



Ofwat's response to the Walker review call for evidence

13 February 2009

Executive summary

English and Welsh ministers have appointed Anna Walker, Chief Executive of the Healthcare Commission, to lead an independent review of charging and metering for household water and sewerage services in England and Wales. This document provides our formal response to the call for evidence and completes the evidence we provided in December 2008.

This response draws on the conclusions we set out following our consultation on ['Ofwat's future strategy for customer charges for water and sewerage services'](#) and on our aim to protect consumers, promote value and safeguard the future.

In this document we:

- confirm our view of “fairness” which is embedded in our charging principles;
- show how metering can improve fairness, encourage sustainable use and enable innovation through increased competition;
- note that our policy in relation to vulnerable customers is that explicit support for such customers is best provided through the tax and benefit system rather than through introducing new cross subsidies between groups of water customers;
- provide advice and support to the Walker charging review to identify where Parliament might make a difference through extending protection to vulnerable groups through the tax and benefit system;
- provide examples of the effect of introducing some illustrative social cross-subsidies between groups of customers while noting that a mandate from Parliament through legislation would be required for any such approach, and that this would also have to be transparent to all customers; and
- provide data to further inform the debate on charging and metering.

More specifically, in the area of debt management we recognise the cost burden placed on those who pay their bills by those who will not. We look to the review to

support our proposals to provide additional tools for companies to help them collect revenues from those customers who choose not to pay. In particular, we:

- propose the introduction of a requirement for landlords, owners or managing agents to supply information to the water company to identify who is the “liable person” for any property. Companies would then have accurate and up-to-date information on which to charge. Alongside this, we will propose amending the legislation to place responsibility for water charges on the “liable person” instead of “the occupier”.
- support the extension of the Third Party Deduction Scheme that others are taking forward if it appears to be cost-beneficial.
- support further work on investigating the costs, benefits, and practical implications of removing the ban on trickle flow devices. In particular, we would wish to see appropriate safeguards developed to ensure that any water company proposal to reintroduce these devices would protect the most vulnerable customers, and those who cannot pay.

While we have addressed the key questions posed by the call for evidence, we are pleased to help the review team with any further questions they would like to put to us.

1. Background to the review

- 1.1 English and Welsh ministers have appointed Anna Walker, Chief Executive of the Healthcare Commission, to lead an independent review of charging and metering for household water and sewerage services in England and Wales.

The review has been asked to:

- examine the current system of charging households for water and sewerage services, and assess the effectiveness and fairness of current and alternative methods of charging, including the issue of affordability;
 - consider social, economic and environmental concerns; and
 - make recommendations on any actions that should be taken to ensure that England and Wales have sustainable and fair systems of charging in place. This could include changes to current legislation and guidance.
- 1.2 On 19 December 2008, we provided an initial response to the call for evidence that was issued on 14 November. This document supplements the evidence we provided in December.

2. Ofwat's duties and policies

- 2.1 Ofwat is the economic regulator for the water and sewerage sectors in England and Wales. Our work on charging is carried out within the context of our duty to protect the interests of consumers, wherever appropriate by promoting effective competition, as well as our other duties as set out in the Water Industry Act 1991 (WIA91) as amended by the Water Act 2003, and our aim of protecting consumers, promoting value and safeguarding the future.
- 2.2 Under WIA91 water and sewerage companies may only charge household customers according to a published charges scheme, which fixes the charges to be paid for the services provided. Each scheme can only be applied with Ofwat's approval.

Each year, we check and approve charges schemes for each water company in England and Wales. We check that, on average, each company's charges do not exceed its allowed price limit. We also ensure that "no undue preference is shown, and that there is no undue discrimination in the fixing of those charges", in line with our duties under section 2(3)(a) of the WIA91.

- 2.3 When approving charges schemes we have a duty to have regard to the interests of particular customers who:

- are disabled or chronically sick;
- are of pensionable age;
- are on low incomes;
- reside in rural areas; or
- are customers who are ineligible to be supplied by a licensed water supplier;

and also to have regard to other descriptions of consumer.

- 2.4 Therefore, we have a key role to play in informing the review. We are pleased to respond and offer ongoing support, assistance or data which will help the review to draw its conclusions.
- 2.5 This paper sets out our response to the review. It builds on the high-level views which we provided in December 2008 on the subjects set out in the call for evidence. It includes supporting information in annex 1 and details further supplementary information which has also been provided in annex 2. We confine our responses to household customers, in line with the review's terms of reference, unless we state otherwise.

3. Structure of our response

- 3.1 The call for evidence included 43 specific questions. Because of the close inter-relation between many of the questions, we have structured our response in sections covering the following broad areas.
- Fairness of charging and potential alternative charging methods.
 - Metering policy and the underlying economics.
 - Scope for managing demand through charging.
 - Understanding and managing debt and the needs of vulnerable customers.
 - Incentives for surface water and highway drainage.
- 3.2 In each section, we summarise the questions asked in the call for evidence and set out our key points, before offering further detail to supplement or back up our views.

Our response

4. Fairness of charging and potential alternative charging methods

What was asked?

- 4.1 The call for evidence invited submissions to cover a range of issues of principle relating to charging. It asks what constitutes a fair charging system and how the consumer and individual characteristics should be taken into account. Would this be different in a metered rather than unmetered system? We are also invited to comment on whether the current system is fair and what the alternatives might be. Are there examples of fairer systems elsewhere?

Our views

- We believe that charges should be related to costs and broadly cost reflective.
- By focusing on principles of fairness and equity and the provision of incentives, the interests of all groups will be protected.
- Metered charging offers fairer tariffs for customers than unmeasured systems, but some customers (such as large families) may require extra help as a result.
- There is a role for Government in making sure that groups not protected by broadly progressive charges and tariffs can access extra protection.
- Social cross-subsidies through water and sewerage charges would have a significant impact on all water bills and should be exposed clearly if they are introduced. This is so that customers know what they are paying for.

Fairness

- 4.2 In January 2008, we consulted on our strategy for charges going forward. We published the conclusions of the consultation in August 2008. We have recently carried out further work on some of the areas set out in this document. Our response to the review reflects the conclusions of that work. It also reflects our latest views on the issue of social support provided through water charges.
- 4.3 The review is seeking to reach a view on what is “fair charging”. We set out our view of fair charging in the conclusions to our charging strategy consultation. We believe that charges should be broadly cost reflective. We also set out our charging principles. Two of these were that charges should:

- be fair and equitable and
 - provide incentives for customers and companies.
- 4.4 We have a duty to ensure that water companies' charges are structured in such a way that they are neither unduly discriminatory nor unduly preferential to any class of customer. As we note above, we also have to have regard to the interests of consumers, including specified groups.
- 4.5 In focusing on fairness and equity in our approval of charges, we believe we will fulfil all the elements of our duties and the interests of all groups will be protected. We make sure that the tariffs we approve do not offer undue preference in favour of, or undue discrimination against, any class of customer – including the specific groups set out above. If any specific groups still needed extra protection through social transfers in tariffs once these two principles have been applied, then this is for Parliament to decide as it is a social policy matter.
- 4.6 In our view, customers who use similar services in similar circumstances should pay similar charges. These should be broadly cost reflective. There should not be cross-subsidies across water company boundaries. Any differences in charges should reflect properly differences in the efficient costs of supplying water and taking away wastewater.
- 4.7 Where appropriate, charges should also address differences between customer groups. A charging system that incorporates tariffs which provide the right incentives to customers (for example, to use water wisely) can be broadly socially progressive without the need for explicit new social transfers in tariffs. So, a rising block tariff with blocks based on the number of people in a property may offer lower bills to some groups of customers. This may not be the aim of the tariff, which seeks to offer enhanced incentives to customers to manage their demand for water. We would encourage the implementation of such a tariff if the outcome also resulted in reduced bills to some groups, as well as reducing customer demand. We have approved a number of trials which will explore opportunities to develop tariffs in this way, and will gather more data on the effects of such tariffs based on actual customer behaviours.
- 4.8 If we identify groups which are not protected by cost reflective charges, in conjunction with fair and equitable tariffs that provide the right incentives, we will bring them to the attention of Government. If Government considers it appropriate, these customers could be helped through the benefits system. This would be fair, equitable and transparent. Alternatively, legislation could be considered to introduce new social transfers in tariffs for the purposes of supporting specific customer groups and in that case key issues of

transparency and implementation would have to be addressed. We consider this issue further in section 7.

Do more fair systems exist elsewhere?

- 4.9 We have looked at the systems in place for water charging across Europe and whether they meet our view of what is fair. Water and sewerage charges in England and Wales currently cover the full costs of investing in and operating the water and sewerage system.
- 4.10 Apart from other northern European countries, water pricing in the rest of Europe is generally not fully cost reflective. Therefore, we believe the charging systems are not directly comparable and might not be considered fairer.
- 4.11 For example, the price of water in Spain normally reflects both operating and maintenance costs. Capital investment comes from public funds (recently EU funds) and is not recovered through the price for water. Local authorities in Spain set water prices. This means that they can be influenced by local political opinion. This is not the case in England and Wales where an independent regulator sets water price limits.
- 4.12 Similarly, water prices in eastern European countries have been heavily subsidised in the past. New EU States are currently in the process of achieving standards set out in EU Directives such as the Urban Waste Water Treatment Directive. However, these standards have applied in England and Wales since 2005. As a result, the associated sewage treatment costs have been recovered in our water prices since then.
- 4.13 If we assume that fairness means customers should be charged according to how much water they actually use, then the current rateable value-based charging system in England and Wales might be considered less fair than other countries. This is because most of the western and central European countries meter most of their customers. However, as we note above, the pricing systems are not comparable.

How should the consumer and individual characteristics be taken into account?

- 4.14 Under our current system, water and sewerage companies' charges must not be unduly discriminatory or unduly preferential. Ofwat has a duty to enforce this requirement. As we have set out above, we have interpreted this to mean that charges should be broadly cost reflective and that there should be no new transfers of funds between customers through the charging system to

meet social objectives. Our charging principles do not support introducing explicit social cross-subsidies. We consider any such social policy objective should be set out in legislation. However, we also accept that a system based entirely on water use and without reference to customers' individual circumstances might leave some customers in need of additional assistance in paying water bills. We look at this issue in terms of how vulnerable customers can be protected and in relation to customer debt in more detail in section 7. We also offer details of tariff trials which might show that some customer groups can receive lower water bills without the introduction of specific social transfers (or social cross-subsidies) embedded in tariffs.

- 4.15 We believe that it is appropriate for Parliament to provide social policy and in particular to decide whether groups of vulnerable customers should receive assistance. Should Parliament consider such assistance to be appropriate, we believe it is fairest to deal with this through the tax and benefits system and not through water charges. Social transfers implemented through water charges could be legislated for, and would have to be transparent to customers. Such transfers could have a significant impact on customers' bills. We provide below, for information, indicative numbers to show the impact of some theoretical social transfer scenarios.

