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3 November 2022

Dear Ofwat,

### **Response to: Consultation on charging innovation to support affordability**

I am writing to you on behalf of independent Water Networks Limited (“IWNL”), part of the BUUK Infrastructure Group of companies, in response to the Ofwat consultation on charging innovation to support affordability which was published in September 2022. We have not responded to each of the individual questions that were posed within the consultation but rather have summarised our high-level thoughts on the issues presented. I can confirm that this response is not confidential.

### **Summary of IWNL views on charging innovation**

We welcome the Ofwat consultation on charging innovation, particularly given the joint emphasis that it places on the role of new approaches to charging in supporting both affordability and water efficiency. We note that this latter issue has been subject to extensive discussion as part of Ofwat’s bulk supply working group and that, to date, there has not been an obvious solution that would facilitate the desired outcomes.

Over the course of the year to date, both affordability and water efficiency have been the subject of extensive public and media attention; the former due to the cost-of-living crisis and the latter due to the droughts experienced this summer and the increased focus on environmental sustainability more generally. While the theoretical arguments for and against innovation in charging, via the use of a range of possible mechanisms, are well understood, there are limited examples of these approaches being deployed in practice; particularly in the context of the water sector in England and Wales. We are therefore very much supportive of the steps that Ofwat proposes to take to encourage incumbent water companies to explore the potential for, and actively engage in, charging trials that could help to facilitate improvements in affordability and / or water efficiency outcomes.

## **International lessons learned**

We note that, in the context of potential charging mechanisms that could help to enhance affordability and / or water efficiency, Ofwat makes reference to the experience of Sydney Water and their use of premium charges to encourage consumer behaviour change under pre-defined conditions e.g. water stress. We agree this is a useful case study for water incumbents to be aware of, and would note that there are other pertinent examples which incumbents should also be considering e.g. Cape Town and California.

During the renowned 'Day Zero' crisis which took place between 2016 and 2018, Cape Town was faced with the potential for the water supply to be almost completely depleted; with the taps turned off for most homes and businesses. Using a combination of demand incentives, supply management, and behavioural change campaigns the city was able to avoid this outcome. This crisis provided a number of useful lessons in terms of ways that behaviour change can be effectively facilitated and could provide insights to water incumbents regarding appropriate mechanisms that could be tested as part of any trial.

We think it would be appropriate for these kinds of lessons learned to also be reflected in the good practice principles that Ofwat proposes for charging trials. In this respect, the definition of 'maximising learning' could be expanded to encompass an expectation that companies should ensure they are aware of, and understand, the experience of others in implementing the mechanisms they are proposing to trial.

## **Proposed updates to the Charges Scheme Rules**

In line with our comments above regarding the value that trials could have in enhancing industry understanding of the impact of charging innovation on affordability and water efficiency, we are supportive of Ofwat's proposed changes to the Charges Scheme Rules. The proposals clarify and formalise the regulators expectations around potential trials that incumbents may progress to enable them to fully explore possible innovations in charging arrangements. We anticipate that the setting of clear regulatory guidelines in this area is likely to encourage companies to more actively consider the benefits of engaging in these types of activity. The outcomes from resulting trials could provide valuable insight on the role of various mechanisms in eliciting behaviour change on the part of water customers in England and Wales, which could in turn improve affordability and / or water efficiency.

However, we note that the proposed clarifications to the Charges Scheme Rules will allow for the possibility that trials will be run involving customers who are largely the same paying different charges. We recognise, and welcome, the clarification from Ofwat that incumbents should have a strong evidence base to justify any differential in charges across customers to ensure that they do not infringe licence condition E (prohibiting companies from undue discrimination against any class of customer in setting charges). Given Ofwat's expectation that any trial should run for a full charging year, it is possible that participants in the trial may face materially different charges from those that they would have incurred if they had not taken part in the trial. If there is a possibility that, due to their participation in a trial, customers could become worse off financially, we think it is important that they are given assurances from their incumbent that they will be

appropriately recompensed. In the absence of these assurances, the affected customers could be unduly disadvantaged and it may prove difficult to engage willing participants in future proposed charging trials.

### **Wider application of charging lessons learned**

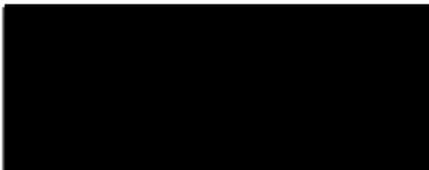
We welcome the clarification that Ofwat provides in the consultation where it states that the charging trials it is seeking to encourage “primarily relat[e] to the 17 incumbent water companies in England and Wales, and [are] of less relevance to new appointees”. We agree that this is an appropriate approach to take given the respective resources and associated customer portfolio of incumbents as compared with NAVs. However, we recognise that our customers are facing similar affordability challenges due to the cost-of-living crisis and acknowledge the importance of doing all we can to facilitate water efficiency. We also note that, in line with the ‘no worse off’ principle, we should seek to provide comparable customer offerings / incentives to those put in place by incumbents.

Having said that, we think it is important that NAVs retain the flexibility to offer our own tailored charging arrangements which could be derived utilising insights from charging trials. If NAVs are subject to a blanket requirement to replicate the charging arrangements offered by incumbents in their respective regional monopoly areas, this would introduce unnecessary complexity for both NAVs and our customers. Therefore, while we are keen to remain apprised of behavioural insights attained during charging trails, we would like the flexibility to develop tailored IWNL charging arrangements that utilise these lessons learned. We believe this will better meet the needs of our customers and the environment.

We note that in the consultation Ofwat specifies that “Companies may decide to design charging innovations that span both households and non-households or apply to each separately”. We agree that incentives to trial charging innovations should apply equally to household, non-household and developer customers. In addition, if incumbents offer incentives to developers to promote affordability and / or water efficiency in the design and build of networks, for the purposes of maintaining a level playing field it will be critical that equivalent incentives are available to NAVs where they act on behalf of a developer.

I hope that this letter is helpful; if you have any questions on any of the issues I have raised or would like to discuss these in more detail, please feel free to get in touch.

Yours Sincerely,



Keith Hutton  
**Group Regulation Director, BUUK**