B.8 Tariffs and Revenue Projections

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Executive Summary

Revenue forecasts

- Our revenue forecasts for tariff basket charges are based on our current tariff structure and the levels of switching assumed in our Water Resources Management Plan and those of our inset water companies.

- In accordance with the above, our revenue forecasts for tariff basket charges do not reflect the high-level tariff and charging strategy that is outlined in the Commentary. Further analysis and consultation with customers, CCWater and Ofwat is required before this strategy is finalised.

- The revenue forecast for 2009/10 as modelled by Ofwat’s Tariff Basket Model has been aligned with our independently calculated revenue estimate for that year.

- AMP5 forecast billed water and sewage volumes align with the latest version of our Water Resources Management Plan and those of our inset water companies. These volumes have not been adjusted for any forecast impact of the current economic downturn.

- Trade effluent volumes are forecast to continue to decline year-on-year based on historic trends.

- Other non-tariff basket revenue is forecast to remain at 2009/10 forecast levels, adjusted for any exceptional items.

Tariff and charging strategy

- We propose to amend our large user water tariff and offer a banded discounted volumetric charge to non-household customers using 5 Ml/a or more from April 2010.

- We propose to lower the threshold for our sewerage large user tariff from 135 Ml/a to 100 Ml/a from April 2010.

- We have undertaken extensive analysis to understand the potential impact of our metering programme on customer bills, and will seek to put in place a range of measures aimed at mitigating this impact.

- We propose that customers metered under our universal metering programme are offered the opportunity to remain on unmetered charges for up to 12 months following the installation of their meter, to give them the opportunity to understand and, where appropriate, adjust their consumption.

- We would like to discuss with Ofwat the opportunity to “return” to households who lose as a result of the switch to metered charges the “additional” income that is generated by the programme via the tariff basket model arithmetic.

- During this 12 month period, customers would be provided with data on their consumption and indicative metered charges.

- We are minded to implement a rising block tariff, with additional volume allowances in the first block for large families.

- We will put in place a social tariff, with eligibility based on the receipt of defined means-tested benefits/allowances.

- In the longer term, we see a seasonal tariff as offering the optimum solution from a demand management perspective and from the perspective of mitigating bill impacts for large families.

- We will work with customers, CCWater and Ofwat in the development of our tariff and charging strategy.
B.8.1 General

In accordance with the Guidance:

- An explanation of the impact that our overall AMP5 strategy will have on customers’ bills is included in the commentary to Part A;

- An explanation of our metering policy is included in the commentary to Part B5 (B.5.2.3).

The content of this commentary is therefore confined to our tariff and charging strategy and forecasts of non-tariff basket revenue streams.

Before discussing our tariff and charging strategy, the following points should be noted regarding our Final Business Plan revenue forecasts:

- Our revenue forecasts for tariff basket charges are based on our current tariff structure and the levels of switching assumed in our Water Resources Management Plan and those of our inset water companies.

- In accordance with the above, our revenue forecasts for tariff basket charges do not reflect the high-level tariff and charging strategy that is outlined in the Commentary.

- Our revenue forecasts for non-tariff basket water and sewerage revenues assume implementation of our new Large User tariff with effect from April 2010.

- Other non-tariff basket revenue is forecast to remain at the levels forecast for 2009/10, adjusted for any exceptional items.

- The revenue forecast for 2009/10 as modelled by Ofwat's Tariff Basket Model has been aligned with our independently calculated revenue estimate for that year.

- AMP5 forecast billed water and sewage volumes align with the latest version of our Water Resources Management Plan and those of our inset water companies. These volumes have not been adjusted for any forecast impact of the current economic downturn.
B.8.2 Tariff and Charging Strategy

In section B.8.2 we discuss our tariff and charging strategy for:

- tariff basket charges,
- non-tariff basket charges for water, sewerage and trade effluent, and
- surface water drainage charges.

B.8.2.1 Tariff Basket Charges

Principles and Objectives

In their report “Ofwat’s future strategy for customer charges for water and sewerage services: consultation conclusions”, Ofwat stated that the final charging principles they will adopt are that water and sewerage charges should:

- be fair and equitable;
- be as easy as possible for customers to pay;
- provide incentives to customers and companies; and
- be simple and transparent.