Current and potential alternative charging methods

- 4.16 This section sets out the current charging methods within the charging system. It looks at how these meet our principles of fairness and equity and incentives and sets out alternatives.
- 4.17 Ideally, the structure of charges should reflect the underlying costs of providing the service. The most prevalent current system of charging in England and Wales, rateable value (RV), does not provide this level of cost reflectivity. RV charges are not related to usage. Metered charges are better related to costs. Developing alternative, sophisticated tariffs improves this relationship and, in our view, the fairness of the charging system. However, metering levels vary across England and Wales and the potential for cost reflective charging is limited in those areas where metering levels are low.

Current charges

- 4.18 The exact basis for charging customers varies by water company. The table below gives a broad indication of the way household customers are charged for water, foul sewerage and sewage treatment, surface water drainage and highway drainage and the relative proportion that each service represents in the average bill across England and Wales.

Table 1 Percentage of household customers charged on each basis (2007-08)

Basis of charge/service	Linked to RV	Linked to metered volume	Assessed/ fixed	Property type	Percentage of average bill
Water	65%	33%	2%		47%
Foul	65%	33%	2%		37%
SWD	28%	7%	63%	2%	9%
HWD	35%	8%	56%	1%	7%
Percentage of customers' bills	60%	29%	11%	<1%	100%

Current charging methods – rateable value

4.19 Table 1 shows that most household customers are charged for their water and sewerage services according to the RV of their property. RVs have not been updated since 1989. They are now only used as a method of calculating charges for water. This method provides a poor proxy for water use as it is based on characteristics of the property, which were not related to water use and may have changed since the last occasion on which the RV was updated. This type of charge does not accord with our charging principles. It is neither cost reflective nor fair and equitable, as customers using similar amounts of water may pay very different amounts under this system. It also does not provide any incentive to customers to manage their use.

4.20 The RV system offers an element of social protection for some lower-income customers in low RV properties. This is because lower-income households are more likely to occupy properties with lower RVs, and are less likely to be paying an amount which more fully reflects how much water they use. This is most likely in the case of larger households. Smaller households in properties with higher RVs will pay more than would be the case if they had a meter and, as a result, they subsidise lower-income households. However, these smaller households are amongst those most likely to opt for metered charges so the extent of this 'social protection' is progressively falling. The social protection is also balanced by the fact that some customers in low RV-rated houses may be wealthy and be paying a lower rate for their water than they would on a meter.

Another benefit of the RV system is that customers may find it easier to budget as charges are fixed for the year in advance.

4.21 The RV-based system of charging is becoming increasingly out of date. In addition, it does not necessarily reflect the cost of a customer's use of water

and sewerage services. If fairness incorporates some element of taking account of an individual's circumstances, then an unmetered system based on property will not always meet this objective. Our preferred alternative method of charging is for customers to be metered.

Alternative unmetered charges

4.22 The water and sewerage sectors have also been looking at alternative unmetered charging methods. These include charging related to:

- council tax bands;
- property type; or
- the number of bedrooms in a property.

Some of these are already in use as “assessed charge” alternatives to metered charging. All alternative options would offer significant numbers of winners and losers if rolled out across the customer base. There is no evidence that any of these methods is more or less “fair” than the current RV system in terms of cost reflectivity, as they do not take full account of water usage. Equally, we have not seen evidence that any other means of charging would be easy to implement as a complete alternative system to RV. The costs of setting up and administering an alternative system would be substantial.

4.23 It is not clear that any other suggested unmetered system would be more “socially fair” or progressive (with lower income or disadvantaged customers paying less than other groups). Alternative methods do not take the characteristics of all individuals into account any better than the current RV system. The groups helped are always funded by other customers, some of who might also be in need of assistance.

4.24 We look below at the impacts of possible alternative tariffs to those already in place. We have been informed by the current draft of the report that ICF/ICS has produced. This report has not been published yet, which means we cannot be explicit in the details we set out on alternative tariffs, offering only high-level comment instead. We could provide more information to the review team once the report has been published.

4.25 This project was jointly commissioned by UKWIR, Ofwat and Defra to examine the impacts of possible alternative tariffs on a variety of customer groups. (The original contractor was ICF, which later became ICS.) The report concentrates on the national picture and cannot be read to apply to each water company area. The data was drawn from the ONS' Family Resources Survey.

4.26 The ICS report looked at possible alternatives to the RV system.

- Some tariffs were specifically designed to be progressive (for example, with customers in lower property banded housing paying lower charges than those in higher banded property). These tariffs were always going to produce a progressive result, but because of the re-distribution show very large numbers of gainers **and** losers.
- Other tariffs without a specific aim to target customers groups (for example, charges based on numbers of bedrooms in properties or a property type) show similar numbers of gainers and losers. But the profile of winners and losers is less progressive with the top income deciles included in the gainers.

4.27 As metering increases, it becomes more difficult to make a sound economic case for another unmetered system of charging to replace RVs. We do not believe that RV should be replaced with an alternative unmetered system of charging. If customers cannot be metered, an assessed charge may be the most appropriate alternative method of charging. In our charging strategy we said:

We believe that assessed charges should reflect as closely as possible the customer's likely use, while remaining efficient to implement. Well-designed assessed charges are likely to be more cost-reflective than RV-based charges. If the assessed charge is to be rolled out to large numbers of customers, each company will need to consider the most appropriate form of charge for its area. Of the types of assessed charge currently in use, our order of preference is:

1.
 - **An occupancy-based charge. These are relatively reflective of the expected use within a property. They require regular checks to operate effectively.**
 - **A bedroom-based charge. This would usually require one set-up enquiry by the water company, but is less reflective of the likely water use.**

Both of these charges can be varied to reflect the expected high or low level of use of the household overall.

2. A bespoke assessed volume charge based on the household's specific characteristics. This is expensive to implement and requires regular updates, but is the most cost-reflective assessed charge if correctly set up.

3. {
- A property type-based charge. This is very basic and not particularly reflective of individual use. It is easy to implement.
 - A charge based on average use, with reductions for single person occupancy.

Although companies decide the assessed charging structure for their customers, we are not supportive of charges which introduce a new RV type charge as these are least likely to reflect a customer's water use and are contrary to our policy. We also believe that more work will be needed here to ensure that assessed charges proposals align with our charging principles.

The more sophisticated an assessed charge is, the more personal information customers will need to share.

Assessed charges will only ever be a proxy for metered charges. Changes in metering technology may enable meters to be fitted more easily, at less cost and in more locations than is currently cost effective.

4.28 Our conclusion is that while alternative unmetered tariffs can be designed to help specified groups of customers, this is likely to be at the expense of other customers, who may equally be in need of assistance but not fall within the defined groups. This creates additional cross-subsidies in the water and sewerage charging system which we would not support. In our view, a metered system with a variety of tariffs which aim to produce the right incentives to customers can be socially progressive and this is the best way to ensure customers receive the most cost reflective "fair" price.

Current metered tariffs

4.29 At present, 36% of household customers receive bills for water and foul sewerage based on metered consumption. This varies by water company area, with 64% metered in the South West Water area and only 12.5% in the Portsmouth Water area.

4.30 The tariffs applied are similar across all companies. Each company will apply a standing charge and a charge based on the volume of water the customer uses. The structure will be the same for water as for foul sewerage, although highway drainage and surface water drainage charges can also form part of

the sewerage element of the bill. We say more about charging for highway drainage and surface water drainage in section 8.

- 4.31 Metering is our preferred charging method for water and foul sewerage. It offers incentives to customers to manage their demand and to value water as a resource. It is fair because customers pay for how much water they use, and all customers within a water company region using the same amount will pay similar charges. Tariffs can be designed to enhance incentives. We examine how they could help to deliver demand management and social protection in sections 6 and 7.

Alternative metered tariffs

- 4.32 We aim to encourage tariff innovation. A number of companies in the water sector are currently testing the scope for alternative metered tariffs.
- 4.33 The development and investigation of new metered tariffs is centred on two main areas. As metering aims to charge customers according to the costs they place on the system, the first area is demand management. Metering offers the opportunity to encourage management of water use by charging customers more for services they use at peak times, or for using more than an efficient amount of water overall. We look at examples of demand management tariffs being trialled by water companies in section 6.
- 4.34 The second area is social protection. The potential for alternative tariffs structures to offer assistance to specified or vulnerable groups (with or without specifically targeting those groups in the charge) have been looked at on a theoretical basis. We refer again to the ICS report and set out some high-level findings in section 7.

Bulk metering arrangements

- 4.35 Bulk metering may be an option if issues of practicality or undue expense mean that individual meters cannot be fitted (for example, in blocks of flats). This may be particularly appropriate in cases where communal services such as central heating and hot water are in existence. However, where one meter is installed to register the consumption of a number of dwellings, and sub-meters are not in place, some imbalance in charging may arise as a result.
- 4.36 Whilst the Water Resale Order is designed to ensure that resellers (for example, landlords, mobile home site owners, managing agents) do not overcharge in total for water services, in the absence of individual water meters, dividing the bill between users may result in some inequity. Our experience from dealing with purchasers under the Water Resale Order

shows that many feel that the method that resellers use to divide the total bill between occupiers is unfair. (While six methods are available, the most common method is to simply divide the total bill between the number of purchasers. The result is that regardless of the size of property, number of occupiers, level of usage etc all purchasers pay the same.)

- 4.37 While block metering may raise awareness of water use by the property owner (who may in turn encourage occupants to use water wisely), the incentive on individual occupiers to manage their consumption may be reduced if they see no direct link between how much water they use and their share of the bill.
- 4.38 Finally, because the occupiers will not always be classed as “customers” of the water company (the bill will be sent to the managing agent or site owner), some of the benefits that directly billed customers receive (for example, wide range of payment options, access to WaterSure tariff, free meter option) are not available.

5. Metering policy and the underlying economics

What was asked?

5.1 The review is looking to understand the optimum rate and extent of metering, or the alternatives. This is in the light of a range of strategic considerations including fairness, cost effectiveness and sustainability.

Our views

- Metering offers a range of charging benefits, but should not be an aim in itself.
- Meters provide the fairest and most transparent way of charging customers.
- Water company strategies for increasing selective metering should include a full assessment of the costs and benefits of metering (including the optimal timing of metering programmes) over other methods of maintaining a supply/demand balance.

Charging benefits of metering

5.2 Metering should not be an objective in itself. It is a means to achieving other objectives, including:

- increased fairness in charging;
- reducing consumer demand;
- promoting choice and flexibility; and
- enabling greater consumer control over usage and bills.

