

Northumbrian Water Response to: Ofwat's Consultation on charging innovation to support affordability

Q1: Do you agree that companies should be looking at how they can introduce charging innovation to support affordability, as well as supporting environmental goals?

We welcome the opportunity to respond to Ofwat's Consultation on charging innovation to support affordability.

We agree that companies should be looking at how they can introduce charging innovation to support affordability, as well as supporting environmental goals. We are pleased to see the proposed changes to the charging rules that would enable this to happen.

The main barrier to charging innovation is that many customers struggle to understand and respond to complexity, either because they don't want to, or aren't able to. This is one of the main reasons behind the low level of awareness and uptake of social tariffs across the industry, despite clear benefits for individuals.

We welcome the willingness from Ofwat to engage with how the wholesale charging rules could support innovative approaches to tariffs. We think the charging rules could be more specific about how the allocation between household and non-household costs (and between different groups of non-households) should happen, and/or what is permitted.

We also welcome further discussions on proposals to introduce charging innovation and on the balance between household and non-household charges.

Q2 - Do you have any comments on our regulatory framework for protecting customers, in the context of charging innovations?

We strongly believe that customers in water poverty shouldn't pay any more than they otherwise would have.

Any innovation needs to be balanced with over complication of tariffs rather than introducing change and complexity for the sake of it. In other places there is a push for greater tariff standardisation across the sector.

Insight

Research needs to consider the needs, considerations, and priorities of customers at a local level – this includes reflecting the varying degrees of poverty and deprivation across England and Wales. Any research needs to be based on robust qualitative and quantitative analysis that also gives customers adequate opportunity for any changes to be embedded.

Engaging customers on the benefits of tariff changes may be challenging, especially where there is scope for customers to be charged more under any specific proposals. As always with tariffs, any change should consider the incidence effects – which might outweigh any expected benefits.

Partnerships

We would like to see more work done at a national level to encourage industry-wide partnerships and data sharing agreements. We were an early adopter of data sharing with DWP¹ to provide social tariffs to customers, but there are still barriers to doing this across organisations.

We would also like to see a national focus on establishing partnerships with third parties to promote and build trust in charging innovation. This has been successful in, for example, universal metering programmes for other water companies.

¹ <https://www.nwg.co.uk/about-us/nwl/how-we-are-performing/our-commitments-to-you/data-sharing-with-the-dwp-to-move-customers-out-of-water-poverty/>

Incentives

We consider that tariff changes can provide important incentives to drive changes in behaviour or practise that can support affordability or indeed other objectives such as in relation to managing consumption or protecting the environment.

Rising block tariffs

We agree with the theoretical advantages of rising block tariffs, but these can only work with a robust way of establishing occupancy as this otherwise penalises larger households.

While advancements in data science since the Walker Review in 2008 (which drew a similar conclusion) mean that there are likely to be ways to do this in future, any method would have to be very detailed and robust to support charging arrangements.

There are further complexities to overcome too – for example, there is no easy way to reflect temporary changes in occupancy for groups such as students or transient customers. Setting charges based on other data points, such as bedrooms, would provide a disproportionate benefit to customers with large houses and relatively low occupancy and may not effectively target support where it is most needed.

Premium charges

We already have options within our charges scheme to charge a premium to households that use of water for swimming pools, hot tubs, or large-scale sprinkler systems. In principle, we agree that it makes sense to apply higher charges for this discretionary use if it can be metered correctly.

This needs to consider the additional costs and practicalities to installing, maintaining, and reading meters, especially if these are in less accessible locations such as back gardens.

We could also consider offering incentives to reduce the non-return to sewer allowance. Although we already remove surface water drainage charges for customers who can demonstrate that they are not connected for drainage, the burden of proof lies with customers and applications are rare.

We don't see the benefit of price signals to households to reduce water demand at times of drought and we are concerned that the New South Wales example does not provide any evidence that this reduces water demand in practice. This would need more exploration. Providing customers with information through communication and asking them to be more careful with water is likely to have a greater impact on influencing behaviour. There is also a risk that raising charges during drought conditions would be seen as profiteering.

Time-of-use and seasonal tariffs

We do not believe time-of-use tariffs will be beneficial as there is no material benefit of changing daily usage patterns (that is, there is no corresponding reduction in costs for lower peak use as there would be in electricity, for example).