We broadly support Ofwat's charging principles as stated in their consultation conclusions. However, we are also mindful of the potential distributional and affordability impacts of our AMP5 metering strategy. We are therefore pleased to note that Ofwat went on to say in their consultation conclusion that they now proposed to carry out more work on a number of key areas that were identified in the original paper and during the consultation, including:

- social tariffs;
- the impact of changing levels of metering; and
- debt management conclusion.

In developing our tariff strategy for AMP5, our objectives are to put in place a tariff structure that will:

- broadly meet Ofwat’s charging principles;
- support our metering strategy in reducing per capita consumption;
- mitigate the impact of the switch to metered charging for those customers who are most vulnerable to an increase in the level of their charges.

In preparing our Final Business Plan, we have undertaken work to understand the potential impacts of our AMP5 metering strategy and to investigate tools that could assist in meeting the objectives set out above. The tools investigated are:

- alternative tariff options;
- social tariffs;
- phasing of bill increases;
- customer payment options and cash/debt collection methods.

These tools are discussed below, together with our response to the Walker review call for evidence.

Tariff Modelling

We have employed the services of ICS Consulting Limited to model the impact of our AMP5 metering programme on customer bills, including the modelling of a range of tariff scenarios.
The commentary in this section comprises a précis of, and extracts from, a report produced by ICS Consulting for us at the conclusion of their modelling work. All monetary values quoted in this section are at 2007/08 prices. It should be noted that the modelling undertaken by ICS Consulting did not use the same data set as our Final Business Plan submission. The modelling results should therefore be viewed as being indicative. We intend to continue to refine this modelling prior to commencement of the metering programme in 2010.

The modelling was based on an assumption of zero K’s in AMP5 in order to provide a clear picture of the impact of our metering strategy on customer bills and affordability.

Initially, a baseline position was established, based on current tariff structures and assuming growth in metered households limited to new properties and meter optants.

Next, the impact of our metering strategy was modelled based on current tariffs. The table below summarises the headline results against the baseline position:

**Table B.8.1 - Impact of AMP5 metering programme with current tariffs**

<table>
<thead>
<tr>
<th>Category of Impact</th>
<th>With K5 Metering</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of total households with lower bills</td>
<td>17.0%</td>
</tr>
<tr>
<td>% of gains &gt; £60 per year</td>
<td>10.2%</td>
</tr>
<tr>
<td>% of gains &gt; £40 per year</td>
<td>1.4%</td>
</tr>
<tr>
<td>% of gains &gt; £20 per year</td>
<td>2.9%</td>
</tr>
<tr>
<td>% of gains : £5 - £20 per year</td>
<td>2.4%</td>
</tr>
<tr>
<td>% of total households with higher bills</td>
<td>18.3%</td>
</tr>
<tr>
<td>% of losses &gt; £60 per year</td>
<td>10.4%</td>
</tr>
<tr>
<td>% of losses &gt; £40 per year</td>
<td>2.6%</td>
</tr>
<tr>
<td>% of losses &gt; £20 per year</td>
<td>2.5%</td>
</tr>
<tr>
<td>% of losses : £5 - £20 per year</td>
<td>2.7%</td>
</tr>
<tr>
<td>% of total households with bill changes</td>
<td>64.7%</td>
</tr>
<tr>
<td>in range +/-£5 per annum</td>
<td></td>
</tr>
</tbody>
</table>

From the above table it can be seen that by 2014/15:

- 64.7% of households would only experience a nominal change in their bills (+/- £5 per annum).
- 17% of households would experience lower bills by £5 or more.
- 18.3% of households would experience higher bills of £5 or more.
- 10.4% of the 18.3% of household with higher bills would experience significant increases (more than £60 per annum)

The modelling also suggested that:

- The smallest bill changes (an increase of about £2 on average) are experienced by the households already metered before April 2010.
Of the households metered under the AMP5 strategy:

- 30% would experience lower bills of £73 per annum on average by 2014/15, and
- 70% would experience higher bills of £41 per annum on average by 2014/15, although for 55% of this group the increase would be less than £5.

Note that the metering programme, as a result of the tariff basket model arithmetic, generates additional revenue over the course of AMP5 with K factors of zero. The modelling suggests that in 2014/15, revenue from household customers will have increased by £4.5million. This additional forecast revenue will offset the need for prices increases through higher K factors.