5.3 Metering is crucial to implementing key changes in water charging, notably, the development of innovative, volume-based tariffs. Meters are the fairest and most transparent way of charging customers, as charges are based on the volume of water used. Metering allows companies to tailor their tariffs to best suit their customers' needs and to reflect the costs customers impose on the supply system.

5.4 In addition, metering should facilitate the development of sustainable competition for a wider customer base in the future. First, improved price signals that can be developed through metering can send signals to customers, as well as revealing where entry would be most profitable and sustainable. Second, metering would allow a much-improved relationship with customers, the gathering of better information on customer usage and preferences and the tailoring of tariffs to customer groups. This would also

provide an opportunity for new entrant water suppliers to offer differing tariffs and service levels.

Switching to a meter

- 5.5 Household customers can ask their water company to switch them to a metered charge. The company is obliged to install the meter free of charge. This type of metering – optional metering – increases cost reflective charging, but usually only for customers likely to save money by moving from a high unmetered charge to a lower metered charge. This type of metering is unlikely to motivate customers to reduce their water usage significantly.
- 5.6 Unless they are in a designated water stressed area, water companies in England can only oblige a household customer to have a water meter installed under certain circumstances. These are:
- when the occupancy of a property changes; or
 - if one of the following is used on the property:
 - a sprinkler or automatic garden watering device;
 - a bath of more than 230 litres.
 - a swimming pool
 - a reverse osmosis unit; or
 - a power shower.
- 5.7 Water companies that operate mainly in Wales (Dŵr Cymru and Dee Valley Water) are not restricted in their powers to meter household customers.

Extending metering

- 5.8 All companies have considered their future metering strategies and set these out in their [strategic direction statements](#), water resource management plans and draft business plans for the 2009 price review (PR09). We require further information from them in support of their final business plans. The extent to which they intend to use compulsory metering powers varies.
- 5.9 While we recognise that there can be significant benefits from increased metering, there are also additional costs. If virtually universal metering were to be in place by 2030, we estimate it could raise average household bills by about 2.2% more than would have been the case under the 2004 price review (PR04) metering projections.
- 5.10 In our policy paper on water supply and demand policy (PR09/20), we stated that companies, “**should choose the pace of any further selective metering (including planned metering) by comparing its costs and benefits with those**

of other options to find a solution that provides the best value to customers and the environment.” Further noting that, “we accept the quantified **costs** might exceed the quantified **benefits** but we will make allowance for selective metering as long as there is a reasonable prospect that unquantified net benefits can bridge that gap.”

5.11 In our recent review of water company draft business plans we (re)stated a similar message: “**We support both metering and smart metering in principle. We challenge the companies to include in their final business plans robust proposals as part of a coherent strategy to deliver value for consumers. We have seen that in many cases the quantified costs might exceed the quantified benefits. But we think it will still be appropriate to include selective metering as long as there is a reasonable prospect that unquantified net benefits can bridge that gap. We encourage companies to review their metering proposals and work to identify the full range of benefits, including social and environmental benefits, even where it is difficult to quantify these.**

5.12 **We will include selective or planned metering proposals in our final baseline assumptions for PR09, as long as each company can show that the benefits are likely to outweigh the costs as part of a long-term strategy. We will include proposals for smart metering – or well-reasoned proposals for its trial – on the same basis.”**

5.13 Wider considerations can extend the scope of the cost-benefit analysis to include:

- the environmental cost of changes to abstraction;
- the environmental value of processed wastewater returning to watercourses;
- the incremental and decremental costs for a supplying clean water and treating waste water;
- the cost to customers and water companies of devices and appliances that reduce water consumption; and
- the cost of repairing supply pipes or leaking taps.

The approach we apply when we assess the costs and benefits of individual company metering proposals includes the need to comply with existing legislation as underlying assumption.

5.14 But it is important to emphasise that metering also offers the following wider benefits:

- environmental benefits, where these are likely to outweigh the environmental costs of installing and operating meters;

- energy cost savings by customers would have heated some of the water saved as a result of having a meter installed and using water more efficiently;
- the possibility of even more cost-reflective charges through new metered tariffs, providing greater flexibility for managing demand in the future;
- fairer charges for customers, based on how much water they use rather than the rateable value of their property; and
- greater scope for extending the benefits from competition;

as well as the more easily quantifiable benefits of:

- encouraging customers to curtail demand; and
- helping to identify supply pipe leakage.

- 5.15 Whether a selective metering plan can be judged to be cost beneficial will depend largely on how its relative costs compare with other ways of maintaining the supply/demand balance (including increasing abstraction and storage, network reinforcement, leakage reduction and improved consumer water efficiency). Consequently, the cost-benefit analysis should reflect the specific circumstances in individual water supply zones.
- 5.16 Companies have published indicative access price information for each of their water resource zones and this can be used as a guide to the marginal price of maintaining the supply/demand balance. (However, we expect that significant further work on separated accounting and costing will greatly improve the quality of this information over time.) These prices range from under 20p/m³ in many zones where no significant investment is planned in the next five years to more than £1.50/m³ where investment is necessary to maintain the supply/demand balance.
- 5.17 It is possible to infer the likely circumstances under which compulsory metering may be cost effective at an individual household level by dividing the cost of providing a metered service by the volume of water expected to be saved. This could then be compared with the cost maintaining the supply/demand balance in a particular the supply zone.
- 5.18 If the annualised cost of providing a metered service is assumed to be £35 (based on companies' metered/unmetered household differential). A meter would be required to generate a volume saving of around 23m³ a year in a zone with a planned investment equivalent to £1.50/m³ to be cost beneficial. This would rise to 175m³ a year in a zone with minimal planned investment. By means of context, unmetered per capita consumption has been estimated to be 151 litres/person/day, which is equivalent to 55m³ a year. (Source:

Ofwat, 'Security of supply, leakage and water efficiency 2005-06 report', page 53.)

- 5.19 This indicates that selective metering is most likely to be cost beneficial in cases where customers curtail their demand significantly and live in areas with high costs of maintaining the supply/demand balance. Households with above average per capita consumption may have scope to save most water.
- 5.20 There are many factors that will influence whether a particular compulsory meter proves to be cost beneficial. The most fundamental considerations are whether (and how) the customer will change their behaviour in the long term. This will depend on personal factors including income level and how much discretionary water use is valued.
- 5.21 Smart meters can offer a range of additional functionality which can potentially support additional benefits. These can include:
- storage of date-stamped meter readings to support seasonal tariffs;
 - automated meter reading to reduce the need for manual meter reading; and
 - internal displays for customers to encourage demand management.

Meters with additional functionality are currently more expensive to purchase and operate than traditional dumb meters. We would support companies' trials of smart meters where it is expected that the additional costs can be outweighed by the likely additional benefits that particular meter functionality could offer.

6 Scope for managing demand through charging

What was asked?

- 6.1 The call for evidence asked whether reductions in demand could be achieved from new (metered) tariff, and what these might be. Does metering itself produce a demand reduction and what price signals are effective in permanently reducing demand?

Our views

- We assume that compulsory metering will generally result in about a 10% reduction in customer demand based on previous research¹.

¹ 1993 Water Metering Trials – Final Report – The National Metering Trials Working Group page iii.

- Metered tariffs should be considered among the demand reduction tools available to companies before proposing high-cost schemes to increase resources.
- Tariffs are being trialled in the water sector that will show how effective alternative charging structures can be in securing further demand reductions.
- We recommend that the review should consider the benefits that this type of exercise can bring and add its support to this area of water company activity.

Managing demand

- 6.2 Managing demand through charging is closely linked to metering. With the exception of high level water efficiency messages and the supply of low-cost water saving (hippo) devices, there is a limited amount that companies can do to encourage unmetered customers to reduce the amount of water they use. When we assess company plans for metering, we assume that a typical consumer reaction to a meter being installed is a 10% reduction in demand.
- 6.3 We encourage companies to consider innovative tariffs when looking for solutions to resource issues in their areas. Until now, there has been little evidence about how customers respond in the long term to simple metered tariffs or more sophisticated seasonal tariffs and rising block tariffs. We have approved tariff trials for a number of companies seeking to understand the effects of seasonal and rising block tariffs on demand. These trials will start to provide results in the next two to three years. Some of these tariffs can also provide some degree of social protection because they make some allowance for essential use or household size.
- 6.4 The options we have approved for 2008-09 include a:
- seasonal tariff with higher volumetric rate for use in summer period and lower volumetric rate for use in winter period. The dates on which the rates change are fixed;
 - seasonal rising demand tariff, with the winter period determining the household's "essential use" and charged at a standard or lower rate. During the summer any use above this level is classed as discretionary and charged at a higher rate; and
 - rising block tariff with set usage blocks which do not vary with occupancy levels.
- 6.5 We have also recently approved proposals for 2009-10 for a rising block tariff with usage blocks based on occupancy levels.

6.6 We detail below the potential effects of these different tariff structures. Clearer conclusions about the effectiveness of these are not yet available.

Seasonal tariffs

6.7 The main objective behind seasonal or seasonal rising demand tariffs, is to curtail discretionary water use in periods when supplies may be most stressed and when demand may be highest.

6.8 Any seasonal tariff will require a minimum of two meter readings within the year. This will require either physical reading at specific times or meters that can store time-stamped meter readings and therefore will generate additional costs.

6.9 The potential customer response to such tariffs is complicated and difficult to judge. This is because there are several factors that could influence the behaviour of individual customers. The response will depend on:

- the customer's perception of impact of the higher charge on their bill;
- the actual effect on the bill that they subsequently observe;
- whether these effects are significant to their expenditure budget; and
- the value they personally attribute to their discretionary water use.

The overall scale of customer response is likely to be lower than the initial impact of compulsory metering (usually assumed to be around 10%) unless the seasonal volumetric charges is significantly more than the standard volumetric charge.

Rising block tariffs

6.10 The main objective behind rising block tariffs is to discourage water use as volume increases.

6.11 A rising block tariff with blocks that operate for a year will not require additional meter reading. A similar tariff that operates with usage blocks spread over six- or three-month billing intervals will require extra meter reading, or the use of a smart meter.

6.12 The potential effect of this type of tariff is to encourage customers to manage their discretionary use whenever possible. Whether a customer reacts to this type of tariff will again depend on whether they believe they can make worthwhile savings by reducing water use without unduly compromising their lifestyle. This type of tariff structure is likely to have a very similar impact on curtailing peak summer use to a seasonal tariff.

6.13 This type of tariff can be set so that the size and number of the pricing blocks can produce a bill reduction to customers with below average use and a significant bill increase for households with above average use. Under this type of tariff structure larger households may be significant losers. Linking the block size to household size can help to avoid this effect.