Customers are generally either unable to change their usage behaviours (for example, they might only be able to shower at specific times in the morning or evening as they have to be physically present); or their choices would be influenced more by electricity prices (for example, running costs for washing machines are more dependent on electricity use than water).

We see that seasonal charges could be an effective way of managing demand at peak times – as above, providing information and water efficiency advice might have a greater impact in practice than tariffs, and there is a risk that raising charges during drought conditions would be seen as profiteering.

Companies would also need to consider the impact on customers in water-stressed areas who struggle to pay their bills and cannot meaningfully influence their water consumption.

There may be opportunities for a broader balancing of water and energy bills, for example reducing the costs of water bills in the winter when energy bills are higher and increasing these in the summer when demand is higher and energy costs are lower. This may not be appropriate for customers who

pay by direct debit where costs are generally spread equally over the year and do not match actual usage.

Smart tariffs in the energy sector have clear benefits in shifting patterns of energy use. In water, though, this has less impact because a) there is not as much change in the marginal cost of water during the day or even seasonally; and b) smart tariffs in energy are often used by customers who can store energy through batteries or electric vehicles, but this is not generally possible for water.

Sewerage services

We expect wastewater bills to increase during 2025-30, mostly driven by WINEP - including tackling storm overflows.

Storm overflow costs mostly relate to surface water and highway drainage, and so it might be reasonable for these charges to increase as a proportion of the bill to reflect this increase in costs. Increases in drainage charges may incentivise customers to reduce their dependence on surface water drainage, or invest in rainwater harvesting devices, and therefore reduce future investment expenditure.

Allowing for partial rebates for surface water drainage, including for example offering free water butts or other measures to reduce the water entering sewerage systems, may also influence changes in customer behaviour. However, this would be very challenging to administer and validate usage. Ofwat could consider how this might be achieved.

Ofwat should consider again how highway drainage is paid for, as there is currently little incentive (through charges) for local authorities to reduce highway drainage or install SUDs. The Walker Review in 2008 considered shifting this burden entirely away from customers, but this is not the only option – Ofwat could consider how it can incentivise water companies to partner with local authorities to share the costs of improving both flooding and reducing highway drainage. Under PR19, water companies are disincentivised from bringing forward such schemes if they were not included upfront in cost allowances. Sharing these costs would make a big difference to customers who are likely to see increasing wastewater bills – and these outcomes would be delivered more efficiently in partnership.

Unmetered supplies

Rateable value is a long-outdated mechanism for billing. It does not identify households who need help with their water bills, and it also does not provide effective incentives for water efficiency.

While the Walker review recommended neither rateable value nor council tax bands should form the main long-term basis for charging for water, where compulsory metering is not taking place, and meter penetration is low, it may be worthwhile to assess the effectiveness of using council tax as the basis for billing in order to support affordability targets.

As this is commonly used today, basing billing on council tax may improve transparency and customers perception of fairness compared to a system that has not been updated in over thirty years.

Developer services

Ofwat should consider the role of developers and their contribution towards capacity growth at treatment works, as discussed in the PR24 methodology consultation (in relation to nutrient neutrality). This could potentially reduce bills for customers in future by providing an additional income stream to fund expenditure to improve river water quality. Outcome based environmental regulation could support more partnerships and attract more sources of funding than just existing customers.

This could include incentivising the building and purchasing of water efficient homes through new tariff options, to support a reduced nutrient load. Some companies have suggested a reduction in developer charges for water efficient properties.

These incentives do not necessarily need to be large. For example, Vehicle Excise Duty rates are not significant in comparison to other costs, but this has been an effective way of influencing customer purchasing decisions and there may be parallels that can be explored.

Q3 - Do you have any comments on our proposed principles for good practice charging trials?

We support the intention and direction of the proposed principles however we feel the current wording is too broad and vague to provide sufficient clarity or to be incorporated within the charging rules. Instead, we would welcome the development of a series of clear and unambiguous tests that can be used to design and evaluate the relative effectiveness of charging trials.

We would also welcome the introduction of industry-wide standards to minimise complexity and support overall stability and predictability for customers. Giving customers a voice in how they choose to prioritise the principles will be key to achieving wider outcomes.