Having modelled the impact of our metering strategy based on current tariffs, the next step was to model the impact with alternative metered tariffs to understand the extent to which they could change bill impacts. The alternative tariffs modelled were:

- Rising block tariff with fixed blocks
- Rising block tariff with extra allowances for large families
- Seasonal tariff
- Current metered tariff with 25% discount for households in receipt of defined state benefits
- Current metered tariff with 50% discount for households in receipt of defined state benefits

The table below illustrates the bill impacts experienced by households metered under the AMP5 metering strategy compared to the baseline position.
From the above it can be concluded that the rising block tariff options are associated with fewer households experiencing lower bills. Moving towards universal metering means that higher use households become included in the metered household base, and the modelled rising block options indicate that these households would pay more compared to current tariffs. As expected, it is households with lower water use that would tend to benefit from a rising block structure.

The seasonal tariff option and targeted discount options result in fewer gainers than the rising block options.

The alternative tariff options do impact on the size of the average gains and losses. See the figure below.
Figure B.8.2 - Comparing average bill changes by tariff option

Although the rising block options benefit more households, the average bill increase exceeds the average bill reduction.

Whilst the seasonal option and targeted discount options benefit fewer households compared to the rising block options, they result in the average gain exceeding the average loss, and they also result in higher average gains and lower average losses.

The average gains and losses tend to mask the specific household impacts of targeted options like the rising block with additional allowances and the targeted bill discounts. The modelling of alternative tariffs therefore also included a study of the potential bill impacts for specific household groups. Headline results of this study are set out below.

- **Single pensioner and other pensioner households:**
  - Pensioner households generally benefit from the AMP5 metering programme.
  - Under the rising block tariff options, more pensioners gain and fewer lose as they tend to be lower use households.
  - Pensioner households are not generally captured by the targeted discount options.

- **Single parent families:**
  - The number of gainers in the single parent family group increase slightly with the rising block options, and the additional allowances for 3 or more children would also provide some benefit for this group.
- Single parent families would benefit in particular from the targeted discount options.

- **Families with three or more children:**
  - Families with three or more children benefit from the targeted discount options, with notable increases in the size of average bill reductions.
  - Overall numbers of gainers are outweighed by overall numbers of losers and average losses remain the highest of all household groups.
  - Therefore it could be said that alternative tariff options do relatively little to mitigate the negative impacts of AMP5 metering for this group of households.
  - The policy of additional allowances for 3 or more children is, as anticipated, most effective for this group.
  - However average losses continue to dominate average gains under this option.

- **Bottom income decile households:**
  - The number of gainers increases and the number of losers decreases for bottom income decile households under the rising block options.
  - This is suggestive of a relatively higher proportion of low use households in the bottom decile, confirming that the AMP5 metering programme will benefit a significant number of low income households.

Finally, the modelling of alternative tariffs compared each option in terms of its impact on the affordability measure (defined as households who would pay more than 3% of disposable household income on their water and sewerage bills). This is illustrated in the table below.
Table B.8.2 - Impact of tariff options on affordability measure

<table>
<thead>
<tr>
<th>% of households spending more than 3% of income on water bills in 2014-15</th>
<th>Current tariffs</th>
<th>Rising Block - Fixed</th>
<th>Rising Block - Variable</th>
<th>Seasonal</th>
<th>25% Discount</th>
<th>50% Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Households</td>
<td>9.9%</td>
<td>10.6%</td>
<td>10.5%</td>
<td>9.9%</td>
<td>8.6%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Top Decile</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>9th Decile</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>8th Decile</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>7th Decile</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>6th Decile</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>5th Decile</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>4th Decile</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>3rd Decile</td>
<td>10.9%</td>
<td>17%</td>
<td>17%</td>
<td>11%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>2nd Decile</td>
<td>31.1%</td>
<td>31%</td>
<td>31%</td>
<td>31%</td>
<td>20%</td>
<td>18%</td>
</tr>
<tr>
<td>Bottom Decile</td>
<td>67.6%</td>
<td>68%</td>
<td>68%</td>
<td>68%</td>
<td>67%</td>
<td>62%</td>
</tr>
</tbody>
</table>

From the above table it can be noted that the overall proportion of households meeting the affordability criteria increases with the rising block options.

