



Ofwat's response to the independent review of charging for household water and sewerage services

Protecting consumers, promoting value, safeguarding the future

About this document

This document is our response to the interim report of the independent review of charging and metering for household water and sewerage services in England and Wales (the 'Walker review'). It follows our responses to the review's call for evidence, which we published on 13 December 2008 and 19 February 2009.

In 2008, UK and Welsh Assembly Government Ministers appointed Anna Walker, former Chief Executive of the Healthcare Commission, to lead the independent review. The review was asked to:

- examine the current system of charging households for water and sewerage services;
- 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.

The review published its interim report for consultation on 29 June 2009.

Where the document uses the term 'Government', this refers to both the UK and Welsh Assembly Governments as appropriate, unless otherwise indicated.

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Foreword

The water and sewerage sectors in England and Wales have come a long way since privatisation 20 years ago. Better standards of service, increased environmental and drinking water compliance and a stable infrastructure are proof that the sectors have overcome many of the challenges they faced at privatisation.

To achieve this, the companies will have invested more than £85 billion (in today's prices) over the 20 years to 2010 – double the rate before privatisation. Yet, we have been able to keep bill increases down by driving out inefficiencies from both sectors. Bills are 30% lower than they would have been without our regulation. And a litre of tap water delivered and taken away costs less than a penny.

Looking to the future, the water and sewerage sectors face a number of major new challenges, including:

- **Climate change** – latest scenarios suggest that climate change may alter the seasonal pattern of our weather. Droughts and floods may become more frequent and more severe, as will their consequences.
- **Population growth** – the UK's population is projected to increase over the next few decades, especially in the water-scarce south-east. This will increase the demand for both water and sewerage services substantially.
- **Lifestyle changes** – the number of single-occupancy households, which use more water per person, is increasing.
- **Consumer expectations** – our 21st-century society means that consumers are becoming more sophisticated and their expectations of the services they use (on aspects such as value and choice) are increasing.
- **Environmental standards** – the Water Framework Directive requires challenging environmental standards to be met. These may increase the costs of supplying services to customers significantly over the coming years.
- **The economic environment** – economic pressures are placing greater emphasis on the need for consumers to receive value from the services they receive, particularly where there is a pressure on household budgets.

- **Affordability** – over the past 20 years, water and sewerage bills have increased on average by more than 40% in real terms. At the same time, the cost of bad debt has increased substantially. We need find new ways of supporting those who cannot pay and pursuing those who choose not to.

Together, these challenges will make delivering safe and reliable services – which consumers have every right to expect – increasingly difficult. And the scale, complexity and uncertainty of the challenges mean that we cannot rely on continuing to do things the same way as before.

We need to find new ways of safeguarding the long-term future of the services we rely on for our economy, our society and our environment. To do this, we need to manage our water resources more sustainably. We need sustainable water.

Delivering this vision requires everyone to work together and play their part – from the Government to regulators, from the companies to consumers. It will also require new, innovative and more flexible solutions.

We believe that markets, properly harnessed, have the ability to innovate at a rate and to a standard that outstrips regulated monopolies. But given that household customers have no choice of supplier, we need to find new ways of encouraging monopoly companies to deliver sustainable water.

First, we need to support the delivery of sustainable services. We need to make sure all consumers have access to safe and reliable services that meet their current and future needs. For this to happen, we need to encourage better, more effective planning and more efficient, innovative, sustainable solutions at every stage of the delivery of water, sewerage and drainage services – from borehole to bath, from toilet to treatment, from roof to river.

One of the key ways of making this happen, either through markets or better regulation of monopolies, is to make sure the companies have better information about how services are used and consumed. That is why we support an accelerated increase in the level of metering where the benefits outweigh the costs.

Meters are an effective tool in balancing the supply and demand for water by encouraging consumers to use less. They can also have other indirect benefits, such as improving leakage detection and supporting the development of new tariffs. But meters are also costly to install and to operate. That is why we need to manage the transition to metering carefully, to make sure that customers, particularly where water is not scarce, do not have costs placed on them without clear benefits. It is also why we welcome the Walker review's proposal that Ofwat leads in managing

the transition to metering and exploring the potential costs and benefits of smart metering.

Second, we need to encourage sustainable consumption. As well as making sure that all consumers have access to these essential services, we also need them to use those services responsibly and efficiently. We therefore agree with the Walker review that there should be fair, more transparent and affordable ways for customers to pay for the services they use – based on a clear message that those that use less, pay less.

It is also why, in line with our charges strategy, we will encourage further development and trialling of innovative tariffs. We want approaches to charging that are:

- fair;
- equitable; and
- provide the right incentives to customers and companies.

Finally, we need to improve the way we value our resources. This is the key to both producing and consuming water services more sustainably. It is also the area where it is critical that all stakeholders work together. By valuing our resources in the right way, we send clear messages to the companies about how they should plan and use resources more efficiently, and to consumers about the care they should take in using those services.

A key part of this is developing a greater understanding of costs at every stage of water and sewerage service delivery. This will not only highlight opportunities for innovation, for example in lowering costs and improving service quality, it could also allow greater transparency of costs. This, in turn, could lead to a fairer allocation of costs and more transparent charges both between different types of service and different groups of customers. It is one of the reasons why we are currently implementing formal accounting separation for the water and sewerage companies in England and Wales.

But valuing resources can lead to difficult decisions and the need for trade-offs.

For example, some customers need help to pay their water bills. We think it is right that the Government should decide whether customers, because of their social or economic circumstances, should receive such help and whether other customers should have to pay for it. These are matters for Parliament.

It is right that the companies do everything they can to prevent customers who cannot pay falling into bad debt. This can reduce costs for customers as a whole. It can also reduce the distress that customers in debt experience. But we also think it is fair that there are changes in the law to allow the companies to pursue those that can, but choose not to pay.

Improving the way we value our resources will be a complex and difficult process. It will not happen overnight. It will require stakeholders to work together and may need some changes to legislation. But it can be done. And if the companies are to meet future challenges then it must be done. We are committed to working with all of our stakeholders to make sure that customers continue to receive the safe and reliable services they expect at a price that is fair.

A handwritten signature in black ink, appearing to read 'Regina Finn', is centered on a light gray rectangular background.

Regina Finn
Chief Executive

Executive summary

We welcome the Walker review's interim report. It provides a positive contribution to the debate on how to make the services households receive, and the way they pay for them, more sustainable. We welcome many of the recommendations that the review puts forward in its interim report, in particular those that call for strengthening of existing structures and further joint working.

We believe harnessing market forces can make a major contribution in responding successfully to these challenges. In areas where markets cannot be used, we need to find new ways of encouraging monopoly companies to deliver services more sustainably. That extends to the way households pay for services, as the companies will have to recover the costs of meeting the long-term challenges facing the water and sewerage sectors. Therefore, it is vital that charging systems both reflect how much individual customers use and give them the incentive to use water wisely.

We believe that metering and charging by use has the capacity to provide significant benefits to customers. Metering is the fairest form of charging. It can deliver immediate benefits, such as reduced bills from lower consumption, as well as further indirect benefits such as allowing the development of new tariffs.

We recognise that this means low-income households in low rateable value properties and with high usage could face higher bills. Current legislation means that protection for such customers is not widely available. We think that this is something that must be addressed. Consequently, the transition to universal metering will need to be managed carefully. The relative environmental, social and economic costs and benefits of metering will need to be assessed in different areas. Therefore, we welcome the review's recommendation that we should lead on managing the transition to metering.

Household metering and charging generate complex economic, social and environmental interactions. It is important that key organisations, the companies and customers work more closely together to take a holistic approach to the issues, rather than addressing each in isolation. We are ideally placed to take the lead on the approach to economic issues such as metering, and we welcome the contribution that other organisations can bring to debate and development. We are willing to accept appropriate new duties, which will make sure that these important issues are dealt with properly. It is important that any new duties should be considered together to assess how they will affect the interactions and to promote a joined-up approach.

It is in this context that we comment on the review's interim report. We have taken into account the recommendations, questions and actions set out in annex J of the report. We have not responded in areas that do not relate specifically to us or the companies we regulate. We would be happy to provide further information in these areas if the review would find this useful.

Our main points are listed below.

1. The big issues

- We agree with the review that reforming the abstraction regime to allow the trading of abstraction rights would help to reveal the value of water.
- We will continue to work with the Environment Agency to implement the reforms we have jointly identified. Legislation may be needed to support some of the proposed reforms.
- We welcome the proposal for the Environment Agency to classify areas of serious water stress at a zonal level. This would support the companies in increasing the level of metering.

2. Current system of charging

- Cost allocations can make a big difference to the composition of sewerage bills. But there is no definitive best way to do it and the methods vary between the companies.
- We plan to develop our understanding of cost allocation as part of our work on accounting separation.

3. Fairness principles

- We support the fairness principles that the review team put forward. These are broadly consistent with our own.
- We agree that trade-offs will be involved in applying the four principles – and we strongly agree that affordability issues should be resolved outside of the charging system.

- We agree that charges should be volume based where possible for water, sewerage and drainage services. It is the fairest form of charging.
- We welcome the conclusion that costs should continue to reflect regional differences. There are practical arguments against introducing nationally-based payments from water customers for environmental benefits. Meeting environmental improvements through national taxation would also have similar disadvantages.
- Future legislation, particularly any that covers environmental improvements, should include an impact assessment that shows the anticipated impact on water bills nationally and regionally.
- We accept that there may be circumstances where the benefits from expenditure cannot be attributed to services provided to specific customer groups. In these instances, it may be necessary to consider whether this expenditure is for the common good and whether it should be paid for by all customers.

4. Future charging system

- We agree that the most appropriate way to charge for water is based on the amount that each customer uses.
- We support metering as part of the long-term solution for charging.
- We believe that the rateable value system should not be replaced by an alternative unmetered system, other than where it is not possible to install a meter.
- For customers who cannot have a meter installed, we believe an assessed charge based either on the number of occupants or bedrooms in a property is the best alternative to metering.

5. Metering

- The true value of water is the price established when water is freely traded within the overall limits on abstraction that the Environment Agency sets. Trading is the only way to reveal this. As a result, we believe the definition of the true value of water is crucial.

- Establishing the value of water will require more extensive abstraction trading and reverse auctions. This will require changes to legislation and take some time to establish. Therefore, we are somewhat concerned about the recommendation that the Environment Agency and Ofwat should establish the true value of water “quickly” – such a fundamentally important issue must receive the time and attention needed to get it right.
- We agree that metering is the fairest way to charge.
- Increasing the level of metering is crucial to implementing key changes in water charging. This includes allowing the companies to tailor charges to best suit their customers' needs and reflect the costs they impose on the supply system. It should also allow the development of competition for customers in the future.
- We agree that household customers should retain the right to request a free meter.
- We would support low-income customers being on low tariffs if this was cost-reflective and did not impose additional costs on other customers.
- We believe that compulsory metering should be extended where the benefits outweigh the costs, subject to a clear framework of checks.
- We do not think that there should be a single trigger point beyond which metering becomes compulsory in an individual company area. The appropriate trigger point will probably differ for every company. It should be set based on a proper cost-benefit approach that takes local conditions into account.
- We support the proposal for Ofwat to manage the transition to metering and explore the potential costs and benefits of smart metering. We will work closely with the Environment Agency and set up a steering group of key stakeholders to develop the evidence base, advise the Government and implement Government policy.
- We agree that, where possible, new apartment blocks should have individual meters installed.