Details of approved tariff trials to assist demand management

6.14 For 2008-09, we approved metered tariff trials that offer a range of metered charges that may better suit customers' needs. They aim to find out how customers are affected when they are charged in different ways. We have described them briefly below.

Folkestone & Dover Water

6.15 Folkestone & Dover Water has introduced a rising block tariff trial for a limited number of metered properties in 2008-09. Under this type of tariff, the more water a customer uses, the more they will pay for that water. The charge is made up of a:

- fixed standing charge; and
- variable volumetric charge for each unit of water used.

If the customer uses up to 80m³ of water (the first "block"), they will be charged 25% less for each unit of water than the standard metered volumetric charge.

If the customer uses more than 80m³ (and enter the second "block"), they will be charged 50% more for each unit for the extra water than the standard metered volumetric charge.

This tariff also includes an element of social protection for larger families. If there are three children under the age of 18 in the household, the customer can ask for an extra 15m³ at the low rate, so the first block will be 95m³ of water.

If there are four or more children in the household under the age of 18 a further 15m³ can be claimed taking the first block to 110m³ of water. Any extra water used over these amounts will be charged at the higher rate of 50% more than the standard charge.

Wessex Water

6.16 Wessex Water started three tariff trials during 2008-09. These are:

- rising block tariff;
- seasonal tariff; and
- seasonal peak tariff.

A limited number of customers moving house are being put on these tariffs.

The **rising block tariff** is similar to the Folkestone & Dover tariff trial described above. The tariff is made up of:

- a fixed standing charge; and
- a variable volumetric charge for each unit of water used.

The first “block” is 60m³. Usage up to 60m³ will be charged at 20% less for each unit of water than the standard volumetric charge.

Usage over 60m³, will be charged a volumetric rate 20% higher than the standard volumetric charge for each extra unit of water.

In the **seasonal tariff** the charges change depending on the time of year in which the water is used. customers will pay less for water in the winter, but more in the summer.

The charge is made up of:

- a fixed standing charge; and
- a variable volumetric charge for each unit of water used. This rate changes according to the time of year.

Water used between 1 October and 31 March (the winter charge) is charged at 20% less than the standard volumetric charge.

Water used between 1 April and 30 September (the summer charge), is charged at a summer rate which is 20% higher than the standard volumetric charge.

The **peak seasonal tariff** has elements of the rising block tariff and seasonal tariff described above.

The company will measure how much water each household uses in the winter (from 1 October to 31 March). The amount of water measured in this

period will be used to calculate the household's "quarterly base volume".

The water used from 1 October to 31 March will be charged at a winter rate. This will be 5% less than the standard volumetric rate for each unit of water.

If the household uses up to the quarterly base volume between 1 April to 30 June and 1 July to 30 September, the company will again charge 5% less than the standard volumetric rate for that water.

If more than the quarterly base amount of water is used from 1 April to 30 June and 1 July to 30 September, the extra water will be charged at a rate 90% higher than the standard volumetric rate for each unit of water.

All three trials only affect water charges: the sewerage charge will continue to be the standard tariff. This is because the cost drivers for sewerage are different to those for water. In particular, it could be argued that sewerage should be charged at a higher rate in the winter than in the summer. Therefore, to combine seasonal tariffs for water and sewerage would be counter productive and it would not be possible to determine how customers were reacting to each price change.

- 6.17 We have stated that charges should be broadly cost reflective. As a result, we do not believe that there should be cross-subsidies between the charges for the water and sewerage services. We would not, for example support increasing a sewerage charge to encourage customers to use less water as the result of a higher bill.

South East Water (former Mid Kent area)

- 6.18 In 2007-08, we approved a seasonal tariff trial for a new housing development which will have 250 properties when it is finished. South East Water expects that 100 properties will be on the seasonal tariff once the development is finished. The tariff consists of:

- a fixed standing charge; and
- a variable volumetric charge for each unit of water used. This rate changes according to the time of year.

The winter charge, from 1 September to 30 April, will be 50% less than the standard charge for each unit of water used.

The summer charge, from 1 May to 31 August, will be 90% higher than the standard rate for each unit of water used.

South West Water

6.19 We have approved a three-tier rising block tariff trial which links the block size to household occupancy levels. The blocks are:

- applied quarterly,
- adjusted for each occupancy level for up to six occupants (larger households are excluded from the trial);
- the lowest block level is set for efficient use and is set at 73% of the standard volumetric rate;
- the middle block covers average use and is set at the standard volumetric rate; and
- the premium block is set at 81% above the standard volumetric rate.

Conclusions from tariff trials

6.20 Each tariff trial will need to run for a number of years before robust conclusions can be drawn on customers' reactions (immediate and sustained) to altered price signals. As a result, we do not yet have indications of what these trials will tell us about the use of charging to influence customer behaviours or demand management.

6.21 Like the water companies, we are keen to develop understanding in this area and we continue to encourage new tariff trials.

6.22 We recommend that the review should consider the benefits that this type of exercise can bring and add its support to this area of water company activity.

7. Understanding and managing debt and the needs of vulnerable customers

What was asked?

7.1 The call for evidence asked why bad debt occurs in the water and sewerage sectors and how the position compares with other sectors. It asked for information on who the debtors are and what the most effective ways of managing bad debt might be.

The review is also looking at what can be done to help vulnerable customers, how this group can be defined and what cost effective approaches to helping them are available. Is it possible to do this and retain a fair charging system?

Finally, it also asks what the definition of water "affordability" might be.

Our views

- The level of bad debt and associated costs of recovering it have both increased across the water and sewerage sectors in recent years. Customers who pay their bills effectively subsidise those who do not pay. The current cost of this subsidy is about £11 per household a year.
- There are numerous constraints on debt collection in the water and sewerage sectors that put companies at a disadvantage when compared with other service providers. We would support removing some of these constraints and recommend that work is carried out to assess the cost effectiveness of other potential measures.
- Efficient and effective debt collection and management techniques that target customers who can pay, but choose not to, should help to reduce the overall amount that customers pay as a whole.
- When we set price limits we ensure that prices are as low as they can be while enabling efficient companies to meet their responsibilities. We do not set prices with regard to any absolute or relative level of available income.
- Protection for vulnerable customers should be provided by explicit social policy embedded in legislation, for example, through the benefits system or tariffs required under Regulations made by the Secretary of State.
- There are no standard tariffs or “off the peg” adjustments that can be made to current tariffs to produce a more socially progressive system. Research findings show that tariffs which are designed to help specified groups of customers will do so, but at the expense of a large proportion of other customers (some of who may also be in need of assistance) who may see very significant bill impacts.

The cost of bad debt

7.2 At present, the cost of collecting outstanding revenue and non-payment represents about £11 of the average annual household bill. Bad debt generates costs through additional debt recovery activities, writing off bad debts and the financing costs associated with unrecovered revenue. In 2007-08:

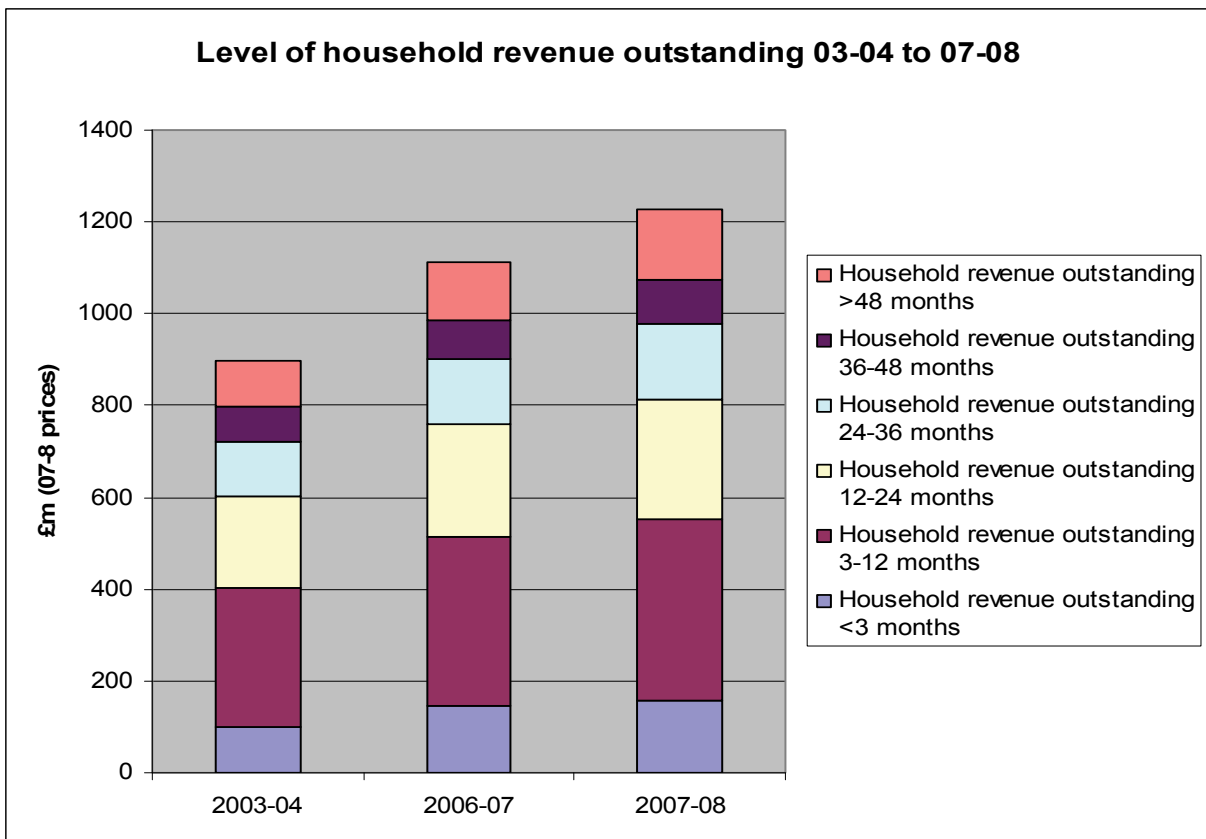
- the water companies spent £71 million on debt recovery activities (equivalent to £3.26 for each household);
- the companies wrote off £104 million of household debt (equivalent to 1.6% of household revenue billed that year or £4.14 for each household);
- household revenue outstanding for more than 12 months (which is less likely to be collected through companies’ debt recovery procedures) stood at £674 million; and

- the total number of households reported with revenue outstanding was more than five million.

Trends in the level of bad debt

7.3 Ofwat has collected information on household revenue outstanding and associated costs since 1998-99.

The following shows how household revenue outstanding (across various age bands) has increased in recent years.