The most effective options overall are the targeted discount tariff options. While the bottom decile group does benefit, the largest improvements in affordability are in the 2nd and 3rd decile groups. This reflects the fact that a larger proportion of these groups will be closer to the 3% of income threshold (compared to bottom decile households) and the 25% and 50% discounts correspondingly have a larger impact on the number of households exceeding the 3% threshold.

In our response to the Walker review call for evidence we have stated that we see no obvious reason why the threshold for fuel poverty is set at 10%, yet an equivalent figure of 3% is often suggested for water. A figure of 5% for water services and 5% for sewerage services would provide equivalence with the fuel poverty definition which properly recognises that water and sewerage services remain for most customers, exceptionally good value compared with other network utilities.

In conclusion, the tariffs modelling undertaken by ICS Consulting illustrates that:

- Overall, the majority (65%) of households will experience only small (less than £5 year) gains or losses as a consequence of the AMP5 metering programme. This covers those households metered before AMP5 as well as those metered under the AMP5 strategy.

- 17% of households will experience a gain of £5 or more as a consequence of the programme.

- For those households who will experience a change to metered charging, there is evidence that the AMP5 metering programme will be beneficial to a significant proportion of pensioner and low income households.

- The analysis of alternative tariffs confirms that no single tariff policy can be expected to address all issues around affordability. Different tariff policies will
create positive impacts for some groups and negative impacts for other groups. Reconciling these differing impacts will require the use of a combination of tariff measures to meet the different objectives of our tariff policy.

- While 18% of households who become metered in AMP5 will experience bill increase above £5, the evidence that we would recover more revenue as a result of the programme offers scope to develop policies that would mitigate these negative bill and affordability impacts. This is discussed in the section “Phasing of bill increases” below.

**Social Tariffs**

As stated in the conclusion to section B.8.2.1.2 above, the analysis of alternative tariffs confirms that no single tariff policy can be expected to address all the issues around affordability arising from our AMP5 metering programme.

Alongside our work with ICS Consulting, we employed the services of SECOR Consultants Limited to undertake a scoping study on how a social tariff may help those of our customers most vulnerable to the imposition of measured charges.

SECOR worked with Wessex Water on the successful development and implementation of the Wessex Water Assist tariff. We asked SECOR to investigate how we might develop and implement a social tariff tailored to our circumstances, using the Wessex Water model.

The Wessex Water Assist tariff was implemented in April 2007, meaning that SECOR’s study on our behalf was able to draw on Wessex Water's experience over the 20 months since implementation.

Based on SECOR’s findings, a high level overview of how the social tariff might operate is provided below:

- We set a number of new charges, representing a range of discounts compared to the standard charge.
- Customers on defined means-tested state benefits are eligible for the tariff.
- The amount that a customer can afford to pay towards their water and sewerage charges is independently assessed by caring agencies such as the Citizens Advice Bureaux and approved debt agencies.
- Based on this independent assessment, we decide whether to place the customer on the social tariff, and determine the level of charge they should pay.
- The customer’s placement on the annual tariff is subject to annual review.

As supported by the experience of Wessex Water, the potential benefits of such a social tariff are summarised below:

- “New” cash generated - Increased cash would be collected from customers placed on the tariff, which would exceed the additional costs incurred in administering the social tariff.
- Reduction in bad and doubtful debts - Whilst the social tariff would create an income deficit equal to the bill reduction for each approved customer joining scheme, this would be offset by a reduction in bad and doubtful debts.
- Reduction in existing cross-subsidy – Customer bills contain an element of cross-subsidy relating to the costs we incur in connection with bad and doubtful debts.
debts. The extent of this cross-subsidy could be reduced as a result of the “new” cash generated by the social tariff.

- **Assisting customers** – The social tariff would assist customers who want to pay but are struggling with debt. It aims to get them back into the habit of making regular payments and reduce their debt by providing them with a payment plan that is affordable and sustainable. The independent financial assessment means that help is given to customers to manage all their debts, ensuring their whole financial situation is reviewed.

Overall, the tariff is expected to be self-financing. The costs and income reductions are more than offset by the new income generated from previous non-payers. Therefore there is no impact on other customers. We note this is consistent with research carried out by CCW, which concluded that customers in general did not support social tariffs where their own bills would rise as a result.

### Phasing of bill increases

As stated in section B.8.2.1.1, we are conscious of the potential distributional and affordability impacts of our AMP5 metering strategy. In conjunction with ICS Consulting, we have therefore considered ways in which we could phase in bill increases. These are aimed at providing customers with an opportunity to understand the amount of water they use and their potential metered charges, and also allowing them an opportunity to modify the way in which they use water and in turn reduce their charges.

