

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

15 April 2008

Dear Mandy,

I am writing on behalf of Cornwall's Liberal Democrat MPs, as 'Chair of the Team for Cornwall', in response to *Ofwat's Future Strategy for Customer Charges for Water and Sewerage Services: a Consultation*.

The submission will follow in four parts: firstly I will give brief attention to the high levels of water unaffordability and unfair charging in Cornwall and across the South West; secondly I will outline the need for a fairer system for distributing the high water costs in this part of the world; in lieu of such a solution, I will outline the need to pilot a fairer tariff in the South West, based on the Rising Block model; and finally I shall explain the importance of catchment management as central to any approach to customer charging.

1. Water Unaffordability in Cornwall and the South West

Water bills have remained higher across the South West than anywhere else in the country since the Conservatives privatised the utility in the 1980s. Failing to put aside the funds necessary to meet the high costs of the beach clean-up, local bill payers have been burdened with the outstanding balance.

South West households with water meters, which account for two thirds of users, can expect to pay an average of £397 in 2008–09, up 5.6% on last year. The remaining, unmetered users, many of whom are unable to switch to meters because their properties do not allow it, face an even bigger rise of 8.7% and will pay a staggering £686 on average. This compares to an average £304 bill in London, and is well above the national average despite many parts of the region suffering from low incomes. In Cornwall earnings are amongst the lowest in the country.

The year on year price hikes that have been imposed on the region are discriminatory and in direct contravention of Ofwat's espoused commitment to the principles that 'charges should be fair and equitable' (page 9) and that 'charges should be as affordable as possible for all customers' (page 9).

By not acting Ofwat is failing to fulfill its 'duty to protect customers' in the context of affordability (page 9). Despite the consultation document's rhetoric around protection, Ofwat absolves itself from this duty by the assertion that 'customers who use similar services in similar circumstances should pay similar charges' (page 9). On the basis of similarity it becomes possible, however unconvincing, to justify the huge disparity between bills in the South West and elsewhere in the country, as the former result from a unique set of circumstances. In other words, the circumstances faced by South

West Water customers are *dissimilar* to anyone else, as the region foots the bill for 30% of the coastline despite containing just 3% of the population, and so *dissimilar* water rates are made acceptable.

We therefore urge Ofwat to amend the principle that ‘charges should be fair and equitable’ to include recognition of the unique circumstances in the South West that undermine the equity and fairness of the charging system. Customers in dissimilar circumstances must not be exempt from Ofwat’s duty to protect them from unfairly high bills.

2. Distribution of the Costs

The only truly fair charging system for the South West is one that redistributes the region’s financial burden more fairly. It is disappointing to read that Ofwat does ‘not envisage cross subsidies across company boundaries’ (page 9), despite the prejudice in the current system towards South West Water customers. While it is true that different areas must pay for different investment at different times, the South West always pays the most. Furthermore, the money is used to maintain a national asset and does not simply serve residents of the South West, many of whom will not use the beaches any more or less than anyone else in the UK. If the costs were spread, either through the benefits system, a fund from Central Government, or some other redistributive mechanism, the additional cost to other bill payers would be extremely low in comparison to the benefit felt by customers in the South West.

Ofwat’s position on cost redistribution is both irrational and inconsistent given that it will continue to support cross-subsidy through the Vulnerable Groups Tariff and the rural/urban cross-subsidy, which spreads costs evenly across company areas (pages 21-22). The Government is similarly inconsistent on this issue, funding caps on water bills in Northern Ireland and electricity bills in Scotland through UK tax payers’ contributions, yet refusing to do the same in the South West.

We call on Ofwat to review its outright rejection of redistributing the unaffordable costs to customers in the South West more fairly across the country, recognising that these costs are to protect a national asset and that redistribution is consistent with other examples of cross-subsidy.

3. Rising Block Tariff Pilot in the South West

While my colleagues and I remain committed to the resolution to water unaffordability in the South West as outlined above, the attitudes and actions of both Ofwat and successive governments do not inspire our confidence that fundamental redistributive measures will be taken.

Therefore we propose that the costs for water are apportioned more fairly within the region through a fairer tariff that better reflects water usage. This is not a wholly satisfactory solution since the region’s total bill would not be lowered to a fair level, but in the absence of progress on redistribution, a reformed tariff would improve matters in the first instance.

We are pleased that the consultation document appears receptive to trials of innovative tariffs, specifically citing the Rising Block Formula. A shift to more widespread metering alone cannot ensure affordability, as demonstrated in the South West where metered users still pay well above the national average. Extended metering must go hand in hand with a tariff that incentivises cost efficiency and protects the worst off in society, such as large families on low incomes, pensioners, or people with disabilities necessitating high water usage. This is possible under a Rising Block Tariff, providing special measures are taken to ensure that the essential water usage for these groups is measured appropriately (i.e. the first 'block', which is charged at an affordable rate).

Furthermore, this tariff has the added potential to ensure that the many second homeowners in the South West pay a fair contribution towards maintaining the beaches. Many of them have switched to meters and only use their properties occasionally, resulting in very low water usage on their part, and consequently disproportionately low charges. This is clearly iniquitous since second home owners are transparently the primary gainers from the region's beaches, which permanent residents pay over the odds to maintain. Under a Rising Block Tariff these users could be charged for a basic year's supply of water whether they are living in the area for the whole time or not, and so make a proper contribution to the environmental clean-up from which they benefit.