7.4 The largest increase has been seen in the “over 48 month” age band with a 21% increase since last year (52% since 2003-04). Companies explain that this is because of a hard core of debtors who continue to evade payment, despite best efforts to recover revenue from them. However, more recently billed debt has also increased at a rate faster than actual bill increases (further information available in Ofwat’s letter to water company regulatory directors, RD19/08²).

7.5 This means that the bills of those who do pay their bills (and in particular those who pay promptly) will be higher to cover the costs of chasing payment

² http://www.ofwat.gov.uk/consumerissues/problemspayingbill/ltr_rd1908_householddebt

and subsidising those who do not pay. Efficient and effective debt collection and management techniques which target customers who can pay, but choose not to, should help to reduce the overall amount that customers pay as a whole.

Constraints on debt collection in the water and sewerage sectors

7.6 Currently, there are numerous constraints on the water and sewerage sectors that put companies at a disadvantage when compared with other service providers when collecting charges. These include the following constraints.

- **Statutory duty to supply.** Water companies are legally required to supply customers. They cannot choose who to supply, introduce contracts which can then be terminated, or impose terms and conditions on which supply is dependent (for example, requirement for security deposits).
- **Lack of disconnection powers.** As water companies cannot disconnect household properties (and other specified properties) for the non-payment of bills the most effective sanction (that is, withdrawing supply or threat to withdraw supply) is not available. While companies can seek to recover charges through the courts, this is only effective in some cases. Similarly, water companies cannot install trickle-flow devices or pre-payment meters as these have also been ruled to be illegal.
- **Restrictions on who can be charged.** Under the Water Industry Act 1991, companies must charge the “occupier” of a property. As there is no legal definition of “occupation” companies have difficulties imposing charges in situations such as multiple occupiers, tenants or void properties.
- **Lack of powers to gather information.** The companies do not have the statutory powers to gather information to help when billing or collecting charges. In addition, there is little opportunity available for companies to collect such information because no contract exists. Current data protection rules mean that the companies cannot obtain information from other utilities or government departments. Neither can companies legally require landlords to provide information on tenants or occupiers.
- **Priority order of bills.** Money advice agencies tend to recommend that clients prioritise paying those debts which could have serious consequences if left unpaid. As the sanctions for the non-payment of water bills are less severe, agencies place arrears for water behind those for other items such as parking penalty charges and child maintenance arrears. Accenture’s August 2008 survey³ on utility consumer debt found that water bills are not a high priority, with only 58% of consumers seeing them as essential to pay on time.

³ http://www.accenture.com/NR/rdonlyres/9C7A0908-20CC-49E7-9B3F-2D3565AEEB54/0/DaveHotsonUtilitiesWeekConferenceDeck2008_F.pdf

Comparisons with other utilities

7.7 Debt in the water and sewerage sectors is much higher than in the energy sector, despite average energy bills being much higher. We set out Ofgem's figures below. Comparisons are difficult because of the differences in definitions, but this does not affect the conclusion.

7.8 Ofgem⁴ report that in energy:

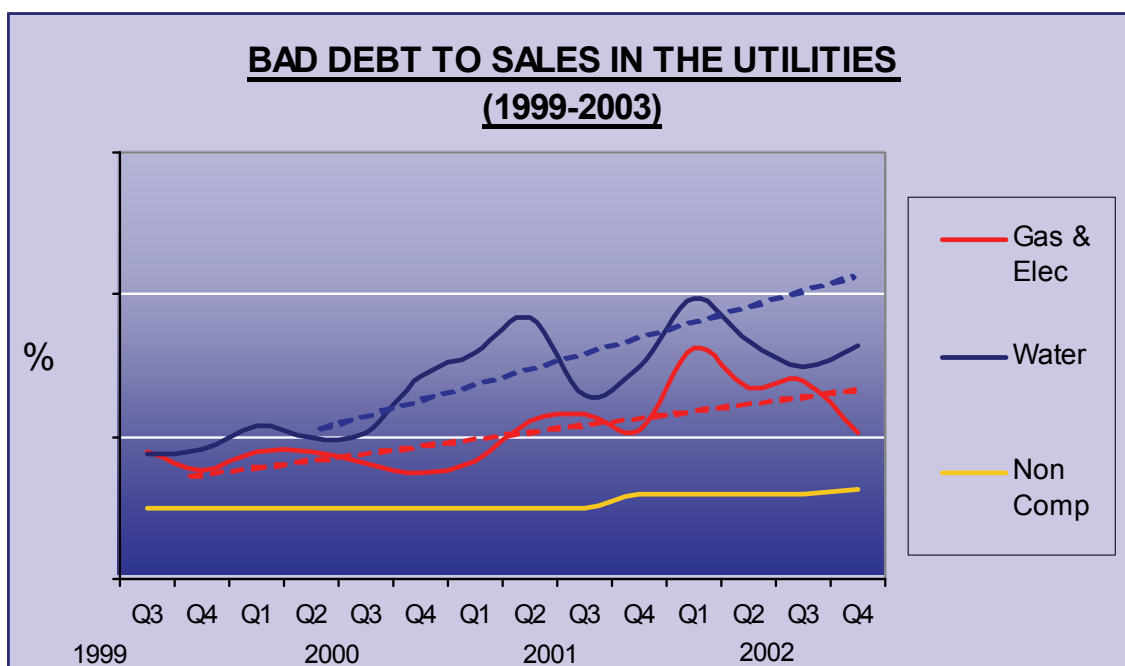
- 1.25 million (5%) electricity customers were repaying a debt at the end of 2007 (0.6 million credit customers and 0.65 million pre-payment meter customers);
- 0.8 million (3.7%) gas customers were repaying a debt at the end of 2007 (0.4 million credit customers and 0.4 million pre-payment meter customers).
- 82% of the electricity customers repaying a debt and 83% of the gas customers repaying a debt in 2007 owed £300 or less; 64% in both electricity and gas owed less than £100.

Note: 'Debt' here refers to customers with pre-payment meters set to collect a debt or who are on a debt payment arrangement to last longer than 91 days. The only direct debit customers included are those who specifically joined the scheme to repay a debt.

7.9 Research commissioned by UKWIR in 2003⁵ concluded that "payment delinquency and indebtedness has generally increased in the water sector in the period from 1998-2003 and this does not follow the pattern of other sectors (gas and electricity). The levels of both outstanding revenue and bad debt write-offs are higher than in other sectors."

⁴ Ofgem, 'Debt and Disconnection best practice Review' (January 2008)
<http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Debt%20and%20disconnection%20best%20practice%20review.pdf>

⁵ UKWIR, Water Industry Debt - Current Trends and Good Practice Approaches (03/CU/04/1)
<http://www.ukwir.org/ukwirlibrary/80817>



7.10 The UKWIR report also concluded that, within the existing legal and regulatory constraints, water companies had developed and adopted good practices in debt management, collection and recovery.

7.11 We believe that this supports the case for the review to examine proposals to enhance companies' debt collection potential through measures such as:

- **Extending the Third Party Deduction Scheme.** This allows customers in debt to have payments made directly from benefits. Recent research by Accent for UKWIR⁶ found that 91% of respondents found the scheme helpful and 82% said they were better able to manage household finances once they were on the scheme. As long as analysis can demonstrate that the scheme is cost beneficial, we would support extending it (for example to allow customers not in arrears to join the scheme or to extend its availability by offering to those on other types of benefit). While the scheme does not reduce bill levels it aids budget management. By reducing the number of customers in debt (and associated debt recovery costs), the impact of debt costs on all customers can be reduced.
- **Potentially removing the ban on trickle flow devices if appropriate safeguards were in place before companies re-introduce them.** We believe there is scope for further work to obtain satisfactory information on the costs, benefits, and practical implications of trickle-flow devices, as well as making sure that companies' implementation plans protected the most vulnerable customers, and those who cannot pay.

⁶ UKWIR Report Ref No 07/CU/04/5, 'Customer targeted debt management' (2007)
<http://www.ukwir.org/ukwirlibrary/91927>

- **Amending legislation to place responsibility for water charges on the “liable person” instead of “the occupier”.** Liability for charges could then be imposed on an ordered list of persons using a similar approach to that seen in council tax legislation – see annex 1 for more detail.
- **Introducing a requirement on specified parties to supply information to the water company in order for them to identify who is the “liable person” for any property.** Companies would then have accurate and up-to-date information on which to charge. This proposal has an existing precedent in council tax legislation – see annex 1 for more detail.

Who water debtors are

7.12 Companies do not currently have a fully developed understanding of their customer base. It is difficult for water companies to identify the characteristics of customers in debt. This is because there is no contractual duty on customers to provide information linked to their financial status under current legislative arrangements.

However, a variety of research has been carried out which provides some insight into what types of customers are more likely to fall into arrears.

7.13 For example, Equifax’s report for UKWIR⁷ found that:

- there is a large group of hard core debtors (20% of debtors owed 70% of the total debt);
- 38% of total debts are owed by those with household income below £10,000;
- debtors are likely to be tenants (34% of debtors live in areas with high levels of rented accommodation), and tenants are worse debtors (tenants represent almost half of total debts despite representing only 34% of the debtor population); and
- 23% of debt is because of “leavers”.

7.14 Debtors tend to be over-represented by the younger age groups and singles/non-traditional family units. They typically have high credit risk, are credit stressed where they are involved in the credit market, have default credit accounts, and are more likely to have a County Court Judgment.

⁷ UKWIR Report reference number 06/CU/04/4 ‘Quantifying different types of water industry debt’ (2006) <http://www.ukwir.org/ukwirlibrary/90896>

7.15 In addition, Citizens Advice (CAB) analysed statistics gathered from their CASE recording system about enquiries on water debt in the first half of 2007-08⁸. This showed that:

- people approaching CAB for advice on water debt problems tended to have low or very low incomes. Nearly 80% seeking advice reported income below £1,000 a month, while 32% reported incomes below £400 a month;
- a significant proportion (28%) of enquirers reported having a disability. Of these, 88% also reported an income below £1,000 a month;
- a disproportionate number of the people seeking advice were lone parents (31%); and
- the most frequently reported household type for enquirers was “single person” at 36%. A large proportion of these single people also described themselves as having a disability (41%).

7.16 For these customers, cost reflective charging systems which conform to a requirement that there should be no undue preference may not provide adequate protection against bills that they cannot afford.

Why do customers fail to pay?

7.17 All customers must pay for the services received and Ofwat supports the right of each water company to collect revenue due to it. Ofwat’s debt guidelines⁹ set out how companies’ policies and procedures might best take account of customers’ needs and we are aware from the Consumer Council for Water’s debt audits that companies comply with these guidelines.

7.18 It is important to balance a firm approach to deliberate “won’t pay” customers against a supportive stance to those who genuinely have difficulty in paying their bill.

7.19 However, the distinction between “can’t pay” and “won’t pay” is not necessarily clear – there is often also a “struggling to pay” category.