The ICS Consulting modelling suggests that, due to the characteristics of households to be metered under the AMP5 strategy and the workings of the Tariff Basket Model, our tariff basket revenues would rise by *circa* £30 million over the course of the five year period. This conclusion is supported by the outputs of the Tariff Basket Model for our Final Business Plan.

In the normal course of events, this “additional” revenue would serve to reduce the gap between the revenue requirement and the revenue forecast, and would therefore have the impact of lowering *K*s.

As stated in section B.8.1 above, our revenue forecasts for tariff basket charges do not reflect the tariff and charging strategy that is proposed in the Commentary. However, we believe that the “additional” revenue generated by our universal metering programme presents us with a potential opportunity to mitigate the bill increases that will be experienced by 50% of the households due to be metered. In effect, we have identified a potential mechanism for us to “return” to households who lose under the policy the additional income that we would otherwise gain. We would like to explore this potential opportunity further with Ofwat.

The bill phasing options that we have considered are discussed below.

- Remaining on unmetered charge for 12 months after the meter installation, or
- New metered bill capped at the level of the current unmetered charge

It would be reasonable to expect that these options would be exercised by those unmetered households who would lose with metered charges. These options could be made available for each charging year in the AMP5 period. This type of approach would have the benefit of being most directly targeted at households who would otherwise be worse off. An additional advantage of these options is that they provide customers with a period of time following their meter installation to understand their water usage. This in turn allows them to take steps to modify their usage in order to reduce their future metered charges.

- “Free” water allowances

An alternative mechanism would be through the use of “free” water allowances, perhaps as part of a modified rising block tariff structure. Over time, these free allowances could
be reduced in size as households adjust to metered charging. In effect this approach would provide another way of capping the level of metered bills for newly metered households. The risk with this approach is that it would not be as well targeted at households experiencing significant bill increases.

- Targeted differential levels of bill discount

A final variant would be to target differential levels of bill discount at different groups of newly metered households according to the size of their loss. Certain groups, particularly high use households, would benefit most from this targeted approach. This approach would be more targeted than the free water allowance approach and less reliant on households choosing the option to cap their new metered charges. Since it would be more interventionist on our part, it is likely this approach would be more administratively demanding and costly. Systems for monitoring eligibility for the targeted discounts would need to be established and maintained.

Customer payment options and cash/debt collection methods

We recognise that debt collection, especially given the current economic climate and the constraints imposed by prevailing legislation, is a key challenge for the water industry. Against this background, we understand the importance of offering payments options that are free, accessible and flexible, together with ensuring that we have efficient methods of collecting cash and recovering debt. The importance of providing flexible payment options is amplified by our proposed universal metering policy.

We aim to provide a range of payment options that:

- provide customers with a choice of where and how they pay their water and sewerage charges;
- provide customers with a choice of instalment frequencies (weekly, fortnightly, monthly, half-yearly);
- where possible are free of charge to the customer at the point of use;
- provide additional assistance to those customers that are least able to pay our charges.

Payment can be made by the following methods:

- Direct Debit – Available for annual, twice-yearly and monthly payments.
- Debit and credit cards – Payment can be made online via our website or via our 24-hour automated telephone service.
- PayPoint – Cash payments can be made at any shop with a PayPoint terminal.
- At a bank or post office – The service is free of charge if paid at the post office or at a branch of the National Westminster Bank.
- Home or telephone banking
- By post

For those customers that are least able to pay our charges we provide additional assistance in the following ways:
• **Water Direct** – Customers may ask us to apply on their behalf to the Department for Work and Pensions for payments to be made directly from certain benefits or credits under the Water Direct scheme.

• **Trust Fund** – Our Trust Fund is managed by Auriga. We provide direct funding of £1 million per annum, and have three employees seconded to Auriga to assist with administration of the scheme. Customer applications for assistance are processed independently and objectively by Auriga, and where grants are awarded to customers we are then responsible for ensuring that the customer maintains their payment plan. Auriga also use our funding to provide support grants to local debt advice organisations.

• **NewStart** - The NewStart scheme is a money matching scheme, with historic debt being written off provided that customers continue to pay current charges. Typically, the scheme targets customers who have been unsuccessful in their application for a Trust Fund grant, and customers referred by our doorstep collection agents and local debt advice organisations.