6. Tariffs

- We have identified the relationship between standing charges and volumetric charges as an important issue that we will look at as part of our work on accounting separation.
- We agree that rising block tariffs are not a suitable tool to resolve affordability issues. And we agree that the declining block tariff is not suitable for household use.
- We are working with the companies to understand the advantages and disadvantages of various tariffs through ongoing trials.
- We do not think updated guidance from the Secretary of State on metered tariffs is necessary.

7. Sewerage

- We would encourage moves to promote the reduction of rainwater run-off entering the drainage system where this would reduce the risk of surface water and sewer flooding.
- There is already an incentive to household customers to make sure that no surface water from their property enters the sewerage system. Further incentives should not unnecessarily complicate or interfere with this.
- We agree that greywater recycling and rainwater harvesting charges do not need to be changed. And we also agree that foul sewerage should continue to be charged on the same basis as water supply.
- We believe that a move to transfer the costs of highway drainage to local authorities would have some benefits. Before this happens, we would need to understand the incidence effects this change would generate. We would also need to understand how this change would fit in the broader context of urban drainage.
- We do not believe that cost allocations should necessarily be standardised across the water and sewerage sectors at this time.

- A standard cost allocation for surface water drainage would produce large incidence effects, particularly for low and high users. It would also have implications for the review's recommendation that local authorities should pay for highway drainage.

8. Affordability

- We agree that affordability is an important issue. We have a clear duty to have regard to the needs of specific groups of customers, including those on low incomes. We carry out a number of activities to meet this duty.
- We are keen to build on the work we have done to date, particularly the development of tariff trials by the companies. As the review recommends, we will publish information on affordability from those tariff trials that are now starting to yield such information. We will also continue to publish information from consumer research and our monitoring of the companies' activities, and promote the sharing of good practice between the companies. We will draw all this information together.
- We believe the review needs to consider the issue of affordability in a wider context, rather than just in the context of our work. We believe the Government should provide a clearly defined framework to deliver its desired outcome on the affordability of water. There is considerable experience in the energy sector that shows how this can work. We would be happy to contribute to the development of the framework and implement it when it is complete.
- Ideally, help for those having difficulty paying their bills should be available through the tax and benefits system. We have considered the following alternatives.
 - The costs associated with introducing a regional water benefit could be significant. We support the view that any costs and administration of such a scheme should fall on the national taxpayer and not directly on other water customers.
 - Offering a percentage reduction in bills for low-income households in receipt of Council Tax Benefit in areas where bills are high has the benefit of retaining the incentive on customers to be water efficient. However, it should be mandated by legislation if other customers are to pay for this.

- We agree that increased promotion of WaterSure could improve awareness of the scheme and take-up rates. Improving the availability of shared data could be the most effective way of increasing these rates.
- We do not support the proposal to cap the WaterSure tariff to the national average bill. We believe the administrative practicalities could make this proposal unduly cost prohibitive and burdensome. However, should this be mandated by legislation, we would implement it.
- We have no objection to expanding the qualifying criteria for WaterSure for large families, or allowing doctors the flexibility to sign certificates where they feel medical conditions require additional water use. However, we would expect Defra to provide guidance to the companies to explain what evidence should be demonstrated to claim eligibility.
- We support the review's work to estimate the number of households eligible for the tariff under any revised WaterSure scheme.
- We agree that targeting water efficiency at low-income households can encourage more sustainable behaviour and will offer financial benefits to those with a water meter. However, there is currently a general lack of information about the real impact of water efficiency programmes. Any trial of this initiative would need to establish the extent of any benefits quickly.
- We plan to collect and share good practice in promoting the availability of all schemes to vulnerable customers in 2010-11. We will also hold a workshop to share good practice in this area.
- We believe that if tariffs are to be developed that increase the level of charges to one group of customers in order to help others who may be in difficulty, this should be clearly mandated through legislation. We would make sure that the companies implement any tariffs mandated by Parliament and that these are fully transparent to all affected customers.
- In approving the companies' charges, we have regard to guidance from the UK Government and Welsh Ministers. We agree that a new set of consolidated guidance that sets out Government priorities on social, environmental and charging issues would be helpful.

- We would caution against using the Council Tax Benefit to target measures at low-income households. We think a more detailed understanding of the cost implications is needed before Council Tax Benefit could be used to target assistance.

9. Bad debt

- We fully support the review's proposed changes to legislation to clarify and widen the definition of who is responsible for paying water bills. This will enable the companies to collect a higher proportion of charges.
- It is unrealistic to expect that all debt can be prevented, but we agree that debt prevention is ultimately the best way forward. The companies have a statutory duty to supply customers and they are restricted in the level and the type of information they are able to demand. Additional data, from local government for example, may prove useful.
- We believe that, subject to a satisfactory cost-benefit analysis, the Government should consider extending Water Direct (a Third Party Deduction Scheme) to allow customers not already in arrears to qualify for assistance. We were disappointed not to see recommendations relating to this area in the interim report. Many parties have identified the extension of Water Direct as something that could make a real difference to those struggling to manage their finances.
- We will continue to challenge the companies to manage debt cost-effectively, and highlight and share examples of good debt management practice. We will review the information we collect and the way we publish it to make sure it is presented in a helpful way.
- We will continue to work with the Consumer Council for Water (CCWater) to monitor how well the companies deal with customers who fall into debt. We think this process is sufficient and have no reason to believe that the companies are breaching our guidance.
- We agree that that some form of data sharing with other government agencies and local government could allow the companies to target assistance at low-income customers. However, further work would be needed to agree how this would be done, given the constraints surrounding data protection and privacy.

- We agree in principle with the review's recommendation for more voluntary agreements with registered social landlords and housing authorities. We support the use of such agreements where they are cost-effective and where customers agree to this method of collection.
- We agree that customers' bills and associated billing literature should be written in plain English (or the Welsh equivalent) and include all essential customer information. While we cannot require the companies to present bills in a particular way, we would support any work the companies carry out on best practice in bill design.
- We agree that more publicity on water debt advice, help from the companies and greater use and funding of advice organisations could be helpful. However, as the review recognises, many agencies do not treat water debt as a priority. This means that the companies may be reluctant to refer customers to them.
- We agree that the companies should do all they can to help low-income customers stay out of debt and that debt prevention is vital. As we have already mentioned, if explicit cross-subsidies for specific groups (and consequently higher bills for other groups) are to be introduced, these need to be set out clearly in legislation. We would implement such legislation transparently and openly.
- We would support the review looking at the case for reintroducing pre-payment meters as a budgeting device. We would also support the review examining other proposals, such as the removal of the ban on trickle-flow devices, subject to appropriate safeguards.

10. Water efficiency

- We do not believe it would be appropriate to exclude all water efficiency activity from our assessment of relative operating expenditure efficiency. We use these assessments to set efficiency targets for the companies, which we include in price limits at each price review. We already have an approach in place, which takes account of the potential impact of additional water efficiency activity on the companies' relative efficiency.

- We agree that we should allow the companies to target their water efficiency activities at low-income customers if they are able to do so. However, we do not think it is appropriate to make this a target or a requirement. Identifying low-income customers is difficult and the companies may find more effective ways of achieving water efficiency and affordability objectives. We think we should not constrain the companies, but rather encourage innovative and creative solutions.
- We believe addressing the issues surrounding climate change is a core aspect of our sustainability duty. While a specific climate change duty would provide a clear focus on this aspect of sustainability, there is a risk that this could constrain or distract us from our wider sustainability duty. For example, the overall affordability of customers' bills could become a lower priority if an emphasis is placed on improving the companies' approach to climate change. Consequently, we do not think it would be helpful to impose a specific climate change duty on us.

11. Customer involvement and understanding

- We agree that the overall performance assessment, which we have used successfully to encourage the companies to improve services to customers, needs reviewing. We are currently piloting new consumer experience measures and consulting on our overall approach towards encouraging further service improvements.
- We welcome the recommendation that the 12-month time limit within which we must pursue breaches and penalise companies should be extended to five years. This reflects a revision we are seeking in the draft Flood and Water Management Bill.
- We agree that the companies need to communicate effectively with their customers, particularly the vulnerable and hard to reach. We already publish guidelines setting expectations for the support we expect the companies to provide vulnerable customers. We will hold a workshop to share good practice on promoting these services.
- As we consider how we will set prices in the future, we will examine the potential role of participatory budgeting (or negotiated settlements). The use of this approach needs careful consideration and we will seek to learn from the experience of other sectors.

1. The big issues

Relevant consultation recommendations and questions

Emerging recommendations:

- The true value of water should be used for decision making in the regulatory system. The Environment Agency and Ofwat should continue to work on a methodology for valuing water so that this can be taken into account in future investment and operational decisions as quickly as possible.
- The Environment Agency should be asked to revise its water stress map for England and Wales on the basis of catchment areas or water resource zones, to fully reflect water resource pressures (both water availability and ecological) and the latest (2009) climate change projections. These revised maps should be used to identify where compulsory metering may be justified.

The value of water

- 1.1 We agree with the Walker review that reforming the abstraction regime to allow trading of abstraction rights would help to reveal the value of water, leading to better use of this increasingly scarce resource.
- 1.2 This is because the full social, economic and environmental value of water in different locations and at different times is neither well understood nor fully taken into account when developing water supplies. This is a fundamental obstacle to sourcing raw water efficiently, which will be critical in meeting the challenges of the future and protecting consumers.
- 1.3 Without good information about the relative values of water, for example, the companies cannot fully know whether it is more efficient and better for customers for them to build a new reservoir or to trade and transfer water from another area. Revealing the true value of water will help maintain and improve environmental conditions. It will indicate the real environmental costs of abstraction. It also has the potential to reduce the need to build new supply capacity.
- 1.4 In February 2009, we published a [joint report](#) with the Environment Agency. This document identified some key measures to make abstraction easier. These included:

- making better information and guidance available (including prices at which licences are traded and the conditions which will be placed on trades). This would give those who hold licences, and those who wish to buy them, more information about the potential value of licences and the water they relate to;
 - using a range of tools (such as reverse auctions and scarcity charges) to reduce over-abstraction to a more sustainable level without restricting trades; and
 - structuring licence charges to better reflect environmental costs and values of water.
- 1.5 We will continue to work with the Environment Agency to implement the reforms outlined in our joint report. These reforms will encourage efficient investment decisions by making the trading of abstraction licences easier in order to reveal the true value of water. We are pleased that both the Cave review's [final report](#) and the Walker review's interim report recognise the value of this important work.
- 1.6 We consider that legislation may be needed to support some of the proposed reforms. This may include changes to the framework for abstraction charging which enables the Environment Agency to link abstraction charges to water scarcity. The Environment Agency can then use the funding raised through these scarcity charges to buy back licensed abstractions, where appropriate.
- 1.7 The funding raised under this framework should be retained in the water sector. This will emphasise the scheme's credibility and serve to protect consumers' interests. Legislation may also be required for the Environment Agency to collect and publish traded prices, and to make payments to licence-holders following reverse auctions. These changes would have no impact on customers' bills.

Water scarcity

- 1.8 We welcome the proposal for the Environment Agency to classify areas of serious water stress at a zonal level. This would increase the scope for the companies to meter customers compulsorily. We also suggest extending compulsory metering further where the benefits of metering outweigh the costs (see chapter 5).

