

Consultation on charges scheme rules for 2016-17 and future developments

About this document

The Water Act 2014 makes changes to the Water Industry Act 1991 that will allow the Water Services Regulation Authority (Ofwat) to set rules about charges schemes—a legal statement of the company’s charges and associated terms, which applies to the vast majority of customers.¹ In setting the rules we must have regard to guidance issued by the UK and Welsh Government’s and consult the relevant persons about our draft rules. On 9 July, the UK Government issued for consultation a draft set of charging guidance to Ofwat. We expect the Welsh Government to issue draft guidance for consultation in the near future².

This document is the statutory consultation on our draft rules about charges schemes issued under section 143C of the Water Industry Act 1991, as well as early stage consultation on some emerging thinking in relation to wholesale charging rules and special agreements. We set out our proposed set of charges scheme rules that would apply to charges schemes from the 2016-17 charging year and demonstrate how our rules have regard to the UK Government’s draft charging guidance. We also discuss and seek views on specific areas where we see charging rules evolving next year and beyond.

¹ See appendix 1 on charges schemes and the new legal framework.

² [On 24 August, the Welsh Government issued for consultation a draft set of charging guidance to Ofwat.](#)

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Responding to this consultation

We welcome your responses to this consultation by 30 September 2015.

Please email your responses to ynon.gablinger@ofwat.gsi.gov.uk, or post them to:

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If you wish to discuss any aspect of this consultation, please contact Ynon Gablinger on 0121 644 7654 or by email at ynon.gablinger@ofwat.gsi.gov.uk.

We will publish responses to this consultation on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory 'Code of Practice' which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

Consultation questions

Q1 Do you have any specific views on the draft rules for 2016-17 included in appendix 2? Are there any other rules that you consider should be included?

Q2 How best can site area-based surface water drainage charges be adopted? And what lessons can be learned from how companies have moved to this basis so far?

Q3 Do you agree with our proposed threshold for 'significant' bill increase? If not, is there evidence for a more suitable threshold? And how this can be assessed for different customer types?

Q4 Do you agree with our current preference of companies publishing their Board's assurance statements?

Q5 Do you consider that the Board's assurance statement should cover anything else than what we propose above?

Q6 Do you agree with our current preference for companies to submit a statement of significant changes?

Q7 Do you have any specific views on the proposals included in chapter 4? Are there any other rules or issues that you consider should be consulted on next year?

Q8 Would it be practicable and/or desirable to include all non-primary charges in the wholesale charges scheme?

Q9 Do you have any specific views on the requirement to publish final wholesale charges for non-household customers no later than the first week of January?

Q10 Do you agree with our outline proposal that indicative wholesale charges be published in July and October?

1. Background and context

Section 16 of the Water Act 2014 (WA14) amends the Water Industry Act 1991 (WIA91) to change the way we oversee charges schemes for end-users (retail customers). From 1 November 2015 it will remove the requirement for the charges schemes of water companies³ to be 'approved' by Ofwat and, instead, allows us to set charging rules which charges schemes must comply with.

We welcome the change in legislation. It is consistent with our strategy, enabling greater company ownership and innovation while also allowing us to set out the principles (as reflected in our rules) we consider to be important for customers.

Our main tool to regulate charges is through the price controls that we set for 18 water companies. We set the overall revenues that these companies are allowed to recover from customers over a period of five years. These water companies are then free to set their charges, within the constraint of legislation, to recover their allowed revenues.

Within these constraints, we consider that charging rules can play an important role in driving further efficiencies and enabling appropriate and effective use of markets. Charges that reflect appropriate costs send signals that will enable and incentivise the creation of value through efficiency. They will also send important information to market participants on whether to supply or not, whether to make or buy. Charges need also be transparent and predictable to help make markets work more effectively. We are also acutely aware of the importance of stable bills to customers, and that with every change in charges there are winners and losers. Therefore a balance needs to be struck when considering the potential benefits of any charging rule against its bill impact on different customer types.

We also recognise that charging rules will evolve over time. The rules will evolve to reflect market developments and reflect learning that we obtain as new information becomes available to assess existing rules. The rules that we propose here, effective for charges schemes from 2016-17, are the beginning of a journey. Over time we expect the evolution of the rules to settle.

³ We use the term "water companies" to mean companies holding appointments as water and/or sewerage undertakers under chapter 1 of Part 2 of the WIA91.

The UK and Welsh Governments have powers to issue charging guidance to Ofwat. In setting charges scheme rules we will have regard to any charging guidance issued by the UK Government (relating to water companies whose area is wholly or mainly in England) and the Welsh Government (relating to water companies whose area is wholly or mainly in Wales).

This consultation sets out our draft charges scheme rules for the 2016-17 charging year. The rules will be made under sections 143(6A) and 143B of the WIA91 and are limited to end-user (retail) charges schemes. The rules will apply to all water companies (including new appointees). The consultation also seeks to provide stakeholders with a clear understanding of the direction that we see charging rules developing over the next year—and how they relate to wholesale charges—and further in the future.

On 9 July 2015 the UK Government published its draft guidance for consultation. In this consultation we demonstrate how our draft charges scheme rules have regard to the UK Government draft charging guidance. If the guidance changes from draft to final guidance, we will have to consider whether, having regard to the revised final guidance, it is appropriate to amend these rules.

The Welsh Government has not yet consulted on its draft charging guidance to Ofwat. However, in setting our draft rules we have had regard to its '[Social Tariff guidance](#)'. Once the Welsh Government's charging guidance is issued we will have to consider whether, having regard to the guidance, it is appropriate to amend these rules.

Given that 2016-17 will be the first charging year that companies must comply with charging rules, and that our rules will be issued relatively late in 2015, we do not propose to introduce fundamental changes to our existing charging principles. In preparing our draft charges scheme rules, we have built on our existing charging principles and guidelines. However, we have also made some amendments to reflect feedback from stakeholders, our own experience from the charges scheme approval process and draft Government guidance. We may make further changes to our charging rules for future years.

In addition to setting rules about charges schemes, the WA14 will allow us to set charging rules in relation to other types of charges. For example, charges for retailers, for the provision of wholesale water and sewerage services by the water company; charges for upstream service providers, for the provision of access to the water company's infrastructure.

As well as setting out draft charges scheme rules, our consultation seeks to provide stakeholders with a clear understanding of the direction that we see charging rules developing in other areas. In the spring of 2016 we will consult on a separate set of rules about wholesale charges. We discuss some of the proposals and issues that we are considering in the context of wholesale charges in order to inform our consultation next year. Following our consultation next year, we will set rules about wholesale charges to be in place for the further market opening in April 2017.