Our methods of recovering unpaid charges are tailored according to the characteristics of the debtor and the debt.

For non-household customers we use:

• Targeted and early outbound calling for debt

• The deterrent of disconnection for customers in our water supply area

• Litigation for the recovery of debt where we are unable to withdraw our services

For household customers we use:

• **Third-party socio-economic data** - To assess customer ability to pay and determine optimum collection strategies for specific customer types.

• **Litigation for home owners** - With the impact of the perceived threat of a charging order acting as a rehabilitation tool.

• **Our internal debt collection agency** - To collect debt upstream and ahead of referral to external collection agencies; targeted mainly at customers who have a good payment history and are assessed as having a reasonable ability to pay.

• **External debt collection agencies** – Targeted mainly at those customers who are regarded as having a lower ability to pay.

• **Doorstep Collection** – Used where all other methods of collection have been exhausted.

Given the increasingly challenging conditions under which we are operating, we are constantly seeking to enhance our customer payment methods and strategies for cash collection and debt recovery. The following is a list of initiatives that have been put in place recently or are currently under consideration:

• **WaterSure** – We are looking to enhance our customer literature and website in order to increase awareness of the WaterSure tariff amongst the segment of our customer base that may potentially qualify for assistance.
• **Water Direct** – We are looking to develop our relationship with the Department of Work and Pensions, and are seeking to be more pro-active in making referrals, in order to increase the number of customers paying by this method.

• **NewStart** – We are looking at how this scheme can be effectively targeted at a wider customer base. We also see this scheme working very effectively when offered with a Social Tariff, providing customers with additional incentives to maintain payments under a social tariff.

• **Water efficiency advice** – We are looking at the most effective ways in which to provide customers metered under our AMP5 metering strategy with water efficiency advice, in order to help them manage their water usage and control their charges.

• **Enforced supply separation** - For non-household customers in our water supply area, we have recently introduced the deterrent of enforced separation of water supply where immediate disconnection is not possible due to a joint supply arrangement or the presence of a domestic usage element.

• **Credit framework** - With effect from April 2009, for non-household customers we will implement a credit framework to limit our exposure to financial loss and provide regular reviews of credit worthiness. The framework will also provide for pre-payment or deposit agreements, security bonds, and application of interest and administration charges for late payment.

• **Promotion of payment tools and customer support** – We have recently embarked on a structured programme of meetings with local offices of the Department of Work and Pensions, Citizens Advice Bureaux and other local debt advice organisations. This is with a view to making these organisations aware of the range of payment options and support mechanisms we offer to household customers, in order that they can inform their clients of these.

**Response to the Walker review call for evidence**

We responded to the Walker review call for evidence, and in order to provide a more comprehensive overview of our tariff and charging strategy, we provide below in summary form a note of those of our responses that are directly relevant to this discussion.

• Metering is the fairest charging system as it is the only one that reflects use and gives customers any control over the bills that they pay.

• We believe that it is right that water companies should take reasonable steps to address the worst affordability issues.

• Ultimately, however, issues of social equity must be a question for elected politicians, not private businesses or regulators.

• Any measure of water affordability or water poverty needs to start, as the fuel poverty metric does, from an assessment of necessary, rather than actual, usage.

• We see no obvious reason why the threshold for fuel poverty is set at 10%, yet an equivalent figure of 3% is often suggested for water.

• A figure of 5% for water services and 5% for sewerage services would provide equivalence with the fuel poverty definition which properly recognises that water and sewerage services remain for most customers, exceptionally good value compared with other network utilities.
• Customer knowledge that their supply cannot be disconnected is a key reason why bad debt occurs in the water industry and it is clear that bad debt has worsened considerably since the ban on disconnection and pre-payment meters.

• Pursuing outstanding revenues is resource-intensive and limits the amount of collections activity that it is cost-effective to undertake.

• We believe there is a case for amending the legislation to allow the use of flow-restricting devices/pre-payment meters for those customers who chose them as a useful means of budgeting and for those customers who can, but chose not to, pay (e.g. those that are not in ‘water poverty’, however this is defined).

• This would ensure continued protection from disconnection for customers that can't pay and extend customer choice to those who like the convenience of pre-payment.