2. Current system of charging

Relevant consultation recommendations and questions

Emerging recommendations:

- Ofwat should explore the variation in the composition of sewerage bills between companies in England and Wales to see if it is justified.

Further questions:

- The review team would like to understand better the rationale for these differences in the composition of sewerage bills across England and Wales. We would welcome evidence on what might explain the differences (for example, household water consumption, population density, and amount of rainfall). We believe that Ofwat should explore this variation to see if it is justified.
- In addition, as the infrastructure used by the three sewerage services is largely shared, the review team would welcome views on the basis of which costs can be fairly allocated between the three services.
- The review team would welcome further information on what type of customer remains unmetered, and why.

2.1 Factors such as population density, land use and amount of rainfall can have an impact on the composition of sewerage bills. Based solely on these factors, we would expect the proportion of the sewerage bill that covers drainage to be slightly lower in the south-east and higher in the north-west. This pattern is broadly observed in the number of surface water drainage rebates for households in each region.

2.2 There is no simple link between these factors and the cost of providing sewerage services. Drains need to have enough capacity to cope with storm flows. However, this is not necessarily related to total rainfall. Similarly, the cost of maintaining the drain is not directly related to its capacity. Many sewers are used for both drainage and foul sewage, and it is difficult to determine how much of the costs are related to each component. For example, 55% of all sewers in the Northumbrian region are combined foul sewage and surface water. In comparison, the figure is only 10% in the Thames region.

- 2.3 Since there is no definitive answer, different companies allocate costs in different ways. These allocations can also make a big difference to the way that sewerage bills are composed.
- 2.4 In 2006, we discussed with the companies how they allocated regulated costs to the drainage service. In response, all ten sewerage companies provided information on their cost allocations and underlying assumptions. We are considering how best to develop our understanding of the companies' cost allocations alongside our work on accounting separation. This work will take a considerable amount of time.
- 2.5 This issue will not be resolved quickly. It could also have enormous impacts on customers' bills. We will make sure that these impacts are understood and managed as part our duty to protect consumers' interests.

3. Fairness principles

Relevant consultation recommendations and questions

Emerging recommendations:

- The review team recommends that while the first four principles involve trade-offs that may have to be balanced against each other, the last four principles should apply in all circumstances; that is, charges should be fair to future generations and to companies, clear to customers, and not too expensive to administer.
- The review team recommends that a fair charging system should:
 - charge according to the costs imposed upon the system;
 - incentivise the efficient use of water by charging by volume;
 - embrace the 'polluter pays' principle wherever possible; and
 - be affordable where affordability is a problem.
- Costs should reflect geographical differences and that water prices should continue to be regionally based and geographically averaged within regions.
- The review team is minded to recommend that, in the long term, the net benefits are likely to be limited to moving to national or taxpayer charging for some environmental benefits. However, the review recognises the complexity of the interactions between different fairness principles here and would welcome views on which environmental improvements, if any, should fall to either water customers nationally or the national taxpayer.
- The review team would also welcome views on a potential recommendation that in future the UK Government and Assembly Ministers should make clear in all impact assessments associated with new legislation the effect of changes on water customers' bills. All impact assessments should quantify the additional cost on the national average bill and those of each water company area. Formal and informal consultation must make specific efforts to engage water customers in the debate on proposed improvements and take the views of customers who will pay. Additions to bills must be taken into account in final decisions.

Fair charging

- 3.1 We support the fairness principles put forward by the review team. They are broadly consistent with those set out in, 'Ofwat's future strategy for customer charges for water and sewerage services' (August 2008). They are also consistent with our duties to:

- make sure that efficient water and sewerage companies can finance their functions;
- have regard to the interests of customers; and
- contribute to sustainable development.

They apply equally to charges for water and sewerage services.

- 3.2 The review acknowledges that there will be trade-offs involved in applying the first four principles. We agree. For example, applying an affordability principle introduces tension with other principles. We note that the review also states that although any future charging system should be assessed against fairness principles, affordability issues should be resolved outside of the main charging system. We agree, and this reflects how we approve charges. We discuss affordability issues further in chapter 8.
- 3.3 We also agree with the review's conclusion that, wherever possible, charges for water, sewerage and drainage services should be based on volume. We agree with customers that this is the fairest method of charging. Our charges strategy states that, wherever possible, customers should be charged on a metered basis.
- 3.4 We do not support introducing an alternative unmetered charge to replace the rateable value. We do not believe that any such charging system could be both fair and cost-reflective. Metering offers the best solution as it can help the companies to develop innovative tariffs. This, in turn, may help to address sustainability and affordability issues. We discuss metering issues in more detail in chapter 5.
- 3.5 We also welcome the review's conclusion that costs should continue to reflect regional differences. We agree that household customers should continue to pay water and sewerage bills that are regionally based and geographically averaged across regions for the present. We hope that as competition develops, there could be changes to the way we set charges for household customers.

Payment for environmental benefits

- 3.6 The review notes that it can be difficult to identify exactly who benefits from environmental improvements. This is especially true when factors such as tourist income in areas where quality of life has been improved are taken into account. It is difficult to make a compelling case on grounds of fairness for poorer urban communities in some parts of the country to contribute to the water bills of those living in attractive rural environments. This is despite the need to address the difficulties of poorer water customers in those areas where bills are high.
- 3.7 There are practical difficulties involved in introducing nationally-based payments from water customers for environmental improvements. The questions to be resolved include:
- How are environmental improvements defined? Catchment management schemes, for example, may have environmental benefits but are primarily aimed at improving local drinking water quality. Would climate change mitigation be included?
 - Assuming a definition is possible, are operational costs included as well as capital costs? Do we include maintenance costs once the initial investment has been made?
 - How would costs be apportioned, given the differing stages of compliance with existing environmental requirements nationally?
 - How would costs be allocated to bills and how would this relate to water company price limits? If impact assessments are used to estimate costs, what would the process be for reviewing them after the fact? Some costs do not become clear until the relevant infrastructure is built and begins operation.
- 3.8 There is the potential that a system of national payments would risk undermining much of the progress that the companies have made in recent years, which has kept costs down. With our encouragement, the companies have improved their understanding of their assets and their impacts. They have also developed their plans for their local areas, taking into account the views of their customers and their willingness to pay for particular benefits.

- 3.9 We have encouraged the companies to develop their relationships with the quality regulators at local level, for example to identify best value approaches to meeting legislative requirements. All this has helped to make sure that environmental obligations are delivered effectively at the lowest cost to the customer. A system of what would effectively be national cross-subsidies will reduce company accountability and lessen the incentive to pay close attention to costs.
- 3.10 Separating environmental improvements from other costs would also risk removing incentives for the companies to deliver all their services in an environmentally sustainable manner.
- 3.11 Such a system could have the effect of watering down the polluter pays principle, which the report otherwise endorses. It could undermine efforts to make sure that other sectors meet the costs of reducing their polluting activities, as required by the Water Framework Directive. Within the wider context of improving the water environment, it is essential to make sure that costs fall to those responsible. This means that other sectors bear their fair share of the costs of delivering environmental standards.
- 3.12 Asking all water customers to pay for certain environmental measures would make this very difficult. It is important to identify what customers should pay for and make sure that their bills cover only these. In line with the polluter pays principle, they should relate to providing water and sewerage services. They should not include the clean-up costs of others' pollution (such as pesticides).
- 3.13 There are also disadvantages with using national taxation to fund environmental improvements. Such a change might:
- undermine the polluter pays principle across all sectors whose activities affect the water environment;
 - worsen affordability problems for vulnerable groups;
 - undermine the clarity and accountability of water service providers and the longer-term incentives for them to deliver services in a manner that is environmentally sustainable; and
 - be administratively difficult to achieve.

- 3.14 We agree that any proposed future legislation covering environmental improvements should include an impact assessment showing the anticipated effect on water bills nationally and regionally. This should also apply to proposed EU legislation.
- 3.15 These measures would help to make sure that consumers' views are taken into account. It would also mean that early consideration could be given to the contributions that other sectors make in meeting the implementation costs of any proposed environmental objectives.
- 3.16 We accept that there may be certain circumstances where the benefits from expenditure cannot be attributed to the services provided to specific customer groups. In these instances, it may be necessary to consider whether these costs are for the common good and whether it should be paid by all customers.

4. Future charging system

Relevant consultation recommendations and questions

Emerging recommendations:

- An alternative basis for charging must be found in the near future, as the system is so outdated.
- Neither council tax nor rateable value identifies those who need help with bills sufficiently accurately; nor does it incentivise the efficient use of water. Therefore neither should form the long-term basis for charging for water.
- There is a close relationship between occupancy and water use, but occupancy rates are not collected nationally and could be open to deception. Therefore the review team does not recommend it as the basis for a national charging system. Number of bedrooms would be a poor proxy for water use and is also not recommended for a national charging system. We have also considered property type and a possible flat rate per household as a basis for charging. However, neither incentivise the efficient use of water nor do they reflect income.
- The basis for water charges should continue to move away from the current mix of rateable value and volume consumed (the current system) towards volume consumed. The speed at which this is achieved depends on the costs of metering and finding solutions to the issues of affordability. Measures outside the main charging system will be needed to address the difficulties low-income households may face in paying their bills.

- 4.1 We agree with the recommendations outlined above. In our charges strategy we concluded that charges based on the volume of water that customers use were the most appropriate. We supported metering as the fairest way to charge over the long term.
- 4.2 We also proposed keeping rateable values while the rate of metering increases. However, we consider that it should not be replaced with an alternative system, other than for customers who cannot have a meter installed. An assessed charge, based on either the number of occupants or bedrooms in a property, should be available for those customers who cannot have a meter installed.

Assessed charges

- 4.3 We understand and agree with the review's reluctance to recommend using the current assessed charging methods instead of the rateable value. Pragmatically however, we accept that these methods are still needed. We agree that property-based charges and flat rate charges are the least cost-reflective. However, five of the six companies that use these methods offer a reduced charge for single occupants to mitigate against this.
- 4.4 We have analysed the current tariffs in use and remain convinced that bedroom- and occupancy-based charges are the most appropriate methods. The companies base these tariffs on an understanding of the volume of water that households use and properties of different sizes.
- 4.5 While the number of occupants is the best way to estimate how much water is used, we accept that this is difficult to monitor – though we have no evidence of deception from the companies. The number of bedrooms is a less effective measure, but is much easier to apply.
- 4.6 We estimate that about two-thirds of households paying assessed charges only have one occupant. A combination of a bedroom-based tariff with a single occupancy charge is much more cost-reflective than one based on the number of bedrooms alone. It is also relatively easy to monitor.
- 4.7 We agree that solutions to affordability issues should be sought outside the charging system. We discuss affordability in chapter 8.