For example, the introduction of seasonal and/or scarcity-based charging may drive environmental outcomes and influence behaviours but at the expense of stability and predictability which may, on balance, be the preferred option. For other customers, stability and predictability of charging may be more important however and fixed-price models may come at the expense of environmental principles. The challenges of stability and predictability can lead to poor outcomes if these do not have broad support and regulatory certainty (for example, the challenges that United Utilities faced in introducing area-based surface water drainage charges).

Fairness and affordability

The 2021-22 CCW Water Mark report highlights that more than a quarter of customers do not perceive their bills to be fair across all water companies.

Whilst improving compliance with the other principles may help with this, it is helpful to recognise the distinction between equality and equity when it comes to evaluating perceptions of fairness. Under the current arrangements, everyone is charged and benefits from the same support equally. Developing charging schemes where everyone gets the support they need would provide greater equity and improve perceptions of fairness.

There has been a growing trend towards “pay-later” services which are now coming under increasing regulatory scrutiny. Any trials incorporating opportunities to pay-later should balance the benefits of short-term support with long-term affordability and risk of indebtedness.

Environmental protection

Some customers may not be able to afford to do the right thing, especially if there are certain inherent barriers such as access to digital devices or having the means to pay for customer-side leakage repairs. It is essential to support customers to do the right thing where barriers exist.

It is important that leakage is identified and acted upon promptly. Establishing consistent eligibility criteria across companies for free supply pipe or internal plumbing repairs will increase perceptions of fairness.

Currently there is a direct correlation between usage and charging and this may have the unintended consequence of undermining a sense of ethical obligation to conserve water. Charging trials need to achieve environmental outcomes whilst also adhering with the other principles and avoid the creation of a two-tier approach to water usage.

Stability and predictability

Current charging is based on a “repayment” basis which, without smart metering, limits the ability of customers to meaningfully influence their consumption and manage their bills and budgets. That is, customers do not generally know their usage until after the meter is read.

There may be demand for metered customers to pay for price control and stability that is not directly

based on their consumption. While this may impact on usage behaviours it may support households who struggle to budget and manage sudden bill changes and prevent them slipping into arrears.

Giving customers a choice of variable or fixed-price products may increase fairness by giving customers some agency over the way they are billed and balance desire for stability against actual usage.

Transparency and customer-focused service

Transparency does not necessarily mean providing a more detailed and granular breakdown of charges – as this can be unhelpful for many customers. This is clear from the energy sector, where people struggle to understand what a kWh means.

It is important that charges are communicated at a customer-appropriate level of detail that reflect individual needs and capabilities and that they balance transparency and simplicity. We would not support breaking down bills into components unless they remain easy to understand.

For many customers, volumetric charges aren't clear or easy to understand and use a unit of measurement that most customers would not recognise in the context of their domestic water use (that is, many people do not know that a cubic metre is 1,000 litres). Research² carried out in 2020 found that nearly half of respondents thought their household usage was less than 20 litres per day, significantly lower than actual usage levels. This may be influenced by the interchangeable usage of different units of measurement.

While a desire for fixed price services may give security and stability this may also lead to customers paying more than they otherwise would have.

Having too wide a range of services may overwhelm customers and lead them to choose simpler but more expensive options. Tariffs options need to be clear and distinct.

Q4 - Do you have any comments on Ofwat's role in supporting good practice charging trials?

Ofwat's proposal to provide visibility of charging trials on its website and assurance is welcomed.

Ofwat could take a leadership role to help to overcome potential tensions between companies working together to share good practice and the importance of complying with competition obligations. We welcome discussions with companies about how Ofwat might facilitate collaboration.

Ofwat should also encourage further national partnerships with consumer organisations, charities, and other trusted 3rd parties to provide customers with confidence. We welcome the encouragement for companies to engage with CCW on proposed trials and we would go further and suggest consulting with CCW is made a mandatory pre-requisite before trials are implemented.

We encourage Ofwat to go further in setting out success and evaluation criteria for charging trials. Ofwat could create a dedicated forum that would review performance of charging trials and share lessons learned to ensure industry-wide benefits can be realised. This evaluation should use robust quantitative and qualitative data.

We encourage Ofwat to work with regulators across other utilities to provide a more holistic and consistent approach to charging that also drives further innovation.

