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Dear Mandy

Future strategy for customer charges

I am pleased to provide you with South West Water's views on the important matters covered in Ofwat's consultation paper on future strategy for customer charges for water and sewerage services.

We identify with the tariff principles set out in the summary of the consultation, including fairness and equity, affordability, incentives, simplicity and transparency; but in practice the most suitable tariff structure may represent a compromise. We think it would be helpful for Ofwat to set out how these principles should be balanced when conflicts arise. In particular, fairness in charging customers using similar services the same, and incentives where services reflect the cost of producing water, can conflict with the affordability impact. To resolve these conflicts water companies have to consult with customers, consumer representatives and other stakeholders and seek their advice. We think that Ofwat in the future will need to show greater flexibility in how the fairness and incentive principles are applied, as is possible within the legislative framework under which charges are set. This will allow companies to present cases where affordability issues should be given greater weight.

The strategic themes that Ofwat sets out, of encouraging innovative tariffs, moving to higher meter penetration and encouraging technological innovation, also require flexibility in how the principles are applied to approving companies' charges schemes. Innovative changes are often trialled in order to establish what the effects are in practice. To learn from trials in the short term may require different customers in similar circumstances to possibly pay different charges. If a cost and service justification is required in advance, the potential for innovation will be significantly reduced.

Attached to this letter are our specific responses to the questions posed in the consultation paper. Please do not hesitate to contact me for any further clarification regarding our views.

Yours sincerely

Keith Richards
Director of Regulation, South West Water

SWW response to specific questions in Future Charging Strategy paper

Unmetered charges

We propose no replacement for the current RV charging system for unmetered customers.

**Would you support ‘no change’ to the current RV unmetered charging system:
i) under the current metering rates (shown in section 3.2 below)?
ii) under a programme that delivered higher levels of metering earlier?**

SWW view – We believe that customers do not like frequent changes. Costs of change are likely to be significant. A change to RV charging should only be made if that change is going to be a permanent replacement for RV charging and not as a step towards longer term tariff changes.

We consider that RV charging should continue in the South West until near-universal metering is achieved.

What factors could make RV charging unsustainable and what other alternatives do you think should be considered?

SWW view – Size of the unmetered bill and access to help with unmetered bills for financially vulnerable; less financially aware customers remaining on unmeasured charges, pushing up unmeasured debt; fairness of unmeasured charging if measured customers are paying a premium for non-essential use through a rising block tariff; disproportionately expensive to maintain two charging systems with small unmeasured customer base; domestic competition.

Assessed Charges as operated for customers who cannot be metered, should be capable of being used for unmeasured charges, subject to equity of outcome compared to metered customers.

Do you agree with our approach to RV modifiers? If not, please explain the basis of your preferred approach.

SWW view – Yes.

Paying for metering

We will support accelerated metering programmes. We have set out our current understanding of the cost of metering.

What are the other issues and evidence that we should consider to gain a better understanding of the costs and benefits of accelerating the uptake of metering?

SWW view – The long term savings in the overall cost of metering the whole customer base by being able to meter whole streets at a time rather than individual properties in diverse locations.

We accept that each company will differ in its estimate of the optimum timescale for universal metering.

What are the factors which you consider should determine when universal metering becomes appropriate?

SWW view – We would repeat our previous comments about fairness of maintaining unlimited use at a single price if metered customers are paying premium prices for non-essential use. Also, when the costs of operating two methods of billing outweigh the costs of serving a universally metered customer base, then a move to a single charging system is economically justified.

Metered standing charges

We propose to consider again how metered standing charges should be structured.

How should metered standing charges ideally be constructed to accurately reflect the customer and volume-driven costs while also enabling competition?

SWW view – Ofwat must be clear as to whether it is discussing standing charges as they are defined currently, or fixed charges. A site charge for surface water drainage could be defined as a standing charge.

The future of fixed charges is something SWW will be considering carefully to assist with affordability issues and reducing debt. There may well be a case for treating sewerage standing/fixed charges differently to water in the South West. There are also options for a social element to charging by having banded standing charges based on Council Tax bands.

However, recovering a greater proportion of costs through a fixed or standing charge will reduce price per cubic metre and therefore the pricing differentials of an RBT; another example of different charging objectives working against each other.

If some costs are more appropriately recovered through a high fixed charge we would want to have a sliding scale for this. If we cannot, we would want low fixed charges.

Tariff trials – gaining the evidence

Encouraging innovative tariffs is a key element of our strategy. We will continue to look favourably on proposals from companies to develop a range of innovative tariffs. We will approve cases for trials as a basis for considering whether we should press for greater adoption of such tariffs in the future.