For example, Dominy and Kempson’s paper¹⁰ analyses in detail the characteristics of debtors who can’t and won’t pay. They identify the following types.

⁸ Presentation by Tony Herbert at Utility Week Debt Conference 23 October 2008

⁹ http://www.ofwat.gov.uk/consumerissues/problemspayingbill/gud_pro_custdebt20070327.pdf

¹⁰ Nicola Dominy and Elaine Kempson, “Can’t pay or won’t pay?: A review of creditor and debtor approaches to the non-payment of bills”, March 2003

- “Can’t pays”, that is those who intend to pay but lack the money:
 - people on low incomes who face unexpected expenditure;
 - people who have had a sudden substantial fall in income; or
 - people with mental health problems which impair their ability to manage their finances.
- Those who are neither “can’t pays” or “won’t pays”:
 - people who have a genuine dispute with their creditor who are withholding payment until it has been resolved;
 - people who are disorganised in their approach to bill payment, leading to irregular payment and often falling into arrears; or
 - tenants, where there is an administrative failure in payment by the local authority.
- “Won’t pays”, that is those who have little or no intention of paying their creditors on time:
 - people withholding money on principle;
 - ex-partners withholding payment;
 - people ‘working the system’; or
 - people ‘ducking responsibility’.

They point out that in each of these “won’t pay” groups some people will have sufficient money to pay, while others will be ‘won’t but can’t pays’.

7.20 Companies can collect more information on their customer base (for example, by purchasing data from credit reference agencies and by individual home visits), so they can better understand their individual debtor’s circumstances.

What are the companies doing to minimise debt?

7.21 The companies already offer a number of forms of practical assistance to help customers pay their bills, and to a lesser degree, financial assistance to reduce the amount to be paid. Examples include:

7.22 Practical assistance.

- **Dedicated freephone debt helplines.** This is so that customers can discuss their payment problems with specialised staff and agree appropriate payment plans.
- **Flexible payment plans.** Customers can choose how frequently they pay with weekly payment plans readily available for customers who need them.
- **Promoting debt advice agencies or providing funding towards them.**
- **Supporting the “Saving from poverty” initiative.** This will be an integrated banking and budgeting system for those on low incomes or

benefits. Based on the Post Office Card Account, it will work by ring fencing allocations for essential financial commitments and direct debit payments which reflect a customer's weekly income.

- **Applying for direct payment from benefits (Water Direct).** There are currently about 155,000 customers on the Water Direct scheme (compared with around 55,000 for energy customers – the difference is likely to be due to the option and prevalence of pre-payment meters in the energy sector). While this does not reduce the amount that has to be paid, it allows budgeting to be made more easy.

Financial assistance.

- **Charitable trusts and hardship funds.** Fourteen companies reported donations to charitable trusts during 2007-08, totalling £9.7 million (not including donations funded by parent groups)¹¹. Other companies have 'Restart' schemes. These give customers an incentive to clear debts by matching payments or writing off a proportion if regular payments are maintained.
- **Opting for a "free" water meter – where this will reduce the customer's charges.** (Ultimately the cost of the "free" meter is borne by the all metered customers.)
- **Promoting the WaterSure tariff to those customers who may qualify.** (Under Government regulations all companies in England must offer this reduced tariff to the defined vulnerable customers; the two companies operating wholly in Wales offer this tariff on a voluntary basis.) For further details see sections 7.46 to 7.48.
- **Introducing innovative tariffs which target those struggling to pay.** This is to reduce bad debt costs on the generality of customers. See sections 7.26 to 7.27.

7.23 In addition, as reported in Ofwat's letter to water company regulatory directors, [RD 19/08](#), companies are increasingly using externally sourced data, such as from credit reference agencies, to ensure that customers are targeted with the most appropriate action. Nearly all companies now use segmented recovery paths which differentiate customers according to a behavioural score, based on a number of factors, such as previous payment history.

Tariff trials to deal with debt

7.24 In the absence of legislation we do not support the introduction of explicit cross-subsidies for specific groups. However, we do encourage companies to

¹¹ [Ofwat RD 19/08](#)

provide help to specific groups of customers where this is also expected to reduce the effect of debt on the generality of customers (win-win). A number of tariffs are currently being trialled in this area. Typically, these either offer customers financial incentives to continue to pay their bills, or reduce their bills on the understanding that the customer will pay a larger proportion of a lower bill than a higher one.

- 7.25 These following trials aim to be self financing, with improved revenue collection and reduced debt recovery costs more than offsetting additional administration costs and reduction in bills to participating customers.

Dŵr Cymru

- 7.26 For 2008-09, we approved two trials (Water Direct and Water Collect). These are aimed at helping eligible customers to pay their bill.

Under the Water Direct scheme, the water company will reduce customers' bills by £25 a year if they are on benefits and sign up, through the Department for Work and Pensions, to have their bills paid directly from benefits.

Customers will only be eligible for this scheme if they receive Jobseeker's Allowance, Pension Credit, Income Support or income-related Employment and Support Allowance, and they are in arrears with their water or sewerage bill. The trial started this year and will last between two and three years.

Through the Water Collect scheme, Dŵr Cymru will offer a limited number of customers a yearly discount of £10 when they pay for their water through a participating local authority or housing association¹².

Wessex Water

- 7.27 Wessex Water's "Assist" tariff (trialled for two years from April 2007) offers customers in extreme financial difficulty a lower bill based on their ability to pay. Customers must be in receipt of at least one of the main means tested benefits and a CAB or other debt advice agency must have applied for the tariff on their behalf. This tariff has been shown to be self financing in that Wessex Water now collects more revenue from customers who benefit from the reduced tariff than they previously collected from the same group.

¹² Some companies use local authorities or housing associations as a form of billing agent, although the exact arrangements will vary from water company to water company. The local authority becomes responsible for billing and recovering revenue from customers, typically in return for a commission payment. Customers' charges will normally be recovered alongside their rent, which can assist with budgeting issues.

“Affordability”

- 7.28 The issues of debt and “affordability” are closely linked. It is our view that “affordability” – where the term refers to the overall level of bills being held down to a point at which specified customers are able to pay – is not a charging issue. We address this issue through price reviews.
- 7.29 The price review process has an overarching objective to ensure that charges to customers deliver value-for-money services for which most customers are both willing and able to pay. Developing charging schemes, the structure of charges and introducing new charges all fall under this high-level protection.
- 7.30 When we set price limits we ensure that prices are as low as they can be while enabling efficient companies to meet their responsibilities. We do not set prices with regard to any absolute or relative level of available income.
- 7.31 However, the broad protection of all customers provided by this overarching work means that most customers’ water and sewerage bills are at levels they are willing and able to pay.
- 7.32 In the joint Ofwat/CCWater charging research 2007¹³, 59% of respondents thought their water and sewerage charges were affordable while 19% stated they were unaffordable. AB and C¹C² respondents were more likely to think their charges were affordable than DE respondents (25% of DE customers thought their charges were not affordable).
- 7.33 Similarly, in CCWater’s 2007-08 tracking survey¹⁴, 76% of respondents agreed that the water and sewerage charges they pay were affordable. Those less likely to feel their charges are affordable were those in lower social groups, respondents with a household income of less than £10,000 and tenants in social housing.
- 7.34 If customers find they cannot pay their bills, they may fall deeper into debt or curtail the amount of water they use. For example, a 1996 report by Save the Children¹⁵ assessed the impact of metering and high levels of water debt on low-income families. Seventy per cent of those surveyed were taking measures to reduce their water use, such as sharing baths, taking fewer baths or showers, washing clothes less often and flushing the toilet less often.

¹³ ORC International, ‘CCWater Charging Research 2007 (April 2008)

http://www.ccwater.org.uk/upload/pdf/Charging_Final_Report.pdf

¹⁴ http://www.ccwater.org.uk/upload/pdf/r7420__CCWater_FINAL_20080325090857.pdf

¹⁵ Cuninghame, Griffin & Laws, ‘Water tight: The impact of water metering on low income families’ (Save the Children, 1996)

- 7.35 Protection for such customers could be provided through the benefits system or through specific, targeted (and transparent) social transfers in tariffs, specified by Parliament.
- 7.36 Our view is that this should be done by explicit social policy embedded in legislation, for example support through the benefits system or tariffs required under regulations made by the Secretary of State under Section 143A of the Water Industry Act 1991. The WaterSure vulnerable groups tariff is currently the only example of a social tariff set down in legislation. See section 7.46 for more information.
- 7.37 If Government were to make changes to existing legislation or regulations to address social policy issues, we would adapt our approach to reviewing annual charges schemes accordingly. We would also work with each water company to implement change in a way that continues to protect all customers. Without such Government legislation, we will not encourage the creation of additional cross-subsidies for social protection purposes.

Vulnerable customers

- 7.38 In terms of who should be protected from the effects of high bills, there is no easy way either to:

- i) define vulnerable customers; or
- ii) estimate how many there are.

Depending on what definition of “vulnerable” is made, the numbers falling into the group will vary significantly.

- 7.39 The Government’s definition for “vulnerable groups” under the Vulnerable Group Regulations only covers specific metered customers (see section 7.46). It is limited to ensure that the impact of the WaterSure scheme on other customers’ bills is not unacceptable.
- 7.40 If “vulnerable” were to be defined in relation to those with financial difficulties, one definition might be as those spending “x percent” of their income on water bills.
- 7.41 However, using an indicator based on water charges as a proportion of income has a number of problems associated with it. For example, at present most household water customers are still unmetered. So, because their bills are fixed they do not need to worry about conserving water in order to keep bills down.

- 7.42 Also, agreeing what to base “household income” on has never been fully discussed or agreed. There are many definitions, including gross income, net or disposable income, and income before or after housing costs. Depending on which measure is used could dramatically alter the number of households classed as “vulnerable”.
- 7.43 A physical characteristic could be used to define vulnerability (for example, the elderly), although this would not mean that all customers with this characteristic are necessarily vulnerable in terms of being able to afford to pay. (Some customers will have special requirements regarding the way water services are **delivered** to them because of age, disability or illness, but companies offer a range of special assistance services in accordance with Ofwat’s guidelines, so such customers should not be at a disadvantage in terms of the provision of services.)
- 7.44 Social tariffs which explicitly target specified groups are one method of helping customers who are having trouble affording their bills. However, defining the groups to be helped can be difficult and there may be others who are equally in need but do not meet the definition.

Help through charitable trusts and debt-related tariffs aimed at collecting more through reducing a customer’s bill can also be effective. Alternatives include implementing socially progressive tariffs that are not designed to introduce explicit social transfers, focusing instead on incentives and water use. While we would not approve tariffs carrying social transfers, we are keen to encourage these socially progressive tariffs.