5. Metering

Relevant consultation recommendations and questions

Emerging recommendations:

- Until the abstraction regime reflects the true value of water, this value should be built explicitly into investment and operational decisions.
- The process of bringing the true value of water into decision making will need to be driven by the regulatory framework. Both Ofwat and the EA have a central role to play in identifying the right values for environmental and social benefits, and in making sure that these are incorporated into the water companies' decision making processes. Both the EA and Ofwat should concentrate on establishing the true value of water in those areas already identified by the EA as being or coming under resource pressure. Establishing a true value for water should become a requirement on both regulators, so they accomplish this quickly.
- Companies have quoted a wide range of meter installation costs, raising a question of whether installation costs deserve greater regulatory scrutiny.
- Where optant metering is the driving force behind the increase in metering penetration, it may be appropriate for companies to be under an obligation to ensure that low-income customers are supplied on the lowest possible tariff.
- The right to opt for a meter should continue to be offered to all customers.
- Water companies must ensure that their low-income customers who are low users and would benefit from being metered are identified and encouraged to apply for a meter.
- Compulsory metering should be introduced:
 - for high discretionary users;
 - where the true value of water is high; and
 - where the levels of metering are already high and running two charging systems is inefficient. The review team invites views on what the level should be.
- The review team concludes that it is both fair and advantageous to compulsory meter properties which have high discretionary use. It also believes that the current regulations are too limited, and that the current regulations need to be extended to cover the other circumstances of high discretionary use. In particular, we would like to explore further whether the powers to compulsorily meter households should be extended to all properties with an outside tap.
- Now that the government has committed to roll out smart energy metering to all households by 2020, the incremental cost of adding water meters to the smart energy communications system needs further examination. Ofwat and the water companies need to take action now to assess the costs and benefits.
- In support of Ofwat's leadership on metering issues, we recommend that Ofwat sets up a

smart meter group, including the Environment Agency and water companies, to determine the costs and benefits of smart meters to inform any decisions on approach and potential roll-out of smart meters. This group should also direct the data strategy and analysis for smart meter trials and exploit any potential synergies.

- When designing metering programmes that use dumb meters, water companies should consider how to minimise the costs of any potential future transition to smart metering.
- The detailed design of assessed tariffs is for Ofwat and the companies, but we recommend that they select charging bases that provide as good a proxy for use as possible without being open to deception by unscrupulous householders.
- Strong leadership in achieving the transition to metering will be needed. The UK Government and Assembly Ministers should set out their policies on metering and make any necessary changes to the regulatory framework; and the regulatory agencies should work together to achieve the desired outcome efficiently
- We recommend that Ofwat is asked to lead the delivery of metering in a proactive way, publishing a report on progress every one or two years.

Further questions:

- At the moment meters can be installed in three locations: the property boundary, on the external wall of a building, and internally. Some 80 per cent of metered properties have their meters located externally, but we do not know what proportion has been fitted at the boundary. We would welcome information on the proportion of meters that are located at the boundary.
- We would welcome information on the cost of leak repair in a form that allows us to include it in the cost-benefit analysis.
- We would welcome comments on the cost-benefit analysis, on our assumptions, the evidence we have used and on the merits of our recommendations.
- The review team believes the trigger for compulsory metering should be when 60 or 70 per cent of households are metered. The review team would welcome views on what the appropriate percentage to trigger a compulsory metering programme for the remaining unmetered properties should be.
- In the case of apartment buildings, individual meters should be the preferred option as with all other properties. The multi-occupied building is a type of property where meter installation costs are often relatively high. In this case a single meter could be used to measure consumption by the whole building and the water company could distribute the measured volume across the households in the building when preparing the bills. We would like to hear views on this proposal.

True value of water

- 5.1 We broadly welcome the recommendation to identify the true value of water. We will continue to progress this long-term project as explained above in our comments in chapter 1. We are concerned about the review's working definition of the true value of water (page 76 of the interim report).
- 5.2 The true value of water is the price established when water is freely traded within the overall limits on abstraction set for environmental reasons by the Environment Agency. This can only be revealed through trading. The review refers to five elements that we should take into account when estimating the true value of water. These are elements for establishing the full socio-economic and environmental 'cost' of water (with the exception of the fourth bullet point) – not the 'value'. The value of water, as revealed by trading, could be different from its costs. This is the case in other commodities, such as oil.
- 5.3 We are also concerned that the report recommends that Ofwat and the Environment Agency should establish a true value of water "quickly". It involves more extensive abstraction trading and reverse auctions. These will require legislative changes. We are fully committed to establishing the value of water and will continue to progress our work with the Environment Agency. However, we do not think it can be achieved quickly because the underlying environmental costs and externalities will need to be considered as part this assessment.
- 5.4 Following the Cave review's recommendation for greater competition in the non-household sector, the Walker review notes the importance of making sure that competition for businesses does not result in more or inappropriate costs being transferred to household customers.
- 5.5 We are aware of these issues. It is important that household customers are able to share in the benefits of a separated retail services market, with competition for non-household customers, and not bear inappropriate costs. The Cave review estimated that households could gain a significant proportion of the benefits from its proposed reforms.

- 5.6 We will develop our plans for implementation as the UK Government moves towards legislating on the Cave review's recommendations. As part of this process, we will learn from other utility sectors, where accounting, effective transfer pricing approaches and price control separation have been used to make sure that costs are appropriately allocated between competitive and non-competitive activities. We will also monitor and evaluate the development of competition in the non-household sector, and use appropriate regulation, to make sure that benefits also accrue to household customers.

Metering

- 5.7 As we stated in our response to the call for evidence, metering is a means to achieving other objectives, including:
- fairer charging;
 - reduced consumer demand;
 - more choice and flexibility; and
 - greater consumer control over usage and bills.
- 5.8 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. This is because charges are based on the volume of water used. Metering allows the companies to tailor their tariffs to best suit their customers' needs and to reflect the costs customers impose on the supply system.
- 5.9 In addition, metering should make the development of sustainable competition for a wider customer base easier in the future. Improved price signals that can be developed through metering do two things. They send signals to customers and can also reveal where entry would be most profitable and sustainable. Metering would also improve the companies' relationship with customers. The companies can gather better information on how much water customers use, and tailor tariffs to different customer groups. This would provide an opportunity for new entrant water suppliers to offer differing tariffs and service levels.

- 5.10 We take account of the costs that the companies cite for installing meters. We use these when setting the metered/unmetered tariff differential for each company. This is amount by which average metered and unmetered bills can vary as a result of only some customers having meters. We adjust the costs for those companies that are outside the usual range in our calculations.
- 5.11 We agree that the option for household customers to request a free meter should be retained. Each company is obliged to advertise the option to have a free meter installed. We would support any company that wanted to target low-income customers who use little water. However, we acknowledge that it can be difficult to identify such customers. At present, most companies only have one standard metered tariff. The option to offer the lowest tariff to low-income customers is not available. We would support these customers being on low tariffs if this was cost-reflective and did not have an impact on other customers.

Compulsory metering

- 5.12 We agree that there can be a case for more compulsory metering in certain circumstances. As part of our current review of price limits, we expected companies that proposed additional metering programmes to demonstrate that their plans formed part of a best value approach to balancing water supply and demand. In general, there was a strong case for metering as part of a best value solution to address a supply/demand deficit.
- 5.13 The issue was less straightforward for the companies that planned to meter customers despite having no supply/demand deficit to address. In such cases, we expected the companies to demonstrate that the benefits of their proposals outweighed the costs. So far, none of the companies proposing metering in areas without supply/demand deficits has been able to demonstrate this. Some could demonstrate that the gap between quantified costs and benefits was relatively small, leaving a reasonable prospect that unquantified benefits might bridge that gap. We accepted the companies' proposals in these cases.
- 5.14 We suggest that compulsory metering should be further extended if the benefits outweigh the costs. We do not think an area should need to be water stressed for this to happen. This would be subject to a clear framework of checks, including the companies making the case in their water resource management plans and us agreeing with the benefits. We support extending the metering regulations to allow this.

- 5.15 In [PR09/20, 'Water supply and demand policy' \(November 2008\)](#), we urged other companies to review the case for metering, looking again at the costs and benefits. Of the various wider benefits that we identified, the companies have singled out energy cost savings as the most significant. Yet some companies have not considered this and other potential costs and benefits in their limited analysis.
- 5.16 The existence of an outside tap may be difficult to ascertain and monitor. It is straightforward to connect a garden hose to an inside tap. We do not think that the fact that a property has an outside tap means that it is used. For these reasons, it may not be a practical basis for selective metering.
- 5.17 We do not think that there should be a set trigger point beyond which metering becomes compulsory. As we have said, we support compulsory metering where the benefits outweigh the costs. This is more likely where there are higher levels of meter penetration because the potential water savings from the remaining unmetered customers become progressively higher after all the lower-use customers have opted for a meter. The incentive to opt for a meter becomes stronger for unmetered customers as more customers switch and as unmetered bills go up.
- 5.18 It is not clear how such a trigger point would be decided upon. If this is to be compulsory then legislation would be needed to allow the companies to compulsorily install meters after the trigger point was reached. The appropriate trigger point will be different for each company and it would be inappropriate to set one reference point.

Leadership

- 5.19 Meters are an effective tool in balancing the supply and demand for water because they encourage customers to use less water. They can also have other indirect benefits, such as improving leakage detection and supporting the development of new tariffs. But meters are also costly to install and to operate. That is why we need to manage the transition to metering carefully so that customers, particularly where water is not scarce, do not have costs placed on them without clear benefits.

- 5.20 So, we welcome the Walker review's proposal that we lead in managing the transition to metering, and exploring the potential costs and benefits of smart metering. We agree that we are the most appropriate body to take up this role as we are best placed to take account of the economic issues involved. We want to work closely with the Environment Agency, which is also responsible for leading the effective long-term management of water resources and making sure that metering is extended in this context.
- 5.21 While we would provide a single point of contact for this group, we would look for significant input from other stakeholders. We will set up a steering group that includes the Environment Agency, Defra, the Welsh Assembly Government, CCWater and the companies. We think that the purpose of the group should be to develop an evidence base in order to advise the UK Government and Welsh Assembly Government on metering policy, as well as to determine how best to implement the policies that the Governments adopt.
- 5.22 We note that the Intelligent Metering Initiative is already examining smart metering in the water sector. However, we recognise that there is a need for high-level leadership on this issue. We think that the metering group we head can provide this leadership.

Apartment buildings

- 5.23 Customers in apartment buildings have the same rights as those living in other types of property and so cannot, as the moment, be compulsorily metered unless they meet one of the prescribed conditions. We would agree that new apartment blocks should have individual meters installed, wherever possible.
- 5.24 While it may appear attractive for a company to supply one meter and divide the bill among occupants, this does present a variety of issues. How should the bill be divided? Should the companies take account of occupancy or likely use? How could they make sure that the bill is fair for each customer? We would consider any proposals from the companies against our charging principles.

6. Tariffs

Relevant consultation recommendations and questions

Emerging recommendations:

- With metered tariffs a proportion of the company's revenue should be collected through the volumetric charge, and the unit price of water should be no less than the true value of water. Ofwat should review the division between volumetric and standing charges in metered tariffs and continue to evaluate the advantages (and disadvantages) to customers of varying the relationship between the standing charge and the volumetric charge.
- In respect of more innovative tariffs, the review team's view is that:
 - rising block tariffs have complex effects in redistributing the burden of costs between households, which may merit further consideration in specific circumstances. However rising block tariffs cannot be recommended as a general tool to address affordability, as there is no robust data on household occupancy.
 - the declining block tariff is not appropriate for a general national household charging system as it weakens incentives to reduce discretionary use of water.
 - seasonal tariffs appear to show potential for controlling summer-time peak demand.
- Ofwat should work with the companies to ensure that the tariff trials provide robust and detailed information on the behavioural response to innovative tariffs.
- Wherever distributional consequences from the introduction of changes to tariffs are likely, they should be assessed and considered against the review's fairness principles.

Further question:

- The team's work suggests that some tariffs will be seen as fairer, and more effective in promoting efficient water use, than others. Given these differences in outcomes for customers, there is a question as to what guidance the government should give the regulator on how metered tariffs should look, and what principles Ofwat should observe in considering the acceptability of different metered tariffs. We present the results of this analysis here and invite views on how the guidance to the regulators on metered tariffs should be cast.