In chapter 2 we discuss our draft charges scheme rules. We structured the discussion around the four overarching principles in the UK Government's guidance:

- (i) fairness and affordability;
- (ii) environmental protection;
- (iii) stability and predictability; and
- (iv) transparency and customer-focused service.

This helps provide stakeholders with a clear understanding of how we intend to have regard to the Government's guidance.

In chapter 3 we discuss the information we will require companies to submit in advance of or alongside the charges schemes to provide assurance under the new regime.

In chapter 4 we discuss initial proposals and next steps on rules for wholesale charges. We will set rules about wholesale charges for the 2017-18 charging year, in time for the retail market opening for all non-households in England in April 2017.

Appendix 1 provides additional information on charges schemes and the new legal framework. Appendix 2 provides our draft charges scheme rules. In appendix 3 we have set out examples of good practice from companies in the 2015-16 charging approvals process.

1.2 Existing duties and obligations

In setting charges companies already have a series of duties and obligations with which they must comply. These include (but are not limited to) the following.

- **Licence condition B.** Companies are required to make sure that their charges comply with their price limits.

- **Licence condition E.** Companies are required to make sure in fixing charges under a charges scheme that no undue preference is shown to, and that there is no undue discrimination against any class of customers or potential customers.
- **Social tariffs and surface water drainage concessions.** As provided for by the Flood and Water Management Act 2010, water companies may include a provision in their charges schemes designed to reduce charges to individuals who would have difficulty paying their charges in full. Companies may also include a provision in their charges schemes designed to reduce charges to community groups in respect of surface water drainage from their property, where the charge is based on the surface area drained. If they include any such provision within their charges schemes, companies must have regard to the relevant guidance issued by the UK Government (in the case of English water companies) and the Welsh Government (in the case of Welsh water companies).⁴
- **Competition Act 1998 (CA98).** Chapter I of the CA98 prohibits agreements that prevent, restrict or distort competition. Chapter II prohibits the abuse of a dominant position. Where anti-competitive agreements or conduct are reasonably suspected, we have concurrent powers with the Competition and Markets Authority to investigate and take appropriate enforcement action.

1.3 Other relevant publications

In May 2013, the UK Government published its '[Strategic policy statement to Ofwat](#)'. The statement identified a series of Government priorities, which the Government expects us to reflect in our decision making and included social and environmental guidance. On 30 October 2013, the UK Government published a set of '[Principles governing future water charges](#)'. These principles have underpinned the development of the charging guidance that the UK Government has developed.

In December 2013, the Welsh Government published its '[Social and Environmental Guidance to Ofwat](#)'. This guidance, along with the [Social Tariff guidance](#), is expected to underpin the charging guidance that the Welsh Government's will issue to us in the future.

⁴ English water companies are companies operating wholly or mainly in England. Welsh water companies are companies operating wholly or mainly in Wales.

In January 2014, we published '[Wholesale and retail charges – a consultation](#)' that set out a series of key themes for consideration in setting future charging rules, as well as features of the overall charging framework, such as information and governance requirements.

In May 2014, we built on the January consultation with a '[Consultation on wholesale and retail charges for 2015-16 and charges scheme rules](#)', in which we provided a set of working expectations on how we envisaged companies to approach the development of their wholesale and retail charges for 2015-16.

We published the responses to the May consultation in our [draft determinations \(technical appendix A8 – charging\)](#), and in November set out our approach for the 2015-16 charging approval process in: '[IN 14/17: Approval of charges 2015-16 – our approach, process and information requirements for large and small companies](#)'.

On 9 July 2015 the UK Government published its [Consultation on Charging Guidance to Ofwat](#).

2. Charges scheme rules

On 9 July 2015 the UK Government published its draft charging guidance for consultation. The consultation provides guidance around four key objectives:

- fairness and affordability;
- environmental protection;
- stability and predictability; and
- transparency and customer-focused service.

We have structured this chapter around these four overarching objectives to help provide stakeholders with a clear understanding of how we intend to have regard to the UK Government's guidance.

At the end of the chapter we discuss a number of additional rules that we considered required clarification.

2.1 Fairness and affordability

The guidance sets out that ensuring that current and future customers get a fair deal is an important principle underpinning the UK Government's approach to charging.

2.1.1 Affordability

Our price controls seek to protect customers by setting performance commitments that reflect what their customers want, and prices/revenue limits that reflect the efficient costs of delivering that performance. Licence condition B requires companies to set charges in a way that complies with our price limits. This provides an overall safeguard on customer charges.

The legislative framework makes a number of allowances for vulnerable groups to receive special protections. This includes the following.

- WaterSure – this is a scheme that caps the water bills of metered customers who are in receipt of certain benefits, if they have a large family, or if a member of their household has a medical condition that requires significant additional water use.
- Social tariffs – in certain circumstances, companies can reduce charges for individuals who would otherwise have difficulty paying their water bill in full. In

developing such charges English water companies must have regard to the UK Government's [guidance on social tariffs](#). Welsh water companies must have regard to the [social tariff guidance](#) issued by the Welsh Government.

- Concessionary schemes for community groups for surface water drainage charges – companies that charge for surface water drainage on a site area basis may offer concessionary schemes for certain community groups. In developing such schemes English water companies must have regard to the UK Government's [guidance on concessionary schemes](#).⁵

We intend for our charging rules to require companies to clearly set out the terms for such schemes (see rule 23). More generally, we expect companies to be engaging with their customers to understand their individual needs, and providing them with suitable information about the different tariff and payment options that are available to them.

2.1.2 Fairness

As noted in section 1.1, charges scheme rules sit within an overall framework of duties and obligations on companies. For example, companies have a licence condition requiring them to show no undue preference or discrimination to different groups of customers in setting their charges. Companies also must ensure that their charges comply with competition law.

A further way of ensuring that charges are fair is for charges to suitably reflect the costs associated with the service provided. As part of our previous [charging principles and guidelines](#) we set out a number of conditions such as that the average difference between metered charges and unmetered charges should only reflect the differences in the costs of, or additional benefits to, one service relative to the other. We intend to retain these requirements through the charging rules in order to protect customers from unjustified charges.

As we set out in our May 2014 [consultation](#) on charges, over the next few years we will be looking further at companies' costs and considering the most beneficial ways for charges to be structured. This may lead to new rules regarding the structure of

⁵ "Guidance to Water and Sewerage Undertakers in relation to Concessionary Schemes for Community Groups for Surface Water Drainage Charges and Summary of Consultation Responses", December 2010.

charges, and how costs are allocated between services and customers. We see the charging rules framework as an evolutionary process whereby we will progressively refine our rules to reflect lessons learned and information revealed through the way that we regulate, and the markets we monitor.