- 7.45 There has been discussion among stakeholders on whether any tariff types would be socially progressive simply because of their structure. The ICF/ICS report looked at a number of alternative metered tariffs to see whether they would have socially progressive effects.

Metered tariffs examined in the ICF/ICS report included:

- rising block tariffs with a free first block of water;
- rising block tariffs with a cheap first block of water;
- metered tariffs with no standing charge;
- metered tariffs with doubled standing charge;
- seasonal tariffs; and
- metered tariffs relating the volume charge to council tax band or property type.

In all cases, there are significant numbers of customers who gain from these tariffs. However, they are not always those on low incomes or in specified

groups such as pensioners or disabled customers. Equally the customer groups who “lose” (through higher bills) as a result of these tariffs often include those specified groups or those already paying more than 4% of their disposable income on water charges.

Social protection tariffs

The current system: vulnerable group tariff (WaterSure)

7.46 At present, WaterSure is the only social tariff operating in England and Wales. It was introduced in 2000 through regulations under section 143A of the Water Industry Act.

7.47 All companies in England must make the tariff available. Companies in Wales offered the tariffs voluntarily in 2008-09. WaterSure applies a capped charge for metered household customers who are in receipt of certain income-related benefits and who either have three or more dependent children or share their property with a person with a medical condition which requires significant additional use of water. (Dŵr Cymru is extending the scope of the voluntary scheme, as a trial in 2009-10, to those who would have otherwise qualified but who wish to remain unmetered. The water company will also be reducing significantly the level of the capped charge from the previous level of more than £400 to £250. Dŵr Cymru expects this change to be self-funding through improved payment levels.)

The WaterSure tariff is effective in the sense that qualifying customers will receive a lower bill than they would on the standard metered tariff. While this helps “vulnerable customers” to a degree, the extent to which it creates a financial benefit will depend on the level of the water company’s average bill and the actual level of usage. The number of successful applications and the costs that companies report of administering the scheme are shown below¹⁶.

Table 2 WaterSure tariff – customer take-up and running costs

	2003-04	2004-05	2005-06	2006-07	2007-08
Total number of successful applications	8,082	9,627	13,187	16,212	24,121
Operating expenditure due to WaterSure (£m)	0.252	0.270	0.300	0.362	0.402

¹⁶ Water company specific information over time and broken down by large family / medical condition criteria have been provided to the Review team separately.

It can be seen that the number of households successfully applying for the reduced charge is relatively low. This is despite the work we have done with the companies, Water UK and CCWater to promote the scheme, introduce a standard application form and brand name.

There may be scope for this review to consider whether schemes such as WaterSure and Water Direct could be more appropriately targeted to identify the customers that would benefit. This could include, for example, the water company working with government departments such as DWP. A change in legislation to allow data sharing is being considered for the energy sector and is something that would be worth monitoring for future consideration.

- 7.48 Other metered household customers in each water company's area typically fund the subsidy introduced through this tariff. The extent of the cross-subsidy that an individual household receives will depend on the how much water is used, the relevant water company's volumetric charges and the level of the capped charge. This information is not formally reported to Ofwat, but we have assumed that it could be on average in the order of £100 for each customer on the tariff every year.

It has been suggested that the uptake of this tariff is unrepresentatively low, and that other customers – such as those without meters might equally benefit from capped bills. As this tariff was originally intended to remove the need for metered customers to curtail their essential use of water in order to reduce bills, there would be little logic in extending the tariff to unmetered customers. However, if customers in the same circumstances without a meter were deemed to be in need of assistance, the infrastructure to implement this tariff already exists within water companies. Therefore, we have looked at the impacts of extending WaterSure.

- 7.49 As the table below illustrates, most customers are paying less than 40p extra on their own water and sewerage bills to support the 24,000 customers who currently benefit from the WaterSure tariff. It has been estimated that perhaps 107,000 are actually eligible. A further 614,000 customers might meet the qualifying criteria if it was extended to unmetered customers.
- 7.50 The table below illustrates the potential scale of the cross-subsidy if the WaterSure tariff was either applied to all those who might qualify, or extended to unmeasured customers.

Table 3 Impact of £100 annual reduction for customers on WaterSure tariff on other customers

WaterSure Customers	Paying Group	Impact on paying group (£pa)
Current take-up of VGT	All other metered customers	£0.37
Full Take-up of VGT by eligible metered customers	All other metered customers	£1.65
Extend take-up to unmetered customers (not currently eligible)	All unmetered customers	£4.45

7.51 If extending WaterSure were to be considered, account should also be taken of other customers’ views on social transfers and what they consider to be an acceptable impact on their own bills to finance help to others. Research undertaken by CCWater in association with Ofwat in 2007¹⁷ confirmed previous research conclusions that most customers think it is reasonable to pay up to an extra £1 on their bills, but no more. While 69% respondents thought this amount was reasonable, 39% would support it increasing to £2; 19% would support it increasing to £5, but only 3% would be content to pay more than £10 to subsidise these customers.

Other potential options

7.52 In order to consider whether a system which might be considered “fairer” in that it offers help to those not protected by tariffs which are socially progressive, it is important to understand the consequences of introducing “social” tariffs that help specified groups.

7.53 The ICF/ICS report examined the effects of tariffs designed to help those who might be considered to have “low incomes”. These tariffs reduced the bills for those customers but again, the customers who saw rising bills as a result were often others who might also be in need of assistance.

7.54 Our conclusion is that there are no standard tariffs or “off the peg” adjustments that can be made to current tariffs to produce a more socially progressive system. The tariffs which are designed to help specified groups of customers will do so, but at the expense of a large proportion of other customers who may see very significant bill impacts.

7.55 Tariffs designed to help those who might be considered to have “low incomes” would not meet our view of cost reflectivity and many would not offer customers the right incentives. We believe that using tariffs to target

¹⁷ See footnote 12

incentives specifically may have socially progressive results and we have set this out further in section 6 above (tariff trials). This would be our preferred approach over designing social tariffs that introduce social transfers into the system.

- 7.56 As discussed earlier, Ofwat/CCWater's charging researchⁱ found that while most respondents thought that £1 a year in their bill to subsidise a social tariff was reasonable, support decreased for larger amounts of subsidy.

Respondents considered that the best alternatives for supporting vulnerable customers were:

- water companies paying out of their profits (30%);
- government help through benefits (29%); or
- government paying monies to water companies to allocate (19%).

The impact of social transfers

- 7.57 While we do not support introducing social transfers into the charging system (we consider support should be provided through the benefits system), if the review is to consider this issue, then it is important to understand:

- the value of those transfers;
- the impact they could have on other customers;
- the fact that they would need to be driven by social policy and set out in legislation; and
- that the transfers would have to be transparent to all affected customers.

- 7.58 The information below illustrates the impacts of theoretical policy changes under a number of scenarios. We do not suggest that the groups below are those in need of assistance, or the customer groups that should be selected to fund the assistance. Our aim is simply to illustrate the possible effects of such action.

- 7.59 The scenarios set out are high level – they illustrate effects across England and Wales and are not reliable at water company level. Actual bill effects would be dependent on the specific detail of tariff structure and the circumstances of various customer groups. The analysis is simply designed to indicate the broad impact on customers required to fund a specified level of discount for a group of other customers.

- 7.60 We would emphasise again that Ofwat does not support introducing such social transfers through the water and sewerage charging system. We offer the analysis as a means of demonstrating that any action taken to support one group of customers has wide-reaching and significant impacts on customers' bills.
- 7.61 Any new social cross-subsidies that are introduced through legislation should be transparent. They should not introduce anti-competitive barriers to entry into the water and sewerage sectors. This is essential if on-going protection is to be maintained.

Approach taken in this analysis

- 7.62 The approach draws on high level data in the ICF/ICS report about the number of customers with certain characteristics. Analysis is based on 2007-08 household numbers.
- 7.63 We have taken the following groups as the basis for the analysis:
- customers whose water and sewerage bill constitutes a specified proportion of their income (8%, 6%, 4%);
 - customers in the lowest 10% band of income;
 - pensioners; and
 - single parents.

These groups will overlap to some extent.

- 7.64 The table below illustrates the effect of reducing water and sewerage bills by £100 for a particular group (the Target group) with that £100 to be paid by other defined groups of customers (the Supporting group).

Table 4 Impact of £100 annual reduction for target group on supporting group

Group with reduced bill (target group)	Paying group (supporting group)	Approx impact on paying group's bills (£pa)
Size of bill relative to income		
Bill exceeds 8% of income	Bill less than 2% of income	£1.50
Bill exceeds 8% of income	Bill less than 4% of income	£1.00
Bill exceeds 6% of income	Bill less than 2% of income	£3.00
Bill exceeds 6% of income	Bill less than 4% of income	£2.00
Bill exceeds 4% of income	Bill less than 4% of income	£6.00
Size of income relative to others		
Lowest income decile	Highest 5 income deciles	£20.00
Lowest income decile	All other income deciles	£11.00
Household make-up		
Single pensioners	All other customers	£22.30
All pensioners	All other customers	£40.00
Single parents	All other customers	£6.30
All pensioners and single parents	All other customers	£50.00

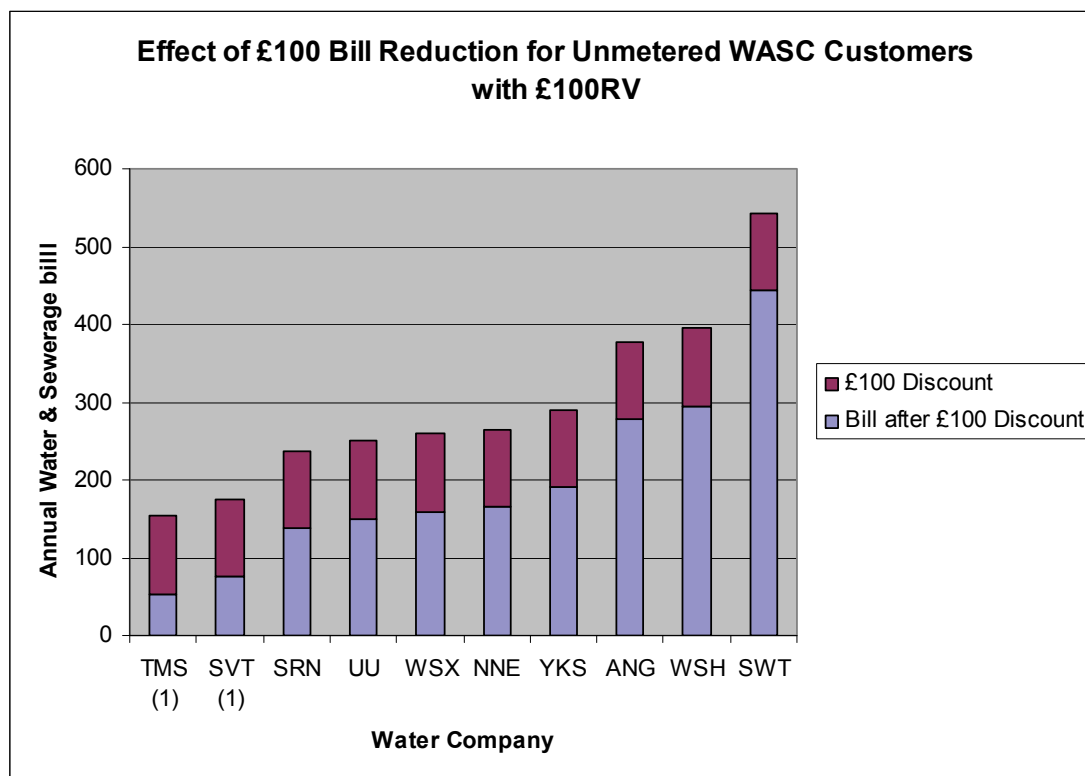
7.65 This analysis assumes that the cross-subsidies operate at a national level. The water company-specific impacts on the supporting group will be affected by the proportion of customers in the target and supporting groups in a water company's area. We do not have the data to support water company specific analysis. Any new social transfers that the Government introduces through water and sewerage tariffs would need to be subject to impact assessment at water company level. This is because the costs and benefits will vary significantly between regions.