Conclusion

In preparing our Final Business Plan, we have undertaken extensive modelling to understand the potential impact of our AMP5 metering programme, and to understand the impact of our current and alternative tariff structures and strategies on customer bills.

During AMP5 we are proposing to move all our remaining unmetered water supply customers to a metered supply. In making such an important shift we are conscious of the need to promote the benefits of universal metering to our customers, and wherever possible engender customer acceptance of this policy. We are also mindful that a proportion of our currently unmetered customer base will experience increases in their bills following the switch to metered charging. We would like to give these customers an opportunity to understand their water usage, and to moderate this usage where possible in order to control their future metered charges.

For the reasons outlined above, we therefore propose to offer customers metered under our universal metering programme the opportunity to remain on unmetered charges for up to 12 month following the installation of their meter. Under this proposal, during this 12 month period customers would be provided with data on their consumption and indicative metered charges. As stated in section B.8.2.1.4 above, we would like to discuss with Ofwat the opportunity to “return” to households who lose as a result of the switch to metered charges the “additional” income that is generated by the programme.

Our tariff modelling suggests that, with universal metering and our current tariff structure, 82% of households would either experience no significant change in their bills or would experience lower bills. The remaining 18% of households would experience an increase in bills of £5 per annum or more.

Further, the modelling suggests the programme would be beneficial to a significant proportion of pensioner and low income households.

The modelling of alternative tariffs indicates that a rising block option would result in more households experiencing lower bills and less experiencing higher bills compared to current tariffs.

We see a seasonal tariff as potentially offering the optimum solution, both from a demand management perspective and from the perspective of mitigating bill impacts for household groups such as large families who stand to face the biggest bill increases. However, in order to be in a position to introduce a seasonal tariff we would need to enhance key IT systems and replace the existing stock of “dumb” meters with meters with AMR technology. Our modelling has suggested that this is not a cost-effective option at this point in time. For these reasons we see a seasonal tariff as a longer term aspiration.
In the short term, based on the results of our modelling, we are minded to implement a rising block tariff, with additional volume allowances in the first block for large families. Such a tariff would meet our dual objectives of targeting a reduction in per capita consumption, and mitigating the impact of the switch to metered charges for households using higher volumes of water. However, before making a final decision we need to refine our impact modelling and carry out further consultation with our customers, CCWater and Ofwat.

We recognise that no single tariff can address all the issues around affordability. Given the success of the Wessex Water Assist tariff, we will therefore develop our own social tariff to assist those households most vulnerable to an increase in their charges. The tariff structure and operation will be along similar lines to the Wessex Water model, with eligibility based on the receipt of defined means-tested benefits/allowances. We believe that on a relatively small scale such a tariff would be self-financing. However, if we were to extend the tariff to a wider group of customers we would wish to discuss the issue of tariff rebalancing with Ofwat.

In further developing our AMP5 tariff and charging strategy, we will work closely with CCWater and Ofwat.

B.8.2.2 Non-Tariff Basket Charges

In section B.8.2.2 we discuss non-tariff basket charges for water, sewerage and trade effluent.

Water Large User Tariff

Currently, the threshold for our water large user tariff is set at 100 Ml/a and comprises a single discounted volumetric rate, together with a fixed annual charge.

Our cost modelling work, using a model designed for us by NERA, supports a banded large user tariff commencing at 5 Ml/a. This reflects the lower costs imposed by these customers as a result of:

- Their non-use of significant parts of the local distribution network, and
- Less pronounced seasonal peaks for the very largest customers.

We are planning to amend our water large user tariff accordingly, with implementation in April 2010. We have assumed that there will be no impact on the volume of water supplied to customers using 5 Ml/a or more as a result of implementing the amended tariff.

In accordance with our exchange of correspondence in early December 2008 and our report accompanying our Principal Statement submission on 22nd December 2008, the reduction in non-tariff basket revenue arising from the implementation of the amended tariff structure will be rebalanced in the price setting process.

For the Final Business Plan, we have modelled the forecast revenue impact of the amended tariff via the “% of household unit rate” lines in Table C7.2 for the appropriate customer groups.

Sewerage Large User Tariff

Our recent cost modelling work supports lowering the threshold for our sewerage large user tariff from 135 Ml/a to 100 Ml/a. The difference in the threshold between water and sewerage large user tariffs reflects the different nature of the water and sewerage networks, and the use of a greater proportion of the sewerage network by large sewerage customers.