2.2 Environmental considerations

Meter-based charging can provide effective price signals to customers about the water that they use and an incentive to use water efficiently. Where customers receive a meter-based charge we expect the charge to reflect the long-run costs associated with providing the service and the cost of the water to be recovered primarily through the volumetric charge (we said previously that we expect the standing charge to recover no more than the customer-related costs of the metered service, such as meter reading and billing). We note that companies have a duty to promote the efficient use of water.

As well as environmental benefits, volumetric-based charging can also help make water more affordable, as customers only pay for the water that they use.

2.2.1 Surface water drainage

In 2003 we reviewed how non-household customers are charged for surface water drainage. We recommended that charges should more closely reflect how much surface water drains off a property so that customers broadly pay for the service they receive and have an incentive to reduce the burden they place on the system by reducing their surface water run-off.

Since then, some companies have adopted an area-based component within their surface water drainage charges schemes. This more closely reflects the costs customers place on the system, as sites with large non-permeable areas cause greater levels of rainwater to drain into the system.

We recognise that moving to area-based charges can cause significant incidence effects on bills if not managed carefully and effectively. UK Government guidance takes the view that the introduction of area-based charging “**should not have an unduly negative impact on organisations that provide a wider benefit to society**” (paragraph 5.7).

We are currently not minded to set a requirement for non-household area-based charging for 2016-17. Instead, we are seeking views from the water and sewerage

companies that have not yet adopted this approach to surface water drainage charging, on how best such an approach could be adopted. This will include views on the most appropriate structure of such charges, the time frame over which they could be introduced, and the measures companies can take to help customers reduce their bills. We recognise the choices that companies have as to the cost drivers they use as the basis for charging, the level of granularity they choose, and how they handle transition issues and we expect companies to choose their approach having regard to the effects they are seeking to achieve but also the impact on affected customers.

We also welcome views from those companies that have adopted area-based charging on their experiences of setting up and operating this charging method, including the costs incurred and any customer response.

Companies currently offer reduced charges to customers who demonstrate that they do not have any surface water draining to the public sewer. Some companies apply reduced charges in an overly simplistic way – that is, only allowing a reduced charge where they know that no surface water is draining from the property into the public sewer. We consider this binary approach to be inappropriate, and that companies should consider offering partial discounts should a customer be able to demonstrate that through installing sustainable drainage systems they have significantly reduced the amount of surface water that drains into the public sewer (see rule 21).

Site area-based charges

Some companies have adopted an area-based component within their surface water drainage charges schemes. This more closely reflects the load that customers place on the system and the associated costs incurred, as sites with large non-permeable areas cause greater levels of rainwater to drain into the system.

Customers can reduce their charges by making surfaces more permeable (for example, replacing asphalt with gravel), or installing soakaways. This reduces the volume of rainwater flowing into sewers, and consequently the costs that the company incurs. This leads to lower bills to customers overall, and puts more water back into the environment. It may also delay or avoid the need for significant new capital schemes which could be expensive for customers and harmful for the environment.

Companies can offer rebates for community groups under certain circumstances,

and also have a range of other tools to manage changes to their approach to charging (as discussed above).

In Germany, adopting transparent surface water drainage charges and subsidies has led to a high amount of retrofitting of sustainable drainage systems (SUDS), particularly green roofs and water reuse systems. In North-Rhine Westphalia, approximately six million square metres of surface area was disconnected from the sewer between 1996 and 2004⁶.

2.3 Stable and predictable

2.3.1 Promoting stable charges

The UK Government's draft guidance sets the expectation that customers should not face disproportionate changes in charges year-to-year where usage does not change markedly.

Ensuring that charges suitably reflect the underlying long run costs helps ensure that charges do not change markedly from one year to the next. In the past we have set a requirement that charging structures should reflect long-run costs (that is, volumetric charges to form a larger proportion of the total revenue to be recovered than implied by short run costs). We retain this requirement in our draft rules.

Despite these requirements on companies, on occasion changes in companies' charges may result in significant bill increases.

In its charging guidance the Government indicated that we should set clear expectations that the companies must undertake a proportionate assessment for any significant incidence effects on customers as a whole or on groups of customers and act on the results.

For 2015-16 we required companies to undertake proportionate impact assessments and handling strategies whenever the nominal value of a customer bill was expected

⁶ See [Learning lessons from the 2007 floods](#)

to increase by more than 5% from the previous year (for a given customer type assuming a constant level of consumption).

The 5% figure was derived from looking at a range of indicators as presented in appendix 3 of our [May 2014 consultation on wholesale and retail charges](#). In our PR14 draft determination (technical appendix A8 – charging) we emphasised that the impact assessment and handling strategies should be linked to the severity of bill increase as experienced by the customer. As such, we consider that the threshold should be stated in nominal terms and not relative to RPI and/or K.

We are currently minded to retain the 5% figure as a threshold for a ‘significant’ bill increase and proportionate impact assessment.

We are still committed to keeping this threshold under review. We would like to see companies develop their own approach, through engagement with their customers. If appropriate we will include provisions for companies to take a different approach if they can demonstrate that a different approach would better serve their customers (and if they get our agreement to this in advance). We welcome views from stakeholders on whether more robust evidence exists for a different measure of ‘significant’, and how this could be assessed for different customer types.

The 5% figure is a formal trigger point. We also expect companies to recognise that, even though an overall increase may be below 5%, certain groups of customers will be affected differently. It is important for companies to consider the incidence effects of any changes on the full range of their customer base and to mitigate any impacts appropriately.

Appendix 3 shows good practice in companies’ impact assessment submissions, from the 2015-16 approval process.

2.3.2 Predictability of charges

It is important that charges be communicated in such a way that customers can have a reasonable idea of what their bill will be ahead of receiving it. As with previous years, we will set a requirement for charges schemes to be published ahead of the new charging year.

We will require companies to publish their charges scheme no later than the first working day of the February immediately preceding the charging year for which they have effect.

2.4 Transparent and customer-focused

We have previously set expectations for companies to consult the Consumer Council for Water (CCWater), and to engage with their customers and their representative groups as appropriate. It is important that charges schemes are suitably transparent and customer-friendly.

We will set a requirement for companies to consult with CCWater (rule 7)⁷. We would consider it good practice for a company to engage with its customer challenge group (CCG) and to be transparent about how it had reflected what its CCG and CCWater had said to it in reaching a final view of its charges scheme.

We will also set a requirement for charges schemes to be published on companies' websites in a transparent way (rule 10). We also require that a charges scheme states how end-user customers can obtain a copy of any standard charges where these are not included in the charges scheme (rule 11).

For unmetered charges, we will require companies to be transparent and clearly state in the charges scheme the basis on which those charges are calculated (rule 19).

We also require that the charges scheme provide a reasonable choice as to the times and methods of payment of charges fixed by the charges scheme (rule 24).