- 6.1 Every year, we monitor changes to each company's tariffs, including to the distribution between standing and volumetric charges. Our considerations include the effect that any proposed change will have on customers' sustainable use of water, as well as affordability issues.

- 6.2 We published our view on standing charges in our ['Tariff structure and charges: 2003-04 report'](#). We stated that, "To give customers sensible incentives to use water efficiently, companies should set the volumetric charge to recover the costs which they will incur over the longer term to meet demand. The standing charge, on the other hand, should recover no more than the customer-related costs for the unmeasured service, plus the additional fixed costs associated with providing a measured service (for example, meter reading)." Our charges strategy identified the relationship between volumetric and standing charges as an issue that we will take forward alongside our work on accounting separation.
- 6.3 Any new tariff structure will involve redistributing costs between households. We agree with the review's recommendation that rising block tariffs are not a suitable general tool to resolve affordability issues. Tariffs may have progressive effects, depending on how they are designed. Those likely to be in low-income groups may pay less than those in high-income groups.
- 6.4 We support tariffs that are cost-reflective. We would support a tariff based on the costs groups of customers impose on the system if it could be proved to have progressive effects. As for tariffs that introduce new social transfers into the system, we address this in chapter 8 where we consider affordability.
- 6.5 The review considers that rising block tariffs may merit further thought, but has concerns about occupancy levels, which it believes are needed to make sure customers pay the right price. We will examine the results of the ongoing trials of the three rising block tariffs based on occupancy levels. We will consider whether the risk of dishonesty among customers outweighs the benefits of such a tariff.
- 6.6 We agree that the declining block tariff is not suitable for general household use.
- 6.7 There are currently four seasonal tariffs under trial. We agree that these have the potential to reduce peak summer use and look forward to the results of the trials.

- 6.8 We are working with the companies to better understand the benefits and disadvantages of various tariffs through ongoing trials. We agree that it is important that the results should be robust. In [RD14/08, 'Checklist for trial planning' \(July 2008\)](#), we gave the companies guidance on how to make sure that a trial will obtain accurate, robust and useful data. We will make sure that the likely effects of rolling out any new tariff structure are taken into account before approving any change. This includes weighing the proposed tariff against our charging principles. We will continue to publish the details of trials and review any significant effects they have on particular groups of customers as results become available.
- 6.9 We think that the charging principles we already apply when approving tariffs comply with the current guidance on charging issues. They protect metered and unmetered customers now and will continue to do so as metering progresses. We are obliged to take account of any guidance that the Secretary of State publishes on charging issues when we approve each company's charges scheme, and we will continue to do so. We do not believe that updated guidance is needed on metered tariffs.

7. Sewerage

Relevant consultation recommendations and questions

Emerging recommendations:

- Defra, the Assembly Government, the Environment Agency, Ofwat and sewerage companies should consider how the future charging system could better incentivise householders to minimise the amount of rainwater run-off from existing and new households, including incentives to install small-scale sustainable drainage systems. We would welcome views on how this could be achieved.
- Ofwat should look at the variation in charging households for surface water drainage as part of its work on the future charging system for this service. The aim must be to ensure that the distribution of the surface water drainage costs between customer types is fair, and that the right financial incentive is in place to install alternatives to rainwater drainage.
- The use of greywater recycling does not justify adjusting the sewerage charges upwards.
- Rainwater harvesting should continue to be charged as now.
- Foul sewerage should continue to be charged for on the same basis as water supply.

Further question:

- The review team invites views on the possibility of transferring highway drainage costs to local authorities – both on the principle and the practicalities, including costs and benefits. It also invites views on alternative ways for highway authorities to be incentivised to reduce the volume of highway drainage run-off to sewerage systems.

Surface water drainage

- 7.1 We agree that customers and companies should be encouraged to behave sustainably. Reducing rainwater run-off to the system will lessen the risks of surface water and sewer flooding and we encourage moves that promote this.
- 7.2 There is already an incentive to household customers to make sure that no surface water from their property drains to the sewerage system. Each sewerage company offers a rebate of surface water drainage charges to customers who can show their house is not connected to the system.

- 7.3 Further incentives to household customers to reduce rainwater run-off (so that only part of the property drains to the sewer) should not dilute this incentive. Four companies have introduced site area-based charges for surface water drainage for non-household customers. Under this system, customers are incentivised to reduce the area of their property that drains to the sewerage system as the charge they pay is calculated on the size of that area. This encourages the use of permeable surfaces and technologies such as sustainable urban drainage systems or soakaways.
- 7.4 This type of system is more difficult to implement for household customers. This is because the size of household premises does not vary widely. It would be difficult to show how the costs vary for individual households that drain partially to the sewer.

Variations in charges

- 7.5 We do not believe that cost allocations should necessarily be standardised across the companies. Each company deals with the geographical and demographic issues specific to its area. A better picture of how costs should be allocated within companies will help to identify where charges could be adjusted to provide better incentives to customers to behave more sustainably.
- 7.6 This would encourage them to manage their demand or reduce the load they place on the drainage system, including reducing the amount of surface water run-off. We have already identified cost allocation as an issue to be addressed in the water and sewerage sectors (see chapter 2). Some of the variations in charges will be linked to economies of scale available in more urbanised areas and differences in historic company-specific decisions about the design of separate or combined sewerage and drainage systems.
- 7.7 In order to illustrate the effects of changing cost allocations, we have looked at what could happen to customers' bills if the companies were to move to a standard cost allocation for surface water drainage, based on the current average of all the applied allocations.

- 7.8 We have found that this would produce large incidence effects – particularly for low and high users. These might prove unacceptable to customers. However, they would have to be combined with changes to the highway drainage and foul sewerage charges, as the costs are taken together for the sewerage service. In particular, it would affect the review's recommendation that charges for highway drainage should sit with the local authorities rather than with water and sewerage customers. We consider that these two recommendations should be considered further together.
- 7.9 We agree that greywater recycling and rainwater harvesting charges do not need to be changed, and that foul sewerage should continue to be charged on the same basis as water supply.

Highway drainage

- 7.10 We believe that transferring the costs of highway drainage to local authorities would have some benefits. This aligns with the polluter pays principle. It also sends the right signals to those responsible for incurring costs. The current charging methods result in charges that bear no relation to the costs that individual customers impose on the system. As a result, charges do not accord with our charging principles, or those that the review put forward.
- 7.11 Local authorities can have an effect on costs by designing systems, including sustainable urban drainage schemes, which reduce the amount of run-off reaching the sewerage system. However, before a decision on this transfer is made we believe it is essential that we understand the incidence effects that this change would generate and how this change would fit in the broader context of urban drainage. This work should inform an impact assessment for the necessary changes in legislation.

8. Affordability

Relevant consultation recommendations and questions

Emerging recommendations:

- Recognising the lack of sensitivity of the benefit system to large regional differences in water cost, the UK government should consider introducing a regional water benefit. The review team would like views on this suggestion.
- In the absence of a regional water benefit, there should be a percentage reduction to the bills of low-income customers (in receipt of Council Tax Benefit) in high bill areas, down towards the national average bill, paid for either by the national water customer or by the national taxpayer. The review team would welcome views on this proposal.
- Retain and refine the national safety net for low-income high essential water users (WaterSure) and increase promotion of the scheme, including providing more information on bills. Recognising the current lack of interaction between the benefit system and the regional variation in water costs, cap WaterSure bills at the national average bill; refine the criteria for a family with older children in education or training, and seek advice on eligibility on medical grounds; make applicants' medical certificates free. The costs of this and the costs of the current WaterSure system should be met by national water customers.
- Companies should be statutorily required by Ministers to develop their own water efficiency programmes which would contribute to their enforceable water efficiency target, with priority given to low-income customers in debt or in receipt of Council Tax Benefit. The review team would like to invite views on the principle of such a scheme, where the costs of such a scheme should fall, and the powers necessary to put it into place.
- Ofwat, building on its current duties, should be more proactive in terms of helping companies tackle affordability problems. The review team would like views on whether the scope and detail of Ofwat's current duties are sufficient to tackle affordability issues, or if something further is necessary.
- Ofwat should produce an annual report on affordability and debt issues, and where it is not clear that it is possible to solve the affordability problems within the current regulatory framework, should provide advice to the Secretary of State and Ministers on what action is necessary and why.
- Within a new consolidated set of guidance on charging, social and environmental issues, new guidance should be provided to Ofwat by English and Welsh Ministers on social tariffs, with the aim of companies being encouraged to develop local social tariffs, acceptable to their bill payers, and for Ofwat to be more ready in accepting these schemes.
- Local Government should consider sharing data on low income customers receiving

Council Tax Benefit with water companies so companies can target assistance.

Further questions:

- The review team would like further views on the value of using receipt of Council Tax Benefit to identify low income households for targeted support.
- In order to model the potential impact of a regional benefit the review team has assumed in the absence of further information from DWP, that benefits currently cover the national average water bills. In high bill areas, people on means tested benefits would therefore require additional benefit to cover the difference between the regional average (metered and unmetered) bill and the national average bill. The difference in the South West Water region between the regional average bill and the national average bill was £171 in 2007-08. The total cost of such a scheme to rebalance this difference for high bill areas could be around £45m in the first year. If the scheme provided for existing metered customers only, the cost would be around £17m in the first year. The costs of such a scheme would fall to the national tax payer, allowing the funding to be on a progressive basis. We would like views on this suggestion.
- The review team would like views on the proposal to apply a percentage discount on bills as a means of assistance for low-income households in high cost areas in receipt of Council Tax Benefit or in debt. The review team would also like views on whether this should be funded by national water customers or national tax payers.
- We believe that as this measure is designed to address the affordability issues that arise because of the mismatch between the tax and benefits system and regional price variations eligibility should also be restricted to those in high cost areas. The review team would like views on this restriction and the administrative implications of such a scheme.
- The review team intends to take advice from the Royal College of General Practitioners on what advice might be necessary for GPs and companies in future on the medical conditions that should qualify under "any other conditions". Any system should make it clear that doctors have the appropriate flexibility to sign certificates for any person receiving benefits they believe requires extra water as a result of a medical condition and that these certificates should be free. The review team would welcome views on this proposal.
- The review team would like views on whether the scope and detail of Ofwat's existing duties are sufficient to tackle affordability issues, or if something further is necessary.

Affordability duties

- 8.1 The report questions whether we are sufficiently proactive in helping the companies to tackle affordability problems.

- 8.2 We agree that affordability is an important issue and that low-income customers, particularly those who use a lot of water, are particularly vulnerable to bill increases.
- 8.3 We have a primary duty under the Water Act 2003 to further the consumer objective. This requires us to have regard to the needs of specific groups of consumers, including those on low incomes. We interpret this duty as requiring us to:
- make sure that an understanding of consumers' views and priorities inform our work;
 - consider the impact on bills and affordability of our policies and decisions; and
 - promote good practice in meeting the needs of such consumers.
- 8.4 We already do considerable work under this duty and we are keen to develop and build on this in a way that aligns with some of the review's recommendations, particularly those on publishing information.
- 8.5 The work we already undertake includes the following:
- When we set price limits, we seek consumers' views and challenge the companies' proposals to make sure that bills reflect consumers' priorities and are no higher than they need to be.
 - We publish debt guidelines, review the companies' policies and promote good practice to make sure that those who may be struggling to pay their bills are treated fairly.
 - We evaluate the companies' proposed charges each year to check that they are managing the impact on customers of any significant year on year changes.
 - We support the companies in piloting trials of new tariffs that help the most vulnerable customers without increasing bills for others who may also have difficulty paying.
- 8.6 We are keen to build on this work. In particular, as information becomes available from the tariff trials we have approved, we will publish it and promote the sharing of good practice as recommended by the review. We will also bring together and publish other relevant information from consumer research and our monitoring of the companies' activities.

