

# Information notice

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## Allocation of social tariff and surface water drainage concessions cross-subsidies

This information notice confirms how we expect the companies to allocate cross-subsidies for social tariffs and surface water drainage concessions to different parts of their business. This is part of our 2014 price review.

In summary, we see no compelling reason for companies not to allocate such subsidies in line with existing guidance that the UK and Welsh Governments have issued. But the companies have requested further clarification on this point. We set this out below.

The 2014 price review is our process for setting the price and service packages ('price controls') that each of the monopoly water and sewerage and water only companies in England and Wales must deliver over the five years between 2015 and 2020. Each company will send us its business plan, setting out its plan for prices and services for its customers, by 2 December 2013.

### Background

In '[Setting price controls for 2015-20 – final methodology and](#)

[expectations for companies' business plans'](#) (our 'methodology'), which we published in July 2013, we stated we would set up to four separate price controls for each company. These are in the following areas:

- household retail services;
- non-household retail services;
- wholesale water services; and
- wholesale wastewater services.

We will publish our final decisions ('determinations') on the companies' price controls towards the end of 2014-15. Companies will then need to convert these determinations into individual charges for their customers.

In doing this, the companies have the option to offer the following.

- 'Social tariffs', which are reduced charges for individuals who would otherwise have difficulty paying their water bills in full.
- 'Surface water drainage concessions', which are reduced charges for community groups that companies are able to offer in certain circumstances.

Other customers pay for these reduced charges through the charges that they pay (a 'cross subsidy').

With the new price control methodology, it is necessary to consider where the cross-subsidies should be allocated in terms of the various different price controls and associated charges.

The UK Government and Welsh Ministers have already issued guidance to companies in this area. This is as follows.

- '[Company social tariffs: Guidance to water and sewerage undertakers and the Water Services Regulation Authority under Section 44 of the Flood and Water Management Act 2010](#)' sets out the UK Government's guidance in relation to companies wholly or mainly in England on social tariffs.
- '[Guidance to water and sewerage undertakers in relation to concessionary schemes for community groups for surface water drainage charges and summary of consultation](#)

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water and sewerage sectors in England and Wales.

responses' sets out the UK Government's guidance in relation to companies wholly or mainly in England on surface water drainage concessions.

- 'Guidance to water and sewerage companies and the Water Services Regulation Authority (Ofwat), in relation to social tariffs under section 44 of the Flood and Water Management Act 2010' sets out the Welsh Government's guidance in relation to companies wholly or mainly in Wales on social tariffs.

## Social tariffs

The Flood and Water Management Act 2010 allows companies in England and Wales to use social tariffs and introduce cross-subsidies to pay for them. The companies are not obliged to introduce social tariffs. The UK Government's guidance on company social tariffs states that:

- companies wholly or mainly in England will need to consider whether a social tariff is the best means for tackling affordability problems; and
- it would be inappropriate for non-households to contribute to the funding of social tariffs in the longer term.

We agree. It will not be feasible for companies to recover costs of any social tariff cross-subsidies through their non-household retail price controls. This is because, under plans by the UK Government set out in its Water Bill, the companies wholly or

mainly in England will be competing with other suppliers to provide retail services to non-household customers at some point during 2015-20. In such a market, individual customers would be likely to switch to those suppliers whose tariffs are not as high because they are not subsidising household customers.

Also, the companies' household retail businesses have direct contact with customers. So they are more likely to be able to identify and help vulnerable customers. They are also responsible for managing bad debt, which social tariffs may help reduce.

The Welsh Government's guidance stated that it:

- wishes to avoid customers funding a social tariff they are not potentially eligible for; and
- expects there not to be cross-subsidy between water customers and sewerage customers.

We agree. Keeping the subsidy within the companies' household retail price controls and the associated customer charges will stop non-household customers paying for a tariff for which they are not eligible. Companies should also seek to structure their charges to avoid unnecessary cross-subsidies.

## Watersure

The Water Industry (Charges) (Vulnerable Groups) Regulations 1999 required companies wholly

or mainly in England to introduce a social tariff known as 'Watersure' and offer it to household customers with a water meter who receive certain government benefits. To qualify, these customers must have:

- three or more children; or
- a medical condition that requires them to use a significant volume of water.

Eligible customers have their bill capped at the average bill for households in a company's area. Dŵr Cymru operates a similar scheme, known as 'The Welsh Water Assist Scheme'. The scheme can help certain customers even if they do not have a water meter.

As these schemes operate in a similar fashion to any other social tariff, we consider that they should be treated similarly to other social tariffs. So companies should allocate the cross-subsidy to their household retail price control – and the associated customer charges.

## Surface water drainage concessions

Water and sewerage companies have to remove and process the rain water that falls on properties and then flows directly or indirectly into the public drainage systems. This is known as surface water drainage.

Some companies charge individual customers for surface water drainage based on the size

of their property ('site area-based charging'). The Flood and Water Management Act 2010 allows these companies to give concessions to certain customers that have buildings for community use, such as sports clubs and churches. In producing such tariffs, companies must have regard to guidance from the UK and Welsh Governments.

The UK Government set out guidance on this matter for companies operating wholly or mainly in England. The Welsh Government has not yet produced similar guidance for companies operating wholly or mainly in Wales, but the sole sewerage company (Dŵr Cymru) does not currently charge for surface water drainage using site area-based charging.

The Flood and Water Management Act 2010 does not define what constitutes a community group. But the UK Government's guidance offers the view that the following might be included in any such concessionary scheme.

- Places of public religious worship.
- Scout and Guide Associations and similar youth or children's groups.
- Community amateur sports clubs and similar types of sports clubs.
- Village and community halls.