2.5 Other charges scheme rules

2.5.1 Rules for assessed charges

Since 1999, domestic customers have had the right to request a meter and be charged by reference to the volume of water supplied unless it is not reasonably practicable, or it would be unreasonably expensive, for the water company to do so. Since then, having had regard to the UK Government guidance, we have required companies to offer alternative charges (known as assessed charges) to domestic customers who request a meter but cannot reasonably be metered. We intend to continue this requirement (rule 18)

⁷ This rule is required by section 143(6B) of the WIA91, as amended by the WA14.

We propose rules on assessed charges with the intention that the assessed charge reflects, as closely as practicable, the volume of water that is likely to be supplied to the customer. We do not propose to prescribe how this should be done. In our [charging principles and guidance – charges approval for 2014-15 charges](#) we listed a range of methods currently in use by companies and ranked them in order of preference, with an occupancy-based charge being the preferred method. But we accept that different methods may be appropriate for different customers.

We recognise that there are certain issues associated with occupancy, such as obtaining and monitoring the level of occupancy. However, we consider that single occupiers are the ones most likely to benefit from opting for a meter, and that there are mechanism in place to fairly easily identify these customers (e.g. through the single occupier discount for council tax). For that reason we propose to set a rule that in the case of a single occupier, companies must offer an assessed charge that reflects the volume of water that is likely to be supplied to single occupancy domestic premises in the relevant area.

We note that the all but one company already offer a single occupier assessed charge.

2.5.2 Default tariffs

We require companies for whom we set full price controls to set out in their charges schemes charges for relevant end-user non-household customers (covering both retail and wholesale activities) that reflect the “default” tariff structure on which their non-household retail price control is based. This is to ensure that companies’ tariff structures are consistent with the price control. This does not prevent companies offering other charges to non-household customers, as long as it is the customer’s choice whether to pay a different charge. We expect this rule to be updated next year, when we determine non-household retail price controls for the period from 1 April 2017.

This rule will not apply to small water companies. It is not relevant for small water companies because, reflecting their size, we do not currently set full price controls for them.

2.6 Consultation questions

Q1 Do you have any specific views on the draft rules for 2016-17 included in appendix 2? Are there any other rules that you consider should be included?

Q2 How best can site area-based surface water drainage charges be adopted? And what lessons can be learned from how companies have moved to this basis so far?

Q3 Do you agree with our proposed threshold for 'significant' bill increase? If not, is there evidence for a more suitable threshold? And how this can be assessed for different customer types?

3. Assurance and Information requirements

3.1 Board assurance

In recent years, we have approved companies' charges schemes based on their Board's assurance that their charges comply with their legal obligations. Going forward, charges schemes will no longer require our approval. Instead we will set rules for charges schemes and, where necessary, take action if companies then do not comply with them ('ex post action'). For example, this could be through issuing companies with a direction under the new rules-based framework, or pursuing enforcement action in relation to a licence breach.

However, we have found requiring companies' Boards to provide assurance of their charges to be a powerful tool for ensuring that Boards are engaged with their charges, thus generating real company ownership of their responsibility to ensure that charges are fair and reasonable. This in turn reduces the risk of unacceptable charges.

We are currently minded to retain a requirement for companies' Boards to provide us with an assurance statement each year, and for companies to publish their Board's assurance statements, no later than the time they publish their charges schemes.

The Boards' assurance statement will provide assurance of compliance with all legal obligations; assurance of the impact assessment and handling strategies, and of the accuracy of its charges scheme. The statement will also provide assurance on the process the company has followed in engaging with its customers on the charges scheme.

3.2 Significant changes

Despite the progressive shift in focus, which the new framework enables us to make, from ex ante regulation (where we check compliance in advance), to ex post action, we consider that there is still likely to be a benefit in companies submitting to us a statement of any significant changes that they anticipate in their charges from one year to the next.

This could help identify possible issues or concerns, and inform us whether we would see any benefit in engaging with a given company in advance of their charges coming into effect. We are currently minded to set a requirement for companies to

provide us with a statement of significant changes three weeks before publishing the charges schemes for the new charging year.

The statement will confirm whether the water company is expecting any changes to its charges scheme to result in a significant bill increase and, if it is, the size of the increase, the type of customers affected and what communication the company has had with the customer, and whether any assistance has been offered. The statement will also provide details of any significant changes in charging policy from the previous year.

It would be good practice that if companies notified us that there were significant changes to charges in its charges scheme, we would get their Board's assurance statement alongside it.

Appendix 3 shows examples of good practice of board assurance and impact assessment from the charges approval process 2015-16.

3.3 Consultation questions

Q4 Do you agree with our current preference of companies publishing their Board's assurance statements?

Q5 Do you consider that the Board's assurance statement should cover anything else than what we propose above?

Q6 Do you agree with our current preference for companies to submit a statement of significant changes?

4. Future developments and next steps

The draft rules that we propose in this consultation, for implementation in 2016-17, are about charges schemes made under section 143 of the WIA91, and as such, relate to charges for end users (retail customers).

The WA14 also introduces powers for us to set charging rules in relation to other types of charges.

In this chapter we set out future developments in charging rules. These are “access” charges made by water companies to providers of retail services to end-users. Our focus here is on developments related to charging rules about wholesale charges. This emphasis is in anticipation of the opening of the retail market to competition from April 2017 to all non-household customers of English water companies.

In section 4.1 we discuss rules about wholesale charges. We will consult and set rules on wholesale charges next year – as well as any specific rules required to support our new interim supply code in this market – so that they are in place for the further opening of the market for retail services for non-household customers in England in April 2017. In section 4.2 we provide a high level plan to set rules about charges for developer services and rules about access charges for upstream service providers.

4.1 Developments in relation to wholesale charges

In April 2017 all non-household customers of English water companies will be able to choose their retailer. Ahead of that we intend to set rules about wholesale charges. These are the charges that retailers (licensees), including new entrants, will have to pay water companies in return for the provision of bundled wholesale water and wastewater services to support retail service provision.

The transparency and cost reflectivity of wholesale charges will be vitally important to help ensure an effective retail non-household market.

At the 2014 price review (PR14) we set for 18 water companies, separate binding controls on service revenues for:

- water wholesale services;
- wastewater wholesale services (for 10 relevant companies only);

- household retail services; and
- non-household retail services.

Wholesale charges for water and wastewater (and connection/infrastructure charges) must be set so as to recover no more than the allowed wholesale revenue for each service. Licence Condition B allows us to require water companies to publish their wholesale charges for the purpose of demonstrating compliance with the price controls. Where relevant, companies published their 2015-16 wholesale charges on 2 February 2015. In September we will publish an information notice asking companies to publish their 2016-17 wholesale charges in January 2016.