Again, we are planning to implement this change in April 2010.
For the Final Business Plan, we have modelled the forecast revenue impact of the amended tariff via the “% of household unit rate” line in Table C7.5 for the appropriate customer group.

Unmetered Tariffs

Our Final Business Plan assumes that our current charging structure for trade effluent customers, based on the Mogden formula, will continue during AMP5. However, we will be reducing our trade effluent large user tariff threshold in line with the sewerage large user tariff.

As discussed with Ofwat in May 2008, we have concerns about the future validity of the Mogden formula as a fair and representative basis of charge for trade effluent, and will be keeping an open mind on potential alternatives.

Revenue for 2008/09 has been aligned with our 2008/09 outturn forecast. For 2009/10 to 2014/15, the number of trade effluent customers and the volume of trade effluent have both been forecast to decline by 5% year on year. This forecast is supported by actual data for the previous six years, which is set out in the table below which points to trade effluent being a declining revenue stream for us.

<table>
<thead>
<tr>
<th>Year</th>
<th>Customer Count</th>
<th>Year-On-Year Change</th>
<th>Volume m3</th>
<th>Year-On-Year Change</th>
<th>Revenue @ 07/08 Prices £</th>
<th>Year-On-Year Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001/02</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002/03</td>
<td></td>
<td>(11%)</td>
<td></td>
<td>(1%)</td>
<td></td>
<td>(2%)</td>
</tr>
<tr>
<td>2003/04</td>
<td></td>
<td>(6%)</td>
<td></td>
<td>(10%)</td>
<td></td>
<td>(7%)</td>
</tr>
<tr>
<td>2004/05</td>
<td></td>
<td>(4%)</td>
<td></td>
<td>(5%)</td>
<td></td>
<td>(7%)</td>
</tr>
<tr>
<td>2005/06</td>
<td></td>
<td>(2%)</td>
<td></td>
<td>0%</td>
<td></td>
<td>1%</td>
</tr>
<tr>
<td>2006/07</td>
<td></td>
<td>(4%)</td>
<td></td>
<td>(7%)</td>
<td></td>
<td>(12%)</td>
</tr>
<tr>
<td>2007/08</td>
<td></td>
<td>(4%)</td>
<td></td>
<td>(6%)</td>
<td></td>
<td>(4%)</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td>(5%)</td>
<td></td>
<td>(5%)</td>
<td></td>
<td>(5%)</td>
</tr>
</tbody>
</table>

Please note this data has been extracted from our Trade Effluent billing system and due to the timing of the extract it may vary from data reported in the June Return and the Principal Statement historically

B.8.2.3 Surface Water Drainage Charges

Currently we charge for surface water drainage on the basis of meter size, for all measured customers, and as a flat fee for all unmetered customers.

We are aware that a number of companies use surface area as the basis of charge for this service, and we will be reviewing our position during the next regulatory period.

At the moment, it is clear that there may be some benefits from area-based charges, including increased fairness and better incentives for customers to modify their behaviour by putting in place environmentally sustainable drainage solutions, such as permeable hard surfaces or soakaways.

Against that we know that the administrative costs of implementing area-based charging are likely to be very significant. In addition, the experience of other companies has been that the switch can lead to very large changes in some customers bills, including those of sports clubs and religious institutions that may not be in a position to respond by altering their facilities.
We will carefully weigh all of these factors in the balance before making a decision on the best way forward. We will only consider a move to a surface-water based system if it is clear that the benefits of doing so outweigh the costs. Should we decide to make a switch, then we will want to take advantage of Ofwat’s commitment to allow phasing in of new charges over a number of years to protect customers from unexpected large increases in their bills.

B.8.3 Economic Downturn

As explained in the Commentary to Part C7 (Tariffs and revenue forecast supporting information, Part C7.1 Lines 20 and 21 and Table C7.4 Lines 11 and 12), for the K setting process for this Periodic Review it is vital that the Tariff Basket Model holds an accurate revenue forecast for 2009/10.

By means of the inputs to Tables C7.1 and C7.4, we have ensured that the Final Business Plan revenue forecast for 2009/10 as modelled by the Tariff Basket Model reflects our independently calculated revenue forecast for that year.

The current economic downturn is likely to continue to have an adverse impact on the volumes of water consumed