All of these are non-household premises, so these customers will be charged for their surface water drainage service by the

companies' non-household retail businesses. Once the retail market has been enlarged, customers of English companies may have a different supplier for their retail services.

The UK Government's guidance also states that its preferred position is for the subsidy to be "shared across both household and non-household customers".

Seeing as it is not feasible to recover the subsidy from the non-household retail controls (for the reasons stated above), and that surface water drainage is a wholesale cost, we consider the most appropriate allocation of the subsidy to be within wholesale wastewater charges.

### Next steps

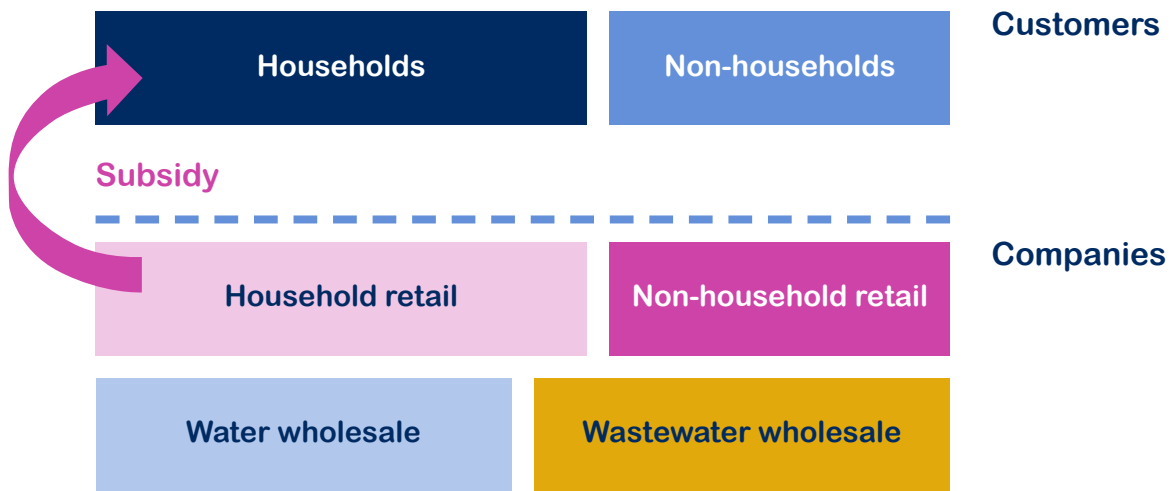
Figure 1 below summarises how we expect the companies to allocate cross-subsidies for social tariffs and surface water drainage concessions to different parts of their business. This will affect the charges that companies will need to develop for 2015-16, and we will consult further on charges schemes in due course.

Although it is now less than a month away from companies submitting their final plans, we expect that companies will have already assumed these allocations given the Governments' guidance.

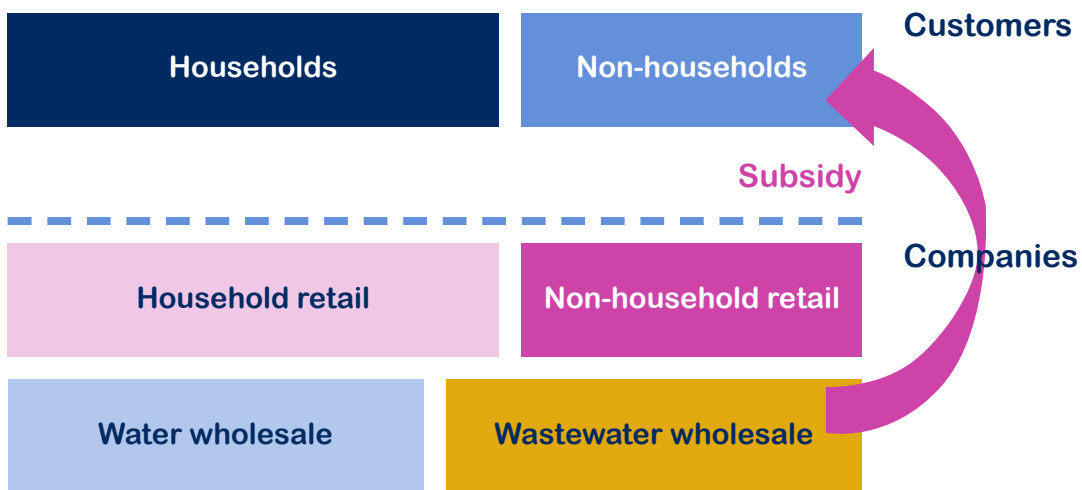
But companies should make sure that their business planning assumptions are consistent with these allocations.

Figure 1 Allocation of social tariff and surface water drainage concessions cross-subsidies

Social tariffs



Surface water drainage concessions



Enquiries

If you have any questions or comments on our approach to cross-subsidy allocations, please send them to [price.review@ofwat.gsi.gov.uk](mailto:price.review@ofwat.gsi.gov.uk).

## More information

Setting price controls for 2015-20 – final methodology and expectations for companies' business plans, July 2013

Setting prices for 2015-20 – delivery plan

2014 price review [web pages](#)

Water Industry (Charges) (Vulnerable Groups) Regulations 1999, UK Parliament

Flood and Water Management Act 2010, UK Parliament

Company social tariffs: Guidance to water and sewerage undertakers and the Water Services Regulation Authority under Section 44 of the Flood and Water Management Act 2010, UK Government

Guidance to water and sewerage undertakers in relation to concessionary schemes for community groups for surface water drainage charges and summary of consultation responses, UK Government

Guidance to water and sewerage companies and the Water Services Regulation Authority (Ofwat), in relation to social tariffs under section 44 of the Flood and Water Management Act 2010, Welsh Government

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