In June we published [Licensing and policy issues in relation to the opening of the non-household retail market – a consultation](#) (“licensing and policy consultation”). In this consultation we said that some of the requirements on water companies, related to their interaction with new licensees, will be given effect in charging rules. We discuss these requirements and others below.

4.1.1 Completeness of wholesale charge schemes

The transparency of wholesale charges is important to ensure a level playing field in a contestable non-household retail market. In our licensing and policy consultation we took the view that wholesalers should not charge retailers in the non-household market for any wholesale service sold in the market using a charge that is not published in its wholesale charges scheme or as special agreements. That is, the wholesale charges scheme must be complete (except for the inclusion of special agreements).⁸

Among respondents to this consultation, there was general agreement with our view and the importance of transparency. A number of water companies sought clarification on whether non-primary charges⁹ would need to be specified in the wholesale charges scheme, as these were not previously submitted to us for charge approval. One respondent argued that there are a variety of non-primary charges where this will not be practicable or desirable, such as charges for developer services and other charges outside the revenue controls or against non-appointed

⁸ The charges scheme will not cover charges for products sold outside the NHH retail market, such as bulk supplies of water from one water company to another.

⁹ Non-primary charges are charges against non-primary services provided by the companies, such as disconnection, meter testing, provision of fire hydrants, pressure tests etc.

activities. One respondent suggested that a standard list of non-primary charges that companies are required to include in their wholesale charges scheme.

We seek further feedback on whether it would be practicable and/or desirable to include all non-primary charges in the wholesale charges scheme. Our approach will develop through dialogue with stakeholders and will be included in our consultation next year, but we are minded to set a future requirement to publish a clear and complete wholesale charges scheme in charging rules.

4.1.2 Timing of publication of wholesale charges

Consistent with our position in our [draft determinations \(technical appendix A8 – charging\)](#) and our licensing and policy consultation, we will require companies to publish their final wholesale charges no later than the first week of January. This will allow retailers additional time (relative to the publication of end-user charges schemes in February) to develop their retail pricing proposals ahead of the beginning of the charging year. It is also essential to ensure that any changes to wholesale charges can be reflected in central systems handled by the market operator.

In our June licensing and policy consultation, we also consulted on a proposal to publish **indicative** wholesale charges in July, for the following charging year. Retailers, CCWater and some other respondents were generally in favour of early publication of indicative charges in principle. However, they recognised that a balance needs to be struck due to the trade-off between the time of publication and the quality of information: the earlier retailers receive the information, the earlier they can prepare their pricing strategy and begin discussion with customers, but also the less reliable this information is as a basis for developing pricing strategies. Respondents pointed out that for a charge to be useful for a retailer, it needed to be relatively certain.

Forecast charges may depend on a number of parameters, such as forecast RPI, forecast of new connections, weather forecast, energy prices and summer usage (the latter is available for an October publication but not for July). When setting final charges, water companies will want to use the most up to date information. Under the wholesale revenue forecast incentive mechanism (WRFIM) of PR14, companies can incur penalties where the revenue recovered from customers, through charges, is significantly different from the revenue allowed in final determination.

Indeed, responses from water companies were less supportive of early publication. While they recognised the benefits in principle for retailers, they were concerned

about the accuracy of indicative charges if they are published a long way before the charging year and the financial implications for them if they are limited in their ability to reflect developments between publication of indicative and final charges (for example, in respect of WRFIM).

Some respondents suggested a way of combining these two viewpoints: an early publication of indicative wholesale charges in July, and a firmer publication in October.

We think that provisions for early publication of indicative charges are important. They can provide a basis for early discussions between retailers and customers.

We seek views on the benefits and limitations around early publication of indicative wholesale charges. We would also be interested in views on a proposal to make an early publication of indicative wholesale charges in July, and a second publication in October, which companies would not be able to revise but for the updating of charges for the November RPI.

In preparing indicative wholesale charges, we would also want water companies to be consistent in using the same forecast of RPI (which we will specify in advance). We will require that indicative and final wholesale charges are published on the water company's website in a clear and transparent way.

4.1.3 Special agreements

The WIA91 allows companies to charge in accordance with agreements (known as "special agreements") with the persons to be charged. In such cases, the agreement constitutes the legal basis of the charge and may specify a different charge to that set out in the charges scheme.

From 1 April 2017 all non-household customers of English water companies, including those already on special agreements at the time, will be part of a contestable retail market. To ensure level playing field in respect of customers under special agreements, a certain level of transparency on the price and non-price terms of such agreements will be required.

There is an obligation, set out in section 142(6A) of the WIA91, on water companies to notify us of the provisions of any new special agreement. We are required to enter on our register (and therefore put in the public domain) such information about such agreements as we think fit.

When making rules about wholesale charges we will be required¹⁰ to include provision requiring water companies, where there is an existing special agreement, to impose on licensees only such charges as would enable the licensee to charge the end-user at the same rate or rates as would have applied under the special agreement. In other words, water companies will have to allow licensees a margin.

In our licensing and policy consultation we discussed the principle that the services provided by special agreements should be contestable along with the wider retail services in the non-household retail market. We proposed that water companies notify us, for the purpose of the special agreement register, the wholesale charge component of any special agreement in the form of:

- the specified wholesale charge which would otherwise apply to that supply, and
- the percentage by which the special agreement wholesale charge differs from the specified normal wholesale charge (the wholesale multiplicative factor).

We are still considering the detailed responses to our proposals, but at a high level, all respondents agreed that more transparency of special agreements is needed to ensure that retail services provided via special agreements are contestable.

We are minded to propose the following rules.

- Where water companies have special agreements with customers, the retail elements of those special agreements must be contestable. This is to ensure that a licensee could provide the same services at the same price should the customer switch.
- Where water companies have special agreements with customers they must provide information about the wholesale charge component of the charge. We will make such information available as part of the special agreement register in future.

We seek stakeholder feedback on our proposals above. We will consult on these proposals in more detail next year.

¹⁰ This requirement will be set out in section 66E(3) of the WIA91 (as amended by paragraph 5 of Schedule 2 to the WA14) for water and section 117I(3) of the WIA91 (as inserted by Schedule 4 to the WA14) for wastewater.

4.1.4 Schemes of terms and conditions applied in specified circumstances (deemed contracts)

The WA14 requires us to publish and review from time to time an interim supply code to cover interim supply arrangements in the non-household retail market. The code will give protection to customers in the event that their licensed retailer ceases to supply them, by ensuring that an alternative interim supplier continues supply until customers have an opportunity to re-engage in the market themselves as appropriate. Deemed contracts will be a feature of these interim supply arrangements.