- 8.7 However, for us to go further than this in tackling the wider issue of affordability requires a coherent and joined-up approach by the Government. It needs to establish a clear framework to deliver its desired outcome on the affordability of water. For example, in the energy sector the Government has taken a lead on fuel poverty, defining the problem, setting targets and establishing programmes and financial support to help customers manage their bills. We would be happy to contribute to the development of such a framework by providing information and other support.
- 8.8 Within such a policy framework, the role of the regulator could be set out clearly. We would see this as a natural development of the work we currently do.
- 8.9 In the absence of such an approach, simply putting a one-sided obligation on us to consider affordability could be counter-productive because it would raise expectations but lack the necessary public policy framework.

Regional water benefit

- 8.10 The review team asked for comments on a proposal to introduce a regional water benefit for those on low-incomes, paid for by the national taxpayer. We consider that help for those who have difficulty paying their water bills should come through the tax and benefits system. We believe that funding for social assistance through national taxation is preferable to funding by water customers.
- 8.11 While we agree with the Department for Work and Pensions (DWP) that people should not be caught in a “benefit trap”, allowing the variation in bills to be better reflected in benefit levels could help many customers living in areas where bills are high. We note that a regional variation is already included in Housing Benefit.
- 8.12 We accept that increasing benefits nationally to cover water charges is unlikely. It would still be helpful to understand how much is typically included in benefits to cover water charges and we agree that the review should seek to obtain this information from the DWP. Without fully understanding how much is already included for water charges, any analysis of the likely level of additional benefit needed and the costs of the scheme will be difficult to establish.

- 8.13 Assuming the figures included in the review's interim report prove correct, the costs associated with introducing a regional water benefit of this type could be significant. We support the view that any costs and administration of such a scheme should fall on the national taxpayer and not directly on other water customers.
- 8.14 If this benefit were to be paid directly to benefit recipients, some reassurance would be needed to ensure that the additional benefit is used to pay water charges.

Reductions in bills in high areas

- 8.15 The alternative option is to offer a percentage reduction in bills for low-income customers who receive Council Tax Benefit in high-bill areas. This has the benefit of retaining the incentive on metered customers to be water efficient.
- 8.16 We maintain that allowing other customers to fund the scheme would create a cross-subsidy across different water company regions. It would also not be cost-reflective. In addition, as we set out in our response to the call for evidence, research has shown that customers do not typically support further cross-subsidies.
- 8.17 There will be customers in low-bill areas who also struggle to pay their bills. Focusing on high-bill areas only (which may change over time) would mean that customers in low-bill areas ultimately pay more (either through higher water charges or taxes) to cover the water charges of those in high-bill areas. Many of these customers may also face financial difficulties.
- 8.18 We continue to believe that any social transfers introduced through water charges would need to be:
- transparent;
 - mandated by legislation; and
 - considered carefully in order to determine the impact on other customers' bills.

WaterSure (customers with low income and high essential water use)

- 8.19 We agree that better promotion of WaterSure could improve both customers' awareness of the scheme and take-up rates. The availability of shared data could be the most effective way of improving these rates.
- 8.20 We check that the companies provide details of the WaterSure scheme with their bills or in consumer literature, such as codes of practice.
- 8.21 Every year, we publish information on our website to show how many customers have successfully applied for assistance (figures for 2008-09 show 28,879 households – an increase of 20% on the previous year). We also set out what we consider to be good practice in promotion of the scheme.
- 8.22 The companies' June returns show that they carry out a wide range of methods to promote the scheme. Some companies, for example, place posters and leaflets in doctors' surgeries, benefits agencies, housing associations, libraries and money advice centres. Others publish articles in national and regional magazines, and talk to community groups and call centre agents to proactively identify potentially eligible customers. Many target assistance at specific groups, for example by engaging with disability and debt charities, and organisations that deal with specific illnesses. They also ask GPs to promote the scheme to eligible customers. Some also track the source of applications to monitor the relative effectiveness of the initiatives used to promote the scheme.
- 8.23 The companies have limited information on their customers. This means that they will continue to face difficulties in targeting assistance at low-income customers effectively. In our response to the call for evidence, we suggested that the review should consider whether schemes such as WaterSure and Water Direct could be targeted more appropriately, for example by companies working with government departments such as the DWP. This route should be particularly effective for these schemes because eligibility often depends on the householder receiving means-tested benefits. We noted that "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."

- 8.24 We do not support the proposal to cap the WaterSure tariff to the national average bill. However, we accept that this could help those living in high-bill areas. Our first concern is that those customers living in low-bill areas that previously benefited would no longer do so. This proposal moves further away from the cost-reflective charging principle, and we would only support this approach if it is mandated by legislation.
- 8.25 The proposed funding for this change would come from national water customers. This could mean that customers in low-bill areas (who may also be on low incomes or struggling to pay) would effectively be subsidising those in high-bill areas. It would introduce a social transfer across company regions. We do not support this.
- 8.26 We also have some doubts over the validity of the £1 million cost of this change reported in the interim report. This appears to be based on 2007-08 numbers for WaterSure customers. This figure has already increased by 20% in the past year. If the scheme is extended as proposed, it could result in a much higher figure. This could increase bills for some customers that also struggle to pay their bills but do not qualify for the scheme, especially if it is paid for by all water customers. Recent customer research from CCWater ('Charging Research, 2007') shows little support for paying more to subsidise others' bills – especially if bills increase by more than £1 as a result. We also believe that the administrative practicalities could make this proposal unduly cost prohibitive and burdensome.
- 8.27 We need further information to consider how this proposal would operate. The change could only take effect through legislation, for example through amendments to the Vulnerable Groups Regulations.
- 8.28 We have no objection to expanding the qualifying criteria for large families to include dependants in full-time education or training and living at home, if this brings the tariff into line with Council Tax Benefit eligibility criteria. We would expect Defra to provide guidance to the companies on what evidence should be demonstrated to claim eligibility.

- 8.29 We agree that doctors should have the power to sign certificates in cases where they believe a medical condition requires additional water use. Our understanding is that this practice already happens. The companies tell us in their June returns that they operate the “medical conditions” criteria flexibly. Many have accepted applications from customers with other conditions (including mental health problems such as obsessive compulsive disorder) where a medical practitioner has confirmed that additional water use is required.
- 8.30 We agree that customers should not have to pay an access fee for the scheme. Therefore, we support the provision of free medical certificates.
- 8.31 Finally, we support the review's work to estimate the number of households eligible for the tariff under a revised scheme.

Water efficiency

- 8.32 Targeting water efficiency advice at low-income households can encourage more sustainable behaviour. It also offers financial benefits to those with a water meter. The review appears to presume that water efficiency programmes will deliver savings of a sufficient volume of water, which in turn will lead to a significant long-term monetary savings for low-income customers. Currently, there is a general lack of information about the real impact of water efficiency programmes, and still less reliable information about the long-term impact of interventions (see chapter 10). As a result, any trial of this type should establish quickly the extent of likely net benefits.
- 8.33 We plan to collate and share good practice in promoting the availability of all schemes to vulnerable customers later in the year. We will also hold a workshop to share good practice in this area.

Guidance

- 8.34 Social tariffs that explicitly target specified groups are one method of helping customers who are having trouble paying their bills. It can be difficult to define the groups needing help. There may be others who are equally in need but do not meet the specified group definition.

- 8.35 We have already accepted several innovative solutions that the companies have put forward to help customers to reduce their debt. This, in turn, reduces the debt burden on all customers. We do not accept tariff structures that increase the level of charges to one group of customers in order to help others who may be in difficulty unless they are mandated through legislation. We believe that the Government should decide whether some groups of customers should be required to support others financially.
- 8.36 We have a duty to make sure that charges are not unduly preferential or unduly discriminatory. We interpret this to mean that new cross-subsidies or social transfers should not be introduced to the charging system, unless there is a legal mandate to do so. The Water Industry Act provides for the Secretary of State to make regulations setting out who should benefit from this type of social policy. We will make sure that the companies implement any such tariffs mandated by Parliament.
- 8.37 We will continue to have regard to guidance from the UK Government and Welsh Ministers when considering tariff proposals. We agree that social tariffs should try to reflect local circumstances. They should also be acceptable to bill payers. We agree that a new set of consolidated guidance on Government priorities among social, environmental and charging issues would be helpful.

Data sharing

- 8.38 As we set out in our response to the call for evidence, we consider that additional data sharing with other government departments should be considered, subject to certain caveats (see section 9.16).

Council Tax Benefit

- 8.39 We would caution against using the Council Tax Benefit to target measures at low-income households. This appears attractive as the benefit is applied at a household (rather than an individual) level. However, recent research carried out for CCWater by the University of York ('Water affordability in England and Wales', 2009) showed that there was no single benefit that effectively targets those who have problems paying water bills. Using Council Tax Benefit may not reach those in need. It may target some that do not need help and miss out others, such as customers who are just under the threshold to receive benefits.

- 8.40 This research found that among benefit recipients, 33.3% of those receiving Child Tax Credit and who were at risk of poverty are “water poor”. Households are defined as “water poor” if water charges exceed 3% of net income. The second-highest figure was for those receiving Income Support or Jobseeker’s Allowance, with 30.9% defined as water poor. We do not accept these definitions of water poverty.
- 8.41 We think that a more detailed understanding of the cost implications is needed before Council Tax Benefit could be used to target help. The review notes that 3.2 million households across England and Wales received Council Tax Benefit in 2007. Depending on the level of help provided, and where the costs of funding fall, the rebalancing effects could be significant. In addition, they may adversely affect those customers not on Council Tax Benefit who also struggle to pay their bills.

9. Bad debt

Relevant consultation recommendations and questions

Emerging recommendations:

- As a priority the Water Industry Act 1991 should be amended to clarify and widen the definition of who is responsible for paying the water bill, through a definition of 'liable person' along the lines of that used in Council Tax legislation; and ensure that water companies have named customers. Three statutory changes are necessary in order to improve the situation:
 - Clarify and widen who is liable for paying the bill;
 - Ensuring the name of the person responsible for paying the bill has to be supplied to the water company; and
 - Identifying the property owner as responsible for paying the bill when the property is in multiple occupation.
- Companies should be encouraged by Ofwat to move towards debt prevention and best practice approaches rather than concentrating on debt management.
- Ofwat, together with CCWater, should be asked by government to monitor company performance on debt prevention, management and recovery against Ofwat's debt guidelines. Ofwat should produce a separate annual report on debt which makes clear which companies are performing well ('name and acclaim') and which should improve. It should also highlight good and poor practice. This annual report could be combined with the report proposed in chapter 8 on affordability issues in the water industry.
- Local government should work with the water companies to identify low income customers receiving Council Tax Benefit so that companies can better target assistance.
- Companies should consider, as a way of helping customers to pay their bills, developing more voluntary agreements with Registered Social Landlords and local housing authorities so that water bills are paid with rent for unmeasured customers.
- There should be clearer bills and better information to customers from companies, clearly indicating methods of payment, contact details for third party debt advice agencies and written in plain English. Greater transparency will provide more information concerning the breakdown of charges and the reasoning behind bill increases.
- There should be more publicity on water debt advice and help from companies and greater use and funding of third party advice organisations. This could be along the lines of current innovative schemes (such as Wessex Water's scheme) or might be part of a company's water efficiency programme.
- The option of current third party deductions scheme (WaterDirect) should be pursued more proactively by water companies, where this would be more helpful to customers in debt.

