practical issues associated with running such trials. However, we have also heard from our members that Ofwat, in practice, is often reluctant to support tariff innovation and, it is said, is actually stifling it. We think that Ofwat charging strategy should be developed in this regard.

- We are surprised that another strategic theme should be described as ‘support for a faster transition towards high levels of meter penetration’ without a qualifying reference to the specific circumstances of each company. This is all the more surprising as Ofwat recognizes elsewhere that companies’ circumstances should influence their metering strategies. In particular, the sound cost-benefit analyses which Ofwat says should support metering may lead certain water companies to conclude that metering is not justified in their circumstances because the value of the water saved is less than the cost of metering. We think that a suitable strategic theme on metering should reflect the fact that metering has a genuine resource cost and increased meter penetration may not be appropriate for all companies to support. This theme seems at odds with the recognition elsewhere that metering has a certain, immediate resource cost and with Ofwat’s emphasis on cost-benefit analyses in PR09 processes.
- Ofwat wishes to encourage technological innovation – we agree that this is a good theme with which to inform its charging strategy. We think that Ofwat’s promotion of forms of competition which support efficient entry by new entrants – and not arbitrage – could be one factor contributing to technological innovation.

Charging principles

Fair and equitable

We support the principle that customers using similar services within one company should pay similar charges if their circumstances are similar. And we support Ofwat’s statement that it does not envisage cross-subsidies across company boundaries.

The essential issue in this principle is the question of which circumstances are relevant in deciding whether differences in customer circumstances justify different charges. While there is general agreement that relevant circumstances could include external considerations such as

geographical location, our members have widely differing views about the extent of the differentiation that should be allowed between customers. As Ofwat knows, some of our members believe that relevant ‘circumstances’ should include a customer’s income and ability to pay while others do not (see our comments under ‘affordability’ below).

Affordability

We agree with the very general statement that prices should be as low as consistent with companies’ ability to fund their activities. We do not believe that concerns about the affordability of water bills for some water customers should constrain the overall expenditure of water companies where policy requires money be spent. At the same time, our policy remains that Government should ensure that water customers’ bills do not include charges for activities for which water customers should not be responsible. We shall be happy to collaborate further with Ofwat in making this point to Government.

Like Ofwat we believe that Government has a role to play in dealing with affordability concerns. We also note findings in Ofwat’s joint research with CCWater that water customers do not wish to cross-subsidize other customers further than they do now through their water bills and their taxes. If water bills are related to income, they are likely to be perceived as taxes, with the risk that customers are not aware that they are paying for a service and a commodity that they need to value and conserve. Such water taxation may not give customers the water saving incentives that metering should create by making customers pay for what they use.

However, some of our members believe that linking volumetric charges to customer income ensures that customers receive similar incentives to saving water – charges need to be higher on high-income customers to have the same impact as lower charges on low-income customers. Moreover, some of our members find that the existing benefits system – that should ensure that there are no ‘can’t pay’ customers – is not effective to such an end and is unlikely to be so in the near future. Faced with an increasing number of ‘can’t pay’ customers and without the prospect of Government intervention, some of our members are taking action with innovative tariff schemes. We believe that Ofwat’s strategy should be clearer on the kind of innovative tariffs it will approve. Ofwat should reduce uncertainty for companies seeking to make progress in dealing with customer payment difficulties.

We would also like to see support in the strategy for measures to ensure that companies recover payment from customers who can pay but choose to exploit various opportunities for avoiding paying. We would like Ofwat's support in pressing for further legislation that would allow water companies to pursue 'won't pay' customers more effectively. We are glad of the collaboration that we have been able to sustain with Ofwat and CCWater on reducing water debt and we are working to ensure that it yields results.

Incentives to consumers and companies should be improved

We agree with the emphasis that Ofwat puts on leaving each company to develop its own tariffs in line with its circumstances and Strategic Direction Statement.

We support Ofwat's principle that charges should be 'broadly cost-reflective', at least taking a class of customers as a whole. However, Ofwat's strategy would benefit greatly from a full discussion of what it means by 'cost-reflective', particular in consideration of the fact that some current charging practices are not cost-reflective. Ofwat's strategy should recognize that there are degrees of 'cost-reflectiveness' and should provide guidance on its position.

In this context, we think that Ofwat's discussion of metered standing charges is insufficient. It notes that there is a range of values for standing charges but does not seem to have evidence on whether this range reflects costs. It would be useful if Ofwat's charging strategy discussed the costs that it considers should be recovered by standing charges. Such discussion would probably inform its comment on tariff structures and their relationship with competition, which deserves to be developed.

We support the comment that a cost-reflective tariff structure – if cost-reflective is appropriately defined – could help customers value water correctly. Ofwat's proposals, often and correctly in our view, refer to forms of tariff that reflect the marginal value of water and the role that such tariffs could have in influencing customers' decisions. Ofwat's charging strategy would be more valuable if it distinguished, and discussed separately, matters of cost recovery – which must be achieved if companies are to finance their functions and achieve other objectives – from matters of incentives, marginal cost and pricing.

As we said above, we believe that Ofwat should support more work in the development of innovative tariffs. We also agree with Ofwat that peak pricing is to be encouraged where it is economic.

How customer bills are made up and what customers can do to influence them

We believe that the work that Ofwat has initiated on cost allocation and accounting separation, in the context of its competition work, could be very helpful in showing consumers the make-up of customer bills.

Water UK has repeatedly expressed its support for work leading to a better understanding of water industry costs. We shall be pleased to contribute to Ofwat's current work.

We shall be happy to discuss our response further and contribute to Ofwat's development of its water strategy.

Yours sincerely

A handwritten signature in black ink that reads "Jeanne Golay". The signature is written in a cursive style with a light blue background behind the text.

Jeanne Golay
Economic Regulation Advisor

Tel: 0207 344 1808

Fax: 0207 344 1853

jgolay@water.org.uk

www.water.org.uk