There will be provision in the interim supply code for us to set deemed contract terms and conditions if required to safeguard customers. The provisions in the code will therefore make reference to price and non-price terms for deemed contracts. We may need to ensure, by specifying charging rules and directing licensees, that the retail terms offered by undertakers and licensees are consistent with our interim supply arrangements as specified in the relevant code.

We plan to consult on our interim supply proposals in more detail during October, as well as consulting on deemed contracts more generally, as they will also be required in regions where the appointed undertaker has exited the non-household market.

4.1.5 Disaggregation of wastewater charges into separate components

The wastewater wholesale charge covers wholesale services for the treatment of foul sewage, highway drainage and surface water drainage. We consider that customers and retailers can benefit from transparency about these components. Transparency would allow customers to respond more directly to price signals embedded in the charge. This can have a positive impact on the environment. Transparency would also allow retailers to have an informed discussion with customers on ways to reduce their bills.

We are minded to set a requirement for 2017-18 for companies to disaggregate their wholesale wastewater charges into these three separate components. We will require companies to publish disaggregated wholesale charges on a 'pilot' basis in January 2016. In future, we will consider whether the same disaggregation would be beneficial in end users' charges schemes.

4.1.6 Standardisation of charge

The UK Government's draft charging guidance says:

“There may be benefits from standardisation of some aspects of tariffs and charging between companies to ensure a reasonable approach can be set out in certain areas of the market codes and to address barriers to entry. However, this could lead to incidence effects for some customers’, as well as reducing the scope for innovation in charging structures.”

We discussed in our January consultation the pros and cons and the different levels of standardisation. We said that while some degree of standardisation may have merit (eg, in reducing system settlement costs and barriers to entry into the non-household retail market), it can also be detrimental to market development and tariff innovation. We also said that our preference is for some level of standardised wholesale charging methodology to be developed over time, but for us not to design and specify companies' tariffs.

We will give careful consideration of whether and to what extent we should standardise wholesale charging structures. We expect to consult on a set of proposals related to standardisation of wholesale charges in 2015.

4.2 Development of charging rules in other areas

4.2.1 Charging rules for developer services

Companies charge developers for the provision of relevant infrastructure and to connect new developments to the water and sewerage network. The current charging framework has been criticised as lacking transparency, with charges not clearly linked to the costs involved and applied on an inconsistent basis across companies.

The WA14 will make changes to the WIA91 to allow us to replace the current charging framework and set charging rules that could address these issues.

The UK Government's draft guidance recognises the lack of transparency in the current developer charging arrangements. The guidance recognises the need to make charging rules that would provide more transparency and predictability for

developers so that developers can better plan for the cost of connecting to the water and sewerage system, which in turn would encourage growth.

Changes made by the WA14 allow the UK and Welsh Governments to issue guidance to Ofwat about the content of rules in this area (section 144ZD of the WIA91). The UK Government has signalled its intention to issue such detailed guidance in the area of charges for developer services. In setting charging rules in this area, we will have regard to such guidance.

We expect to commence work on the development of charging rules for developer services later this year.

4.2.2 Charging rules for access pricing

Access prices are, like wholesale charges paid by retailers, charges that service providers pay to use an incumbent's facilities and networks that are needed to provide services to end users.

The extension of upstream markets, as envisaged by the WA14, requires effective access prices to enable efficient entry and allow new entrants to compete on a level playing field.

The UK Government's draft guidance provides high level principles in respect of access charging rules, recognising the importance of promoting markets. The guidance also suggested that it will be necessary for the Government to issue further guidance in respect of the upstream markets as the plans become more concrete.

The UK draft guidance states the intention to remove the current requirement to set access charges on the basis of the "costs principle". However, the UK Government will only remove the "costs principle" at **"such time as the policy approach to the detailed implementation of upstream reform has been established by the Government and the necessary framework of charging guidance, charges rules and market codes are ready to take its place"** (paragraph 1.10).

We will eventually be required to set charging rules that incumbents must comply with in setting the prices they will charge for providing access to their facilities.

Access pricing is a key area of regulatory focus in our Water2020 programme. In July we published a discussion paper [Towards Water 2020 – meeting the challenges for water and wastewater services in England and Wales](#) where we considered the

challenges facing the water sector in England and Wales, and how we can help it to address these challenges. We also published the supporting document [Towards Water 2020 – policy issues: promoting markets](#) where we discuss the role of access pricing in setting appropriate price signals for market participants and how access prices interact with the recovery of costs including the RCV.

In December 2015 we will consult on our initial proposals on the role of markets and the consequential changes in the regulatory framework. In that consultation we will set out our approach to developing access charges rules.

4.3 Next steps

We welcome your responses to this consultation by 30 September 2015. We will consider responses and issue our final set of charges scheme rules, to be effective from 1 April 2016, in early November 2015.

Next year we will consult on rules for wholesale costs in the spring and will set rules in time for the 2017-18 charging year.

4.4 Consultation questions

Q7 Do you have any specific views on the proposals included in chapter 4? Are there any other rules or issues that you consider should be consulted on next year?

Q8 Would it be practicable and/or desirable to include all non-primary charges in the wholesale charges scheme?

Q9 Do you have any specific views on the requirement to publish final wholesale charges for non-household customers no later than the first week of January?

Q10 Do you agree with our outline proposal that indicative wholesale charges be published in July and October?

Appendix 1: Charges schemes and the legal framework

Water companies have statutory powers under section 142 of the Water Industry Act 1991 (WIA91) to fix, demand and recover charges for the regulated services they provide to their customers (within the legal framework). The vast majority of end-user (retail) water and sewerage customers do not have an individual agreement with their water company. The relationship is statutory (water companies have statutory obligations to provide customers with water and sewerage services and therefore have the statutory powers to charge them for these services). For these customers, charges are fixed in charges schemes made by water companies under section 143 of the WIA91. Charges schemes set out a company's charges for the provision of supplies of water and sewerage services to premises and associated terms, such as times and methods of payment. In the absence of any individual agreement, a charges scheme is the legal basis for end-user charges.

The WIA91 currently requires charges schemes to be 'approved' by Ofwat before they can come into effect.

Section 16 of the Water Act 2014 (WA14) amends the provisions of the WIA91 that relate to charges schemes. From 1 November 2015 these amendments will remove the requirement for charges schemes to be approved by Ofwat. Instead, Ofwat will have the power to set 'rules about charges schemes' that the provisions of charges schemes must comply with. If we consider that a water company's charges scheme does not comply with the rules or certain other requirements then we will have the power to issue a direction to the water company.