In the absence of a national social tariff, we would like to see more done to address societal inequalities. The current charging rules prevent us from showing "undue preference" and the social tariffs guidance sets limitations on water companies – Ofwat could and should take a stronger role in enabling more work to address societal inequalities (including beyond social tariffs), rather than reserving judgement and placing any risk on water companies. This does not necessarily mean setting rules and mechanical policies but could instead mean setting and supporting the right outcomes.

Creating a framework for data-sharing within the water sector and beyond will help customers receive company support and recommendation or enrolment onto appropriate tariffs. Advances in data-

² <https://www.water.org.uk/news-item/vast-majority-of-brits-have-no-idea-how-much-water-they-use-each-day/>

sharing and data science may also create new opportunities to automatically apply more customers onto alternative beneficial tariffs and this knowledge should be widely shared. Where appropriate, creating standardised eligibility criteria will support the delivery of Ofwat's charging principles.

Rateable values (RVs) are now extremely outdated and not fit for purpose. We encourage Ofwat to set a timetable to phase out the use of rateable values for charging purposes, working with the Government to do so if necessary. This could also include removing restrictions on compulsory metering – in our North East region, it is unlikely that this will become seriously water stressed before 2050, and so many innovative tariff options are not possible. Having a clear timeline would encourage further and more accelerated innovation within the industry.

Recognising customer demand to opt-in may be low, companies should be encouraged to automatically enrol customers onto alternative tariffs where this will drive a material benefit whilst still providing customers the opportunity to change or opt-out where appropriate.

Ofwat could consider reforming the revenue forecasting incentive (RFI), as the penalties for forecasting errors are a barrier to innovative tariffs (for example, incorporating more variables in tariffs makes forecasting more difficult). Ofwat could remove these penalties entirely and rely on Condition B of the licence as a backstop for interventions or create an exception for companies using innovative tariffs.

Q5 - Do you have any comments on the discussion regarding our charging rules and related regulatory compliance?

It is important the industry does not embrace innovation for innovation's sake and that any future charging models are based on supporting the achievement of long-term customer and environmental outcomes. At the same time we agree with and support the spirit of the consultation and recognise the inertia that has existed in current tariff structure.

Recognising the current cost of living crisis, continued economic uncertainty, likely increases in water bills for AMP8, and the very low levels of awareness of social tariffs today, it is also important that charges support customer needs and are cognisant of the factors limiting customers receiving support. We recognise that, unlike social tariffs, charges do not differ according to customer need.

There has been mixed success with other household support schemes offered by the Government with a range of factors influencing this. Some hard-to-reach customer groups, including cash payers, have been disproportionately impacted. It is important that charges do not create a form of discrimination by failing to acknowledge potential barriers amongst customer demographics and characteristics including levels of financial and non-financial literacy, access to digital technologies, and so on.

There will be some overheads associated with the design and implementation of charging trials. To avoid charging trials becoming unaffordable by design, we propose that all overheads are distributed in line with current charging practices (rather than allocated to specific tariffs).

It is unnecessarily restrictive to require all proposed trials to be published annually. We propose creating a framework that allows for a more agile and adaptive implementation of trials that still adhere to the principles and ensure appropriate compliance. Smaller limited size and time-bound trials may help understand and answer fundamental questions on efficacy, customer acceptability, in ways that are more palatable to customers.

It may not be possible to determine if a trial has been a success until it has been embedded for a longer period and the new and different charging scheme becomes an accepted norm. It is important that the rules allow for trials to continue where there is insufficient evidence to form a view as to whether it has been successful or not and it shows promise. This may be necessary when assessing long-term behavioural change.

It may also be necessary to terminate trials earlier than otherwise intended. The rules should enable this to be possible where there are unintended consequences that would unfairly penalise customers for remaining on a trial for a longer period of time. This should also be the case where a tariff trial is clearly unaffordable or unacceptable to customers. There may also be scenarios where it is necessary to amend the scope or detail of a charging trials within a 12-month period. It is important that there are no regulatory barriers to this (such as rules around charges schemes).

In certain circumstances, there may be a need to focus on the impact of a charging scheme on an individual principle and to test its effectiveness before synthesising the learning into a broader charging option.

I hope our response is helpful. If you have any questions, then please do get in touch.

Yours sincerely,

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