- Companies need to have available and accessible schemes in place that help low income earners who want to stay out of debt; this could include social tariffs.

Further questions:

- The review team would welcome views on the costs and value of prepayment meters compared to other mechanisms to help customers manage debt.
- The review team would welcome comments on the possibility of introducing trickle valves to reduce supply to persistent 'won't pay' customers. It would be feasible to set up a process whereby trickle valves could be used in exceptional circumstances after rigorous independent safeguard conditions have been met, for example through agreement by the courts or CCWater.

Legislation

- 9.1 We support fully the proposed changes in legislation. Widening the definition of those who can be held responsible for bill payment and allowing the companies to obtain accurate occupancy information will enable them to collect a higher proportion of charges. Overall, this should reduce costs to other customers. We believe that this could make a noticeable difference to debt levels. We will look for this recommendation to be included in a later stage of the Flood and Water Management Bill.
- 9.2 We consider that a hierarchy is the most sensible option. This would retain the link with accountability for usage for those living in metered properties. We do not support simplifying this by switching all liability to owners rather than occupiers.
- 9.3 We accept that further work is needed on how the hierarchy would operate in practice. This includes identifying how the proposal would be enforced (effective sanctions for non-compliance will be needed). As a precedent is already in place (Council Tax), we do not feel this should create any significant obstacles.

Debt prevention and best practice

- 9.4 We agree that debt prevention is the best way forward. Our debt guidelines set out expectations on the companies. These help to make sure that vulnerable customers are treated fairly and that debt is prevented. As part of our work on approving charges schemes, we make sure that customers have access to payment methods that meet their needs. For example, we require

the companies to offer frequent cash payments at reasonably accessible locations. We also make sure that billing literature sets out clearly how bills can be paid and what customers should do if they face payment difficulties.

- 9.5 It is unrealistic to expect that all debt can be prevented, especially with rising levels of indebtedness in society generally. As the companies have a statutory duty to supply, they are restricted in the level and type of information they are able to demand. Without such information, the companies cannot understand which customers need help or where best to target resources.
- 9.6 The [EFRA Committee report on the Ofwat price review](#) also noted this point. The report stated that, “better information on debt would enable understanding of why problems arise for some customers and enable more accurate targeting of assistance”.
- 9.7 Therefore, it is important to use all available data to identify those customers likely to fall into arrears. We are aware that many companies are now purchasing data from external companies (for example, credit reference agencies) in order to understand their customers’ needs and tailor their revenue recovery processes. Having additional data, for example from local government, could also help in this respect (see section 11.3).
- 9.8 We believe that the Government should consider extending the Water Direct scheme to allow customers not in arrears to qualify for assistance (see section 9.34). This is subject to a satisfactory cost-benefit analysis. This would support customers trying to budget effectively and avoid debt. We think this would be consistent with the objective of helping people to manage their finances as set out in the Government’s recent White Paper, ‘A Better Deal for Customers’.
- 9.9 The companies already work together to share best practice on key debt-related practices. Research has also been carried out to identify what might be considered to be good practice. For example, ‘Water Industry Debt – current trends and good practice approaches’ (2004), showed that “the water industry is generally adopting good practice in the collection and recovery of debt”. It also demonstrated “that the water sector is now comparable with gas and electricity across a number of key performance indicators”.

- 9.10 It is also important that the companies manage those customers who have fallen into debt appropriately and in a manner that encourages them to control their future finances. Using charitable trusts or restart schemes can be helpful in this respect.

Reporting

- 9.11 We already publish a significant amount of information on debt issues. After the current price review, we will review the range of information we collect and publish. We will then collect this into an annual report on debt and affordability. We will continue to challenge the companies to manage debt cost-effectively, as well as encouraging them to publish good practice. We will work with CCWater to monitor how well the companies deal with those customers who fall into debt.
- 9.12 The review notes, “despite the comprehensive nature of Ofwat’s guidelines, there are no formal monitoring or reporting structures currently in place. Ofwat currently relies on CCWater to monitor how well companies comply with the guidelines”. We think that this process is sufficient and have no reason to believe that the companies are breaching the guidance. CCWater have raised any areas of concern with us. We have addressed these when we have updated our guidelines. Every year, we receive details of each company’s debt assessment and ask CCWater to raise any issues of concern at the time.
- 9.13 As part of the debt and revenue assessment of the overall performance assessment, we analyse how the companies have done. We will consider whether additional or alternative information should be covered in relation to debt as part of our future review of the overall performance assessment.
- 9.14 Each year, we collect a range of debt-related information from the companies. This includes June return data on the level of revenue outstanding, value of write-offs and costs incurred on debt-related activities. It also includes a specific company return which requests information on the number and type of court actions taken, type of payment methods that customers use and an overview of the companies’ debt collection methods.

- 9.15 We publish an annual document that sets out debt levels across the companies. It also includes information on court actions used at a company-specific level. We carry out comparative analysis across the companies to identify any correlations with average bills. To date, correlations have not been statistically significant. We believe that this goes some way towards the information provision that the review recommends. While there is benefit in comparing the companies to improve performance, this only works where the comparisons are valid.
- 9.16 What may be seen as good or best practice in one company's operating area may not apply equally to all areas. For example, there are differences between the companies in terms of mitigating factors that could affect their individual debt levels (a point that the review acknowledges). These include:
- demographics of the customer base;
 - price rises;
 - average bills;
 - number of Local Authority collection agreements;
 - meter penetration;
 - income deprivation levels; and
 - geographic differences.
- 9.17 As an example, some of the small water only companies visit customers in debt. This personalised approach can work well, but may not be cost effective for a large, more geographically dispersed area. We expect the companies to deal with the variety of debt management challenges that face them as efficiently and effectively as they can. However, we cannot require all companies to use the same methods. It is not our role to tell the companies how to collect revenue. Our debt guidelines take a less prescriptive approach to allow companies the flexibility they need to tailor their practices to fit individual customers' circumstances.
- 9.18 As a result, we do not think it is appropriate to commit to publishing any report which would "name and acclaim" companies. We would be happy to review the information we already collect and publish in order to establish if it could be presented in a more helpful way.

Identifying low-income customers

- 9.19 We agree that some form of data sharing with other government agencies or with local government could help the companies to target assistance at low-income customers effectively. Further work would be needed to agree how this would be most effective, given the constraints surrounding data protection and privacy.
- 9.20 We noted in our response to the call for evidence that “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.” We consider that the review should look at this.
- 9.21 Exactly what criteria should be used to target customers needs further consideration. Evidence, from the recently published House of Commons Public Accounts Committee report on the WarmFront scheme, shows that nearly 75% of households helped by the scheme were not in fuel poverty. It also reported that the scheme was only available to 35% of those households most likely to be defined as “fuel poor”.
- 9.22 CCWater's recently published research, 'Water affordability in England and Wales' (2009), shows that using Council Tax Benefit may not reach those in need. It may target some that do not need help and miss out others, such as those customers who are just under the threshold to receive benefits.

Social landlords

- 9.23 We agree with the principle behind the recommendation for more voluntary agreements with registered social landlords or housing authorities to enable water bills to be paid with rent. We support using such agreements if they are cost-effective and customers agree to this method of collection. They can benefit customers (more effective money management, prevention of arrears and sometimes a reduction in their water bill), the companies (higher levels of revenue recovered and accurate detail on occupation) and the third party (who typically receives a commission).
- 9.24 We have recently approved tariff trials that offer financial incentives for customers if their water charges are collected alongside rent. Both Dŵr Cymru and United Utilities offer such a discount to customers.

- 9.25 Those companies that already operate agreements with local authorities or housing associations tell us that they work effectively and that customers welcome them. Evidence from the companies suggests that acquiring new agreements is not easy. Providing a financial benefit to customers may help.

Better information

- 9.26 We agree that bills (and associated billing literature) should be written in plain English (or the Welsh equivalent) and include all essential customer information.
- 9.27 Each year, we check this literature as part of our charges approval process to make sure that it includes essential information. This includes a clear explanation of payment methods and contact details for the company in order to discuss payment difficulties.
- 9.28 Limited space on bills means that not everything can be included prominently. The unsolicited literature included with bills normally provides additional information. Research suggests that many customers do not read this information. Similarly, others have complained to us that too much information is provided. This raises environmental concerns. Therefore, there need to be a balance between providing a sufficient level of information without overloading the customer.
- 9.29 The companies have already carried out some work on best practice in bill design, for example with BSI and CCWater. We have been involved in this work. While we cannot require the companies to present bills in any particular way, we would support any work in relation to best practice in bill design.

Advice and help

- 9.30 We agree that more publicity on water debt advice from the companies and greater use and funding of advice organisations could be helpful, particularly as customers with water debts will typically have other debts. We make sure that information about debt advice agencies (including contact details) is included in the companies' codes of practice on debt. We approve these at least once every three years.

- 9.31 Our debt guidelines also note that, “to be constructive, it is also important that any correspondence encourages the customer to contact the company and if necessary to seek appropriate expert advice. For example, reference could be included to organisations such as the National Debtline, Advice UK, CLS Direct, Consumer Credit Counselling Service or their local Citizens Advice Bureau.”
- 9.32 Many companies fund various advice organisations and have built effective working relationships with such agencies. We support this work in the interests of offering a holistic solution to debt problems.
- 9.33 Many agencies do not treat water debt as a priority, so the companies may be reluctant to refer customers to them. The review recognised this point in its interim report.

Third party deductions

- 9.34 We agree that the companies should offer Water Direct, the Third Party Deduction Scheme, if this would be helpful to customers. We understand that this already takes place. As part of our work with the Water UK Debt Strategy Group, the companies already inform customers of this scheme. They also apply on customers' behalf. This is in line with our debt guidelines, which states that the companies should, “proactively offer customers who are in debt and in receipt of eligible benefits the option to pay using the Water Direct scheme”.
- 9.35 This approach appears to be effective. The latest data from the companies (collected by Water UK in July 2009) reported approximately 173,000 customers on Water Direct (a 12% increase on the previous year). This figure is much higher than that reported in the energy sector (probably because of the high number of prepayment meters in that sector). It is also much higher than the figure included in the interim report.
- 9.36 We were disappointed not to see recommendations from the review to expand Third Party Deduction Schemes. Many parties have said that extending Water Direct could make a real difference to those struggling to manage their finances.

- 9.37 Research by Accent for UKWIR ('Customer targeted debt management', 2007) found that 91% of respondents found the scheme helpful. In addition, 82% said they were better able to manage their finances once they were on the scheme. Finally, 86% would like the scheme to be extended to cover those not in arrears.
- 9.38 Although Water Direct does not reduce the size of the actual bill, it offers a valuable budgeting tool to customers who occasionally struggle to manage their finances. This could actually work to promote the Government's policy of increasing greater financial inclusion.
- 9.39 Therefore, we believe that this recommendation will not have any real impact. It would be more helpful for the final report to commit to properly consider the suggestions to extend the scheme that we made in our response to the call for evidence.