Rules about charges schemes may in particular—

- (a) make provision about the types of charges that may be imposed;
- (b) make provision about the amount or maximum amount, or the methods for determining the amount or maximum amount, of any type of charge;
- (c) make provision about the principles for determining what types of charges may or may not be imposed;
- (d) make provision about principles for determining the amount of any charge that may be imposed;
- (e) require particular schemes of charges to be available in specified cases;
- (f) make provision about the timing of payment of charges;
- (g) require charges schemes to be published;
- (h) make provision about how charges schemes are to be published.

In addition, we must issue rules requiring water companies to consult CCWater about proposed charges schemes.

The UK and Welsh Governments must issue guidance about the principles to be applied by us in determining the provisions of rules about charges schemes (section 144ZE of the WIA91) and may also issue guidance as to the content of the rules (section 143E of the WIA91). In setting rules about charges scheme we must have regard to this guidance (as well as to any guidance issued under sections 43 or 44 of the Flood and Water Management Act 2010 in relation to social tariffs and concessionary drainage charges).

Appendix 2: Draft charges scheme rules for 2016-17

WATER SERVICES REGULATION AUTHORITY WATER INDUSTRY ACT 1991, SECTIONS 143(6A) AND 143B Draft Rules about Charges Schemes

Introduction

1. These rules are issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991.
2. The rules come into effect on [...].
3. The rules apply to water undertakers and sewerage undertakers when they are making a charges scheme.
4. The rules are supplementary to statutory provisions that apply to relevant undertakers under any enactment, or instrument made thereunder (including the conditions of their appointments), and in the event of any conflict between the rules and any statutory provision, the latter shall prevail.

Interpretation

5. Unless the context otherwise requires, in these rules:
 - “charges scheme” means a charges scheme under section 143 of the Water Industry Act 1991;
 - “domestic premises” means any premises used wholly or partly as a dwelling or intended for such use;
 - “metered charge” means a charge for services that are based wholly or partly on measured quantities of volume;
 - “the Minister” means –
 - (a) in the case of an undertaker whose area is wholly or mainly in England, the Secretary of State, and
 - (b) in the case of an undertaker whose area is wholly or mainly in Wales, the Welsh Ministers;
 - “Mogden formula” means the following formula:
Charge per unit of effluent = $R + [(V + Bv) \text{ or } M] + B(Ot/Os) + S(St/Ss)$ ⁷
where:
R = reception and conveyance charge [p/m^3]

V = primary treatment (volumetric) charge [p/m³]

Bv = additional volume charge if there is biological treatment [p/m³]

M = treatment and disposal charge where effluent goes to sea outfall [p/m³]

B = biological oxidation of settled sewage charge [p/kg]

Ot = Chemical oxygen demand (COD) of effluent after one hour quiescent settlement at ph 7

Os = Chemical oxygen demand (COD) of crude sewage one hour quiescent settlement

S = treatment and disposal of primary sewage sludge charge [p/kg]

St = total suspended solids of effluent at ph 7 [mg/litre]

Ss = total suspended solids of crude sewage [mg/litre];

- “new appointee” means a company holding an appointment as a relevant undertaker where the conditions of that appointment limit the charges that can be fixed under a charges scheme by reference to the charges fixed by one or more other relevant undertakers;
- “rateable value charge” means a charge fixed wholly or partly by reference to a rating valuation list or otherwise determined, whether directly or indirectly, by reference to any value or other amount specified at any time in such a list or which purports to be so fixed or determined;
- “rating valuation list” means a list which is or has at any time been maintained, for the purposes of rating, under section 41 of the Local Government Finance Act 1988, section 67 of the General Rate Act 1967 or any other enactment;
- “service” includes the supply of water; and
- “unmetered charge” means a charge for services that are not based on measured quantities of volume to any extent.

6. Unless the contrary intention appears, words and expressions used in these rules have the same meaning as in any provision of the Water Industry Act 1991.

Consumer Council for Water

7. Before making a charges scheme a relevant undertaker must consult the Consumer Council for Water about its proposed scheme in a timely and effective manner.

Bill Stability

8. Undertakers should carry out a proportionate impact assessment whenever the nominal value of bills for a given customer type (assuming a constant level of consumption) is expected to increase by more than 5% from the previous year.

Publication

9. Charges schemes must be published no later than the first working day of the February immediately preceding the Charging Year in relation to which they have effect.
10. Charges schemes must be published on a relevant undertaker's website and in such other manner as the undertaker considers appropriate for the purpose of bringing it to the attention of persons likely to be affected by it.
11. Where a relevant undertaker has published or fixed standard charges otherwise than under a charges scheme for any services provided by that undertaker, charges schemes must state how customers may obtain a copy of such charges and, if applicable, where on a relevant undertaker's website those charges may be found.

Principles for determining the amounts of charges

12. Consistent principles and approaches must be applied to the calculation of charges for different classes of customers.
13. Charging structures must reflect the long run costs associated with providing the relevant service.
14. Charges for services provided to domestic premises must be fixed so that the average difference between metered charges and unmetered charges only reflects any differences in the costs of, and the additional benefits of, the provision of one service relative to the other;
15. Differences between charges for services provided to larger users of water and charges for services provided to smaller users of water must only be based on cost differences associated with differential use of network assets, differential peaking characteristics, different service levels and/or different service measurement accuracy.

16. Where cost differences associated with differential peaking characteristics are used as a basis for differences between charges for services provided to larger users of water and charges for services provided to smaller users of water, the charges fixed on that basis must be structured on an appropriate peak demand basis.
17. Charges for sewerage services must take into account the different pollutant loads associated with household foul sewage, non-household foul sewage, trade effluent, surface water draining from premises and surface water draining from highways.

Assessed charges

18. Charges schemes must allow a customer to choose to pay an assessed charge determined in accordance with this rule in the specified circumstances:
- (a) The type and amount(s) of an assessed charge must be determined in accordance with the following principles:
 - (i) assessed charges should, as closely as practicable, reflect the metered charges that would apply in relation to the volume of water that is likely to be supplied; and
 - (ii) the amount of an assessed charge payable by an individual who is the sole occupier of domestic premises (a single occupier assessed charge) should reflect the volume of water that is likely to be supplied to domestic premises occupied by one individual in the relevant area.
 - (b) The specified circumstances for the purposes of this rule are where a water undertaker has received a measured charges notice in accordance with section 144A of the Water Industry Act 1991 but was not obliged to give effect to it because:
 - (i) it is not reasonably practicable to fix charges in respect of the premises by reference to the volume of water supplied, or
 - (ii) to do so would involve the incurring by the undertaker of unreasonable expense.

Unmetered charges

19. Charges schemes that include any unmetered charges must clearly state the basis on which those charges are fixed or determined and, in the case of rateable value charges, state:

- (a) which rating valuation list charges are fixed or determined by reference to; and
- (b) if the undertaker uses a different value or other amount to that specified in such a list, the methodology or other basis on which that different value or other amount is calculated.