7.66 This analysis also does not look at any assessment of the change in the overall level of debt that could result by reducing bills to some customer groups. Overall, customers would see the level of bills drop if debtors paid more of their bills, which would reduce the upward impact of any tariff.

How significant is a £100 yearly reduction?

7.67 The relative effect of a £100 reduction in water bills will vary significantly by water company regions because bills differ significantly. If we assume that customers in the categories above may be likely to live in low-value housing (that is, housing with RVs of up to £100), we can demonstrate the resulting bills that these customers might see across water and sewerage companies.

7.68 Charges in 2008-09 for customers with an RV of £100 range from about £154 for Thames Water customers to £542 for customers of South West Water. The effect of a blanket £100 subsidy for customers with an RV of £100 is illustrated by the chart below. Charges for customers in the Thames Water and Severn Trent Water regions would be well below £100 for the year, while customers in the South West would still see bills of more than £400.

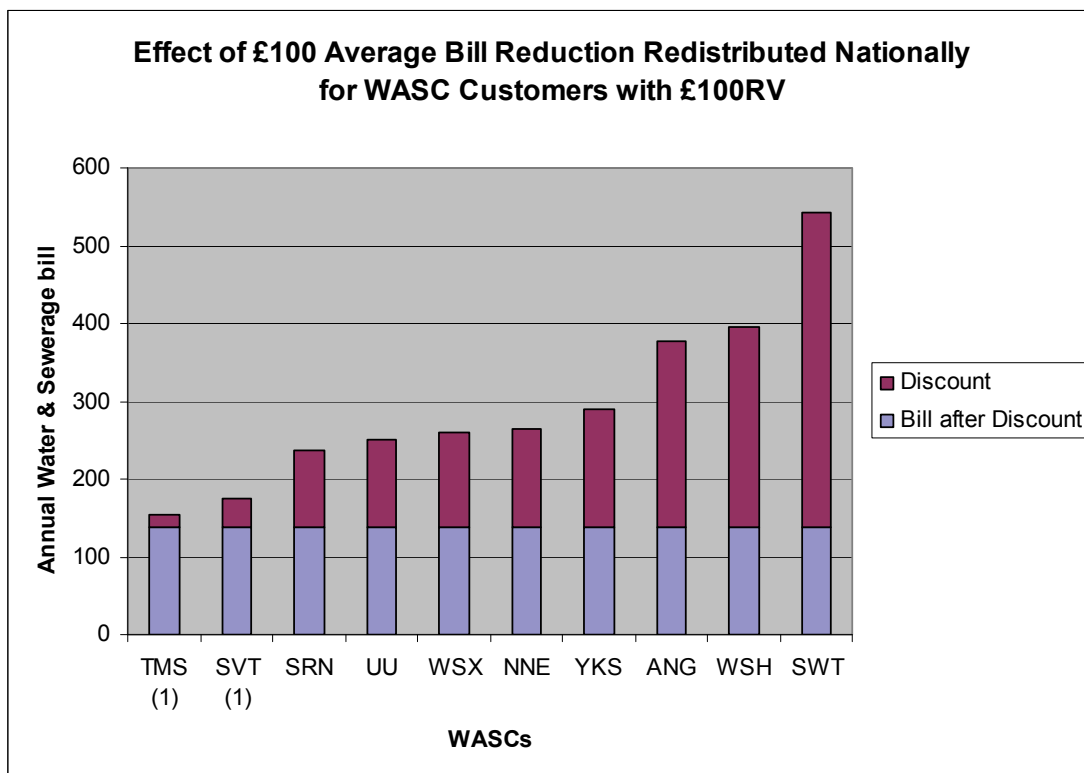


7.69 If the level of subsidy was weighted to take account of the difference between water company charging levels, it might be possible to equalise charges for customers in the target group across England and Wales. This type of approach suggests that in theory a customer in the target group and in a house with an RV of £100 could see a charge of about £140 after discount wherever they live in England and Wales.

7.70 The following chart, which necessarily relies on several simplifying assumptions, illustrates this principle. However, it necessarily relies on several simplifying assumptions. These include:

- that the proportion of customers to receive support is similar across companies; and
- that an RV of £100 is typical for the group receiving the discount.

(Information recently received from one water and sewerage water company broadly supports this second assumption.)



Summary of analysis

- 7.71 If a policy position includes social support to some customers then there will be impacts on those other customers who are required to fund any cross-subsidy that is created.
- 7.72 The above analysis indicates the potential level of bill increases that those contributing customers could face in providing a yearly £100 discount in charges to other customers, assuming the cross-subsidy is contained within the water and sewerage sectors. These bill increases could range from about £1 to help customers currently spending >8% of their income on water charges to £50 to help all pensioners and single parents.
- 7.73 The effect of a £100 discount will vary significantly across the country. Typically, customers with an RV of £100 currently face bills of about £542 in the South West Water area and £154 in the Thames Water area.
- 7.74 It could be possible to equalise charges across England and Wales for specified groups of customers by applying larger discounts in those areas with the highest charges. This would require some form of transfers of funding across water company boundaries. Theoretically, this type of approach could result in discounts of more than £400 for some South West Water customers and very much smaller discounts of less than £20 for those in the Thames Water area. However, this would be difficult to implement because the transfer mechanism would need to be managed at a national level.

8. Incentives for surface water and highway drainage

What was asked?

- 8.1 The call for evidence asked for views on whether the current charging system provides efficient incentives for managing surface water and highway drainage.

Our views

- Currently, the main incentive is the surface water drainage rebate which encourages customers to investigate whether that they are currently connected for surface water drainage services.
 - The size of the rebate is insufficient to fund measures that can reduce surface water drainage from customers' sites.
 - We think there is no correct method to allocate highway drainage costs to individual customers.
 - Our preference is that highway drainage charges should be more properly allocated to highways authorities.
- 8.2 The current methods of charging households for surface water drainage and highway drainage do not always provide clear incentives for those driving the costs of these services. As a result, they are poorly aligned with our strategy to safeguard the future. We want to see long-term solutions that deliver cost-beneficial integrated drainage and provide incentives to companies to develop integrated approaches to managing the supply/demand balance on sewerage systems. Customers should also be incentivised to reduce their use of the drainage system where they can.

Surface water drainage – charging by site area is the fairest way to charge

- 8.3 Sewerage companies currently adopt a range of approaches for charging household customers for surface water drainage. These include linking charges to:
- water usage;
 - RV or property type; or
 - a fixed charge.

These methods of charging for surface water drainage will include a cross-subsidy. This means that some customers with smaller sites will pay more than their share of the costs and larger sites would not pay enough. Although some form of surface area based charge could be most cost reflective no water company directly employs this method for households.

- 8.4 Site area charging is the fairest because it best reflects the cost of providing the service: that is the larger the site, the more surface water is likely to drain from it. This method has been implemented by four of the sewerage companies so far for non household customers. The “site” should relate only to the area of roof or hard-standing that drains to the sewers (after excluding areas which drain naturally, such as most grassed or other porous areas). This means that larger premises which are making most use of the surface water drainage service will see the largest bills. Customers with smaller premises will pay less.

The costs generally depend upon:

- the surface area of the property drained to the sewer because the larger the site area, the more surface water will drain from it; and
- the volume and intensity of the rainfall and, hence, of surface water run-off.

- 8.5 In 2003 we reviewed companies’ approaches to charging for surface water drainage.

Following our review we recommended, in our letter to water company regulatory directors, [RD 35/03, ‘Surface water drainage – charging policy’](#), that companies should consider charging for surface water drainage by site area. We said that the fairest method of charging should reflect the costs of providing the surface water drainage service.

We concluded that charging according to site area was the best method of charging for surface water drainage. We recommended that water companies considered introducing site area-based charging for surface water drainage – particularly for non-household customers where the process is simpler to put into practice.

- 8.6 Charging household premises by site area is unlikely to be a practicable option. There may not be much difference between the size of roof, drive and other impermeable surfaces between a terrace and a large detached home in many cases. However, this would not be the case for households in high rise buildings and flats. A property banded charge may be the most suitable alternative in this case.
- 8.7 We also believe there is a strong case for a better link between those responsible for highways and the associated drainage costs. We need a similar framework to develop demand side measures in sewerage akin to that for water efficiency targets.

Highway drainage

- 8.8 The costs that sewerage companies bear for draining highways and footpaths currently are borne directly by customers. The basis of how these charges are allocated to customers has and will continue to raise concerns from various groups of customers given that there is no clear driver between individual customers' circumstances and the charges allocated to them.
- 8.9 It is not possible for companies to establish the level of the highway drainage service which individual customers are "consuming". At best charges are cost reflective at the water company level. There is no correct way of allocating highway drainage costs among customers. Some companies offer a banded tariff, based on site area or impermeable surfaces on site, others put highway drainage charges in to the volumetric or standing charge elements of their tariffs. None of these will accurately reflect the customers' use of the service.
- 8.10 Our preference is that highway drainage charges should be more properly allocated to highways authorities. At present the law (section 146[4] of WIA99) prevents this.

9. Conclusion

- 9.1 We believe that we have addressed the key questions posed by the call for evidence. We attach at annex 2 a summary of the data and other evidence we have already supplied to the review team.

We would be pleased to assist the review with any further questions they would like to put to us.