Rising block tariffs would also benefit the environment. The World Wildlife Fund predicts that they could reduce demand by at least 10% and by up to 30% in summer. That would cut the cost of treatment, and in turn lower bills.

In the absence of fundamental reform to redistribute the high water costs in the South West more fairly, either through the benefits system, a Central Government fund or some other appropriate mechanism, Ofwat should support piloting a suitable Rising Block Tariff in the South West to apportion costs more fairly across the region. The regulator should work with Government, MPs, South West Water and the Consumer Council for Water, as well as customers, to ensure that the tariff is suitable and benefits all customers, protecting the worst off.

4. Catchment Management

Finally, any strategy for customer charging must take into account the need for a more catchment management based approach to water resource management as we move into the future. As acknowledged by Ofwat, this approach necessarily goes hand in hand with taking a far longer view of water companies' operations than the five year period that has traditionally been taken. We welcome the requirement on companies to prepare a 25 year Strategic Direction Statement, since its preparation alone will demand that they look to the longer-term. However, initial thoughts from stakeholders, NGOs etc. would suggest that this catchment management based approach could actually save customers money in the longer term, particularly in the South West. We are therefore concerned that the consultation document only places secondary emphasis on the importance of companies looking at upstream, low energy catchment management measures. Indeed we are concerned that current Ofwat

positioning may even jeopardise their implementation (for example the need for the company to own the land it deploys measures on).

Delivering a continuous supply of clean, safe water to homes and businesses despite the impacts of climate change and ongoing diffuse pollution is a challenge faced by the water industry. Tackling that challenge requires a new way of thinking and a move away from typical high-energy, end-of-pipe and highly chemical and capital-intensive solutions to an approach that uses soft engineering solutions and works with the natural landscape. A radical new approach, if delivered effectively, would give customers better value and lower bills in the long term as well as an infinitely better environment.

Adopting catchment management methodology enables water companies to lower their expenditure on end-of-pipe treatment without the risk of compromising water quality or safety. Lower capital investment will then benefit the customer by lowering water bills in the long run. Furthermore, ending the need for end-of-pipe treatments will lower companies' carbon footprint and increase their environmental sustainability. It is a long-term solution, whereas capital investment needs constant renewal and expenditure.

These measures require water companies to develop working relationships with landowners, farmers and other stakeholders to prevent the quality of water from being lowered before it enters the water companies' systems. Although not in the consultation document, Ofwat has elsewhere asserted a position that obstructs this, arguing against water consumers offering a cross-subsidy to address third party pollution issues, and, specifically, stating that any proposals for expenditure would be considered only if the company owned the land (PR09).

There is no doubt that a more catchment management based approach to water resource management will take longer to deliver than the more traditional, high energy end of pipe solutions. At present, although the consensus of opinion is that this type of approach will be extremely worthwhile in the long-term from the point of view of customer charging, there is still relatively minimal evidence based on UK studies to demonstrate this. It is essential that during the next Periodic Review period, companies are given the opportunity to determine fully the cost-benefit case of taking this new approach, otherwise progress in a potentially cost saving new direction will be slow, ultimately resulting in customers money being wasted.

There must also be acknowledgement that by their very nature, the catchment management based approach will take longer to demonstrate its benefits than a traditional end of pipe solution. For example a water retention, clarification project that is based around growing trees will not demonstrate its full potential for several years at least. Careful consideration must be given to how this will be taken into account by Ofwat.

Additionally, a catchment management based approach could bring with it benefits for those other than water company customers. For example there could be improvements in biodiversity or in recreational potential of an area. Ofwat has previously voiced its concern over water customer cross-subsidising other industries. We ask that whilst maintaining the water company customers' interests first and

foremost, at this stage, we must certainly not be restricting progress of a more forward thinking upstream approach which may in the long-term greatly benefit the water consumer. There is a clear need for a debate about the real cost of water; Ofwat should lead that debate.

Allowing for the demonstration of the cost benefits, and to ensure that this potentially beneficial new approach is given adequate priority, Ofwat should place catchment management at the heart of its water charging strategy. Importantly at this crucial stage, since Ofwat has asked companies to take a 25 year view of their direction which has encouraged some exciting new thinking; the regulator must allow this type of approach to be fully explored. There must therefore be acceptance of the fact that benefits to water customers may well be brought about by an approach to water resource management that also brings benefits to other stakeholders and industry. This is not necessarily a bad thing providing the customer is not bearing an unfair cost, but in order to determine this, the companies need to be able to demonstrate the cost benefit case clearly and without over-bearing restrictions.

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This consultation is timely, given that over the next year the agenda for the future of the water industry will be set as the Government implements its water strategy and price limits for the next five year period are fixed. However there is an opportunity to go beyond this with a longer-term vision that ensures greater equity and genuine affordability. Should you require further discussion on any of these points please call Zena Elmahrouki in my office on 020 7219 6686 to arrange a meeting.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Matthew Taylor', with a stylized flourish at the end.

Matthew Taylor MP

On behalf of Julia Goldsworthy MP, Colin Breed MP, Dan Rogerson MP and Andrew George MP