Wastewater charges

20. Sewerage undertakers' charges schemes must provide for a cost reflective reduction in the charges payable for the provision of sewerage services to any premises where the sewerage undertaker knows, or should reasonably have known, that surface water does not drain to a public sewer from those premises.
21. Sewerage undertakers must set out in their charges schemes how any reduction in the charges payable for the provision of sewerage services to any premises will be calculated if customers can demonstrate that they have significantly reduced the volume of surface water draining to a public sewer from their premises or explain why there is no such provision.

Trade effluent

22. Charges to be paid in connection with the carrying out of a sewerage undertaker's trade effluent functions must be based on the Mogden formula, a reasonable variant of the Mogden formula or on a demonstrably more cost-reflective basis.

Social tariffs / Concessionary drainage charges

23. Charges schemes must state:
- (a) whether or not undertakers have decided to include in the charges scheme:
 - (i) provision designed to reduce charges to community groups in respect of surface water drainage from their property (having had regard to any guidance issued by the Minister under section 43 of the Flood and Water Management Act 2010);
 - (ii) provision designed to reduce charges for individuals who would have difficulty paying in full (having had regard to any guidance issued by the Minister under section 44 of the Flood and Water Management Act 2010); and

- (b) if any such provision is included, how eligible customers can apply for such reduced charges.

Times and methods of payment

24. Charges schemes must include provisions giving customers a reasonable choice as to the times and methods of payment of the charges fixed by the scheme.

Non-household Default Tariffs

25. Each relevant undertaker's charges scheme must include the types of charges for end-users (known as default tariffs) listed in the first column of Table 6 of the notice given by the Water Services Regulation Authority on 12 December 2014 of a determination of price controls under that undertaker's appointment, unless the type of charge relates to an agreement with the person to be charged (known as a special agreement).

New appointees

26. Rule 9 does not apply to new appointees. Instead new appointees must publish charges schemes no later than the 22 February immediately preceding the Charging Year in relation to which they have effect.
27. Rule 25 (Non-household Default Tariffs) does not apply to new appointees or Cholderton and District Water Company Limited.

Annex: Information requirements

- A1 Each undertaker should provide to the Water Services Regulation Authority an assurance statement from its Board of Directors and publish its statement no later than the time of publication of the charges schemes confirming that:
- (a) The company complies with its legal obligations relating to the charges set out in its charges schemes;
 - (b) The Board has assessed the effects of the new charges on customers' bills for a range of different customer types, and approves the impact assessments and handling strategies developed in instances where bill increases for particular customer types exceed 5%;
 - (c) The company has appropriate systems and processes in place to make sure that the information contained in the charges scheme, and additional information is accurate; and

- (d) The company has consulted the Consumer Council for Water (CCWater) in a timely and effective manner on its charges schemes.
- A2 Each undertaker should provide to the Water Services Regulation Authority a statement setting out any significant changes anticipated by the undertaker, and publish the statement, at least three weeks before the publication of the charges schemes. The statement should include the following:
- (a) Confirmation of whether the undertaker is expecting there to be any bill increases of more than 5% from the previous year (for a given customer type assuming a constant level of consumption) and, if such increases are expected:
 - (i) what size increase is expected;
 - (ii) which customer types are likely to be affected; and
 - (iii) the handling strategies adopted by the company or why the company considered that no handling strategies are required.
 - (b) Details of any significant changes in charging policy by the company from the previous year.
- A3 In addition to the assurances set out above, new appointees' assurance statements must include assurance that their charges schemes offer:
- (a) levels of service at least comparable to the previous appointee's charges scheme;
 - (b) prices that do not exceed those in the previous appointee's charges scheme for similar services; and
 - (c) prices equivalent to those specified in the new appointee's application for each individual appointment or variation area.

Appendix 3: Observations on examples of good practice

Introduction

While appendix 2 sets out our draft charges scheme rules for 2016-17, it should be noted that in some cases there are a number of ways that such rules could be appropriately adhered to. Therefore, we have set out some examples of good practice we observed from companies through the 2015-16 charges approval process. These examples are not exhaustive – that is, there were other examples of good practice observed that we have omitted for the sake of brevity.

Board oversight

As part of the 2015-16 charges approval process we required all companies to provide a statement of assurance from their Boards, and that the statement be published on their respective websites. Companies set out a range of information explaining how their Boards oversaw the development of their charges.

South West Water clearly set out in detail what their Board considered in approving the company's scheme. Furthermore, South West was the only company to have each Board member physically sign the assurance statement. While this in itself is not necessarily a clear sign of effective governance, it further illustrates the extent of ownership and oversight provided by the Board.

Thames Water also provided a clear and detailed overview of its assurance processes. This included clearly setting out the various points that its Board and sub-committees reviewed in the company's charges schemes.

Impact assessments

Despite overall bill decreases in 2015-16, the structuring of charges did result in some bill increases for certain types of customer, for some companies. Where it is expected that customers may experience a significant increase in their bills, we required companies to undertake proportionate impact assessments to identify, which customers would be affected, and to what degree.

Northumbrian Water set out a clear and granular impact assessment. The assessment considered the effect of changes in tariff structures on different customers. The assessment included details of the bill impacts, reasons for the

change, a set of mitigating actions, and an assessment of whether a specific handling strategy would be required. The company chose to undertake such an assessment for all tariff changes; not just in cases where bills were expected to increase by more than 5%. Although we had set a 5% threshold for 'significance', we stated that we would prefer (in the longer term) companies to identify when impact assessments may be required without a uniformly-set threshold. Northumbrian showed initiative in this area by determining when proportionate impact assessments would be required (while adhering to our 5% requirement), and furthermore chose to put in place a number of handling strategies where bill effects were below the 5% threshold.

South East Water also performed a detailed impact assessment, segmenting customers on a highly granular basis by different consumption assumptions.

Handling strategies

Following from the impact assessments, where appropriate, companies were required to undertake handling strategies for managing bill effects on customers.

Both **Anglian Water** and **United Utilities** identified bill increases of above 5% for certain customers. Both companies clearly set out how they had sought to mitigate the bill effects, and how they intended to engage with the affected customers. Furthermore, both companies demonstrated that they had begun work on their handling strategies many months in advance of the new charging year. This increased our confidence as to the appropriateness of the strategies the companies had in place.

Significant improvements

We also noted a marked improvement in the quality of assurance, and (based on our risk-based assessment of the information provided) a significant reduction in the number of issues relating to charges for both **Dee Valley Water** and **Portsmouth Water**. With both companies we had identified significant issues with their draft submissions from October; it was therefore reassuring to see these companies make significant improvements following our assessment of their draft charges.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a leading economic regulator, trusted and respected, challenging ourselves and others to build trust and confidence in water.



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