To what extent have these issues been explored by companies up to now and what evidence is there that could be taken into account when assessing options?

SWW view – We believe there is only limited evidence available and it is mostly theoretical with no hard evidence of UK customer behaviours. This is why it is so important to get trials underway and data gathered.

What are the issues involved in setting up and running successful tariff trials as a way to obtain sound and timely information in support of new household tariffs?

SWW view – The key issues are customer management; impact on bills if some customers are going to pay more during a trial; keeping high users on the trial even if they complain; ability to bill tariffs in a way that gives meaningful information to the customer; providing data through the web or *in readers* for block tariffs – particularly as there is not an adequate established *in reader* available yet; costs of frequent meter readings; cost reflectivity in designing tariffs.

Are there incentives that could be offered to companies to share the results of robust early tariff trials?

SWW view – Under the current water industry structure, we would expect tariff trial results to be shared on an ‘open book’ basis, subject to certain commercial confidentiality. Ofwat could reasonably make the requirement to publish such results a pre-condition of recognition in business plans, but we are aware that this situation would be very different with the advent of competition into the domestic market.

Innovative tariffs

We will encourage the development of a range of alternative tariffs, and will consider the arguments for whether each should be imposed or made optional.

What are the issues each company must take into account when assessing whether to impose a tariff or offer it as an option? Where should the balance lie in offering innovative tariffs and protecting customers who are not on those tariffs?

SWW view – This issue is essential to the success of being able to trial new tariffs. No tariff trial is worth doing if it does not include customers whose bills will be higher on the trial tariff than they would be on standard tariffs. Research we have carried out shows that even if incentivised to participate, large users will not agree to participate in sufficient numbers. Understanding the behaviour of these customers is arguably the main reason for doing trials rather than customers who will pay less by behaving the same as they do now.

Innovative tariffs will not be developed and trialled if a narrow view of cost reflectivity is taken.

Customers who are not on a trial tariff are fully protected by Ofwat's approval of standard tariffs. It is more a case of what is to be done about customers whose bills are higher on the tariff being trialled than if they were on a standard tariff. If they have to be taken off if they complain or if they get into debt, a trial could be rendered meaningless and the investment made by a company in the trial almost worthless. Equally, offering help that would not be offered if the tariff was to be fully implemented may adversely affect data.

The reality is that a tariff trial will put some customers in a worse off position than if they were not in the trial. While they are unlikely to be happy that their short term pain is for the long term good of tariff development in the industry, this is what a real trial involving real people means. Early exploration of this issue involving all stakeholders would be beneficial to trial development as without stakeholders united on how risks and issues should be managed, trials may not be promoted by companies.

What other types of optional tariffs could be developed, beyond those considered in this consultation, and what might their impact be (for example, interruptible tariffs for large users)? How do they meet the objectives we have set out for the development of future tariffs and charges?

SWW view – Running trials is not going to be cheap for companies and it should be expected that companies will prioritise tariffs relevant to key scenarios in their areas. Indeed Ofwat was not initially supportive of our Rising Block Tariff trial because it was not certain we had water supply issues in our region. Therefore if a trial can only be supported in order to test solutions to a problem, it will limit innovative tariffs.

The cost of trials would undoubtedly be spread across companies by different tariffs being trialled in different areas and the data shared.

A theoretical tariff list could be endless, for example:

Time of day tariffs to reduce demand at peak times

Penalty tariffs where customers undertake to use a certain amount of water each year and pay a significantly higher charge for extra use

Cash back tariffs where customers are “rewarded” for cutting use

RBTs geared to commercial customers’ usage rather than a single tariff for all commercial types

Affordability RBTs so even WaterSure customers are encouraged to manage use and not waste water

Green tariffs where customers pay for higher cost green energy generated services

Service level tariffs where customers can choose to pay more for higher, guaranteed service levels or account management

How far do we need to regulate the level of charges set under optional tariffs so long as other customers continue to be protected?

SWW view – If optional tariffs with clear rights of change agreed (eg a customer could change tariff each April) were to be operated by a company, we consider that Ofwat would not need to regulate those charges.

Non-potable charges

Non-potable tariffs are emerging as a developing area for charging.

How should non-potable charges fit with the principles of geographically averaged charging whilst taking into consideration the potential differential use of specific water supply functions (ie, possibly more limited use of service reservoirs, pumping, distribution, etc)?

SWW view – We are still developing our views on this issue.