Schemes to help low earners

- 9.40 We agree that the companies should do all they can to help low-income customers stay out of debt and that debt prevention is vital. We support using schemes to help low-income customers stay out of debt. Such schemes can include charitable trusts or restart schemes, Third Party Deduction Schemes or other forms of social tariff.
- 9.41 Most companies offer some form of charitable trust or restart scheme. These are advertised in various ways and frequently involve referrals from advice agencies. We support this form of assistance as part of an overall package of debt prevention and management. Feedback from the companies suggests that most customers benefiting from such schemes maintain this payment habit.
- 9.42 We would support introducing explicit cross-subsidies for specific groups if legislation were in place to allow this. We believe that explicit support for vulnerable customers is best provided through the tax and benefits system rather than introducing cross-subsidies between groups of water customers (see chapter 8). However, we encourage the companies to provide help to specific groups where this is also expected to reduce the effect of debt on all customers.

- 9.43 We have recently approved several proposals on a trial basis. These include offering customers a financial incentive to continue to pay their bills, or reducing their bills on the understanding that the customer will pay a larger proportion of a lower bill. Such tariffs need to be self-financing. They also need better revenue collection and reduced collection costs to offset additional administration costs and the reduced bills for participating customers.
- 9.44 We will monitor the effectiveness of these trials over the next year, although early indications show some positive results. One trial in the Wessex Water area has proved to be self-funding, and we have approved this as a standard tariff.

Prepayment meters

- 9.45 We support the review in looking at the case for reintroducing prepayment meters as a budgeting device. This would be subject to the companies providing a satisfactory cost-benefit analysis and consideration of the practical implications to assess their overall value. When the initial ban on disconnection was proposed, we urged the Government to retain these devices because we were aware that many customers found them helpful as a budgeting tool.

Trickle-flow devices

- 9.46 We support the review's proposal to look at removing the ban on trickle-flow devices as long as appropriate safeguards are in place to protect consumers. We believe we need to obtain satisfactory information on the costs, benefits and practical implications of trickle-flow devices. The companies' implementation plans would need to protect the most vulnerable customers, and those who cannot pay.

10. Water efficiency

Relevant consultation recommendations and questions

Emerging recommendations:

- While the regulatory framework for water efficiency has improved in recent years, more can still be done to ensure that the right incentives are in place to encourage the use of water efficiency activity by water companies, customers and Ofwat. This includes:
 - The operational efficiency of a company's water efficiency activity to be calculated separately by Ofwat, instead of included in the overall operational efficiency calculation;
 - The true value of water should be used in investment making decisions and any evaluation of the costs and benefits of water efficiency measures; and
 - Ofwat to set a minimum percentage of water efficiency targets to be achieved through water efficiency activity targeted at defined low-income metered household customers to help them reduce their water use and, therefore, their bills. In the longer term, the UK Government and Assembly Ministers should introduce a statutory requirement for all water companies to implement a water efficiency scheme targeted at defined low-income metered customers.
- The UK Government and Assembly Ministers should maintain progress on the water efficiency of new homes and ensure that synergies with existing refurbishment and retrofitting programmes of existing housing stock are fully exploited to ensure that the water efficiency of existing homes is achieved as economically as possible.
- Water and energy companies should be incentivised to work together to retrofit existing homes with energy and water efficiency measures and allocate the respective water and CO₂ savings to their respective water and energy efficiency targets, especially for hot water efficiency measures accredited in the CERT scheme.
- Water companies should be incentivised to work together with social landlords and housing associations to improve the water efficiency of existing homes.
- Where water companies undertake retrofitting projects by themselves, the water companies should be able to accrue and CO₂ savings for measures accredited in the CERT scheme, and then be able to sell the CO₂ savings to energy companies to use against their targets, or to use the CO₂ savings against their own Carbon Reduction Commitment.
- The UK government should encourage the use of more water-efficient fittings and appliances by:
 - ensuring that only water-efficient products can be sold on the UK market; and
 - reviewing the efficacy of the current and proposed labelling schemes and deciding what information consumers need as a matter of priority. Government should work with Waterwise, water companies, manufacturers and retailers to ensure voluntary

schemes are effective or to decide whether a mandatory scheme is needed.

- The UK Government and Assembly Ministers should promote a national education strategy working with stakeholders to influence public behaviour on water use. Regional and local community based campaigns on water efficiency should be developed, using the key national messages, but targeting local issues.
- Household customers' awareness of the links between hot water and energy savings should be raised by:
 - ensuring that the ACT on CO2 calculator includes a section on emissions linked to hot water use and advice on how to use hot water more efficiently;
 - the Act on CO2 campaign including dedicated messages on water efficiency; and
 - water companies including messages to customers on this link, providing information on potential energy savings linked to water efficiency.

Further questions:

- The review team would therefore welcome views on whether Ofwat's current sustainable development duty should be extended to make specific reference to consideration of climate change, in particular mitigation and adaptation measures.
- The review team calls on the UK Government and Assembly members to promote a national education strategy working with stakeholders to influence public behaviour on water use. In addition this sort of campaign will need national operational leadership; the review team invites views on who this should be.

Water efficiency operations

10.1 We use our assessments of relative operating expenditure information to set water efficiency targets. We include these in the companies' price limits at each price review. We do not believe that it would be appropriate to exclude all water efficiency activity from our assessments. We have an approach in place that takes account of the potential impact of additional water efficiency activity on the companies' relative efficiency.

10.2 Each company delivers its services with a mixture of capital and operating expenditure. Water efficiency expenditure is only one element of this. Because we assess operating expenditure on a relative basis, it is not the absolute level of expenditure on water efficiency that affects a company's relative efficiency, but how this level compares with the other companies. However, when expenditure on water efficiency in a year is unusually high, for example when a company is carrying out a large water efficiency trial, that company can ask us to treat this expenditure as atypical when we assess relative efficiency. We can then exclude it from our relative efficiency

assessments. We think that this approach removes the barrier to the companies carrying out water efficiency activity.

- 10.3 We have already commented on the use of the true value of water in chapters 1 and 5.

Water efficiency and low-income customers

- 10.4 We accept that we should allow the companies to target their water efficiency activities to low-income customers if they are able to do so. They already have a significant incentive to target water efficiency measures to customers in debt because it can help to reduce the debt burden.
- 10.5 We do not think it would be appropriate to make this a requirement, or to set a target. This is because there are problems associated with identifying low-income customers. In addition, the companies may find more effective ways of achieving their water efficiency and affordability objectives. The review acknowledges that there might be data protection issues associated with providing privatised water companies with sufficient information for them to identify accurately customers on low incomes.
- 10.6 Targeting all customers will be more effective in delivering the necessary significant reductions in consumption. The current water efficiency duty in section 93A (1) of the Water Industry Act 1991 (as amended) states, "It shall be the duty of every water undertaker or licensed water supplier to promote the efficient use of water by its customers". This duty extends to both household and non-household customers. We think this is the right approach to address the need to encourage a reduction in the quantity of water wasted.

Sustainable development

- 10.7 Our view of sustainability considers social, economic and environmental factors. It is embedded in our approach to the 2009 price review and is a central part of our long-term strategy and aims. Our approach is set out in our recent sustainability document, ['Water today, water tomorrow'](#) (March 2009).
- 10.8 The review highlights a number of issues relating to sustainability and climate change. It notes that sustainability is a broad issue with far-reaching consequences. It demonstrates that to meet the challenges ahead, including climate change, effectively, a holistic approach is necessary.

- 10.9 We accept that it is very important to address the issues surrounding climate change. Although a specific climate change duty would provide a clear focus, there is a risk that this duty could constrain or distract us from our wider sustainability duty. We believe that a balanced approach is necessary to create the correct framework to deliver sustainable water and sewerage services. We are concerned that focusing more specifically on climate change issues could lead to distortions in the water and sewerage sectors. It could also distort the relationship between the sectors, the wider economy and national Government policy towards climate change.
- 10.10 There is a risk that key interactions could be overlooked or given insufficient weight and that unintended consequences may occur if we do not take a broad approach to sustainability. For example, the overall affordability of customers' bills could become a lower priority if an emphasis is placed on improving the companies' approach to climate change ahead of other sustainability factors. A more effective approach would be to consider the key sustainability factors together as opposed to singling out specific elements for special treatment.

11. Customer involvement and understanding

Relevant consultation recommendations and questions

Emerging recommendations:

- The review team recommends that as companies are monopoly providers to household customers, the regulatory regime should include measures on customers' experience in the Overall Performance Assessment which have a real and visible effect on companies and thus incentivise better handling of customers. It would welcome views on this recommendation and what the specific measure or measures should be to achieve this.
- The review team recommends that Ofwat should publish an annual analysis of companies' responsiveness to their customers.
- The review team recommends that the 12 month limit within which Ofwat must pursue breaches and penalise companies is extended to 5 years.
- The review team considers that water customers should be given more information on their bills. Building on best practice in some water, energy and council tax bills, it recommends water bills include the information set out in paragraph 11.8.2. It would welcome views on this recommendation.
- The review team recommends that companies should consider whether best practice in some other companies or other sectors could help them engage better with their customers, such as 'meet the manager' sessions or going out into the community with local councillors and community representatives. Companies should strengthen their work to find out how their customers want to access the information they require, and use those channels in future. Companies should assess the effectiveness of their communication methods, particularly with their harder to reach and vulnerable customers, on a regular basis and Ofwat should report on this activity.
- The review team welcomes further comments on the development of a UK model for a participatory budget approach by Ofwat and CCWater. This would have the aim of achieving better and earlier involvement of customers by companies in the formulation of company plans and proposals.
- The review team's view is that as companies are monopoly providers to household customers, the regulatory regime should include measures on customers experience in the Overall Performance Assessment which have a real and visible effect on companies and thus incentivise better handling of customers. It would welcome views on this recommendation and what the specific measure or measures should be to achieve this.
- The review team welcomes views on the viability of such a participatory budgeting approach for the England and Wales water sector.

Overall performance assessment

- 11.1 We agree that the overall performance assessment needs reviewing and are currently piloting new measures of customer experience. We published [RD 11/09](#) in August 2009, which explains our proposals for a new service incentive mechanism. This focuses on improving the experience customers have when dealing with their supplier. Following consultation, we will publish our final approach in November. We will publish the companies' performance on the new experience measures each year together with other measures of company performance in our annual 'Service and delivery' report.

Enforcement

- 11.2 We welcome the review's recommendation that the 12-month time limit for pursuing breaches and penalising companies should be extended to five years. This reflects a revision that we are seeking in the draft Flood and Water Management Bill.

Communication

- 11.3 We agree that the companies need to communicate effectively with all their customers, including the vulnerable and hard to reach. We already publish guidelines setting expectations for the support we expect each company to provide to vulnerable customers, including appropriate communication. Every year we publish the numbers of customers who have registered for special assistance. We also give examples of good practice in promoting these services. We will consider holding a workshop to share good practice.

Participatory budgeting

- 11.4 As we think about our approach to regulation in the context of future challenges, we will consider the potential role of participatory budgeting (or negotiated settlements). Using any negotiated settlements would need careful consideration. We would want to learn from the experience of other sectors or countries where it has been tried and would need to make sure that we protect consumers.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water and sewerage sectors in England and Wales provide customers with a good quality and efficient service at a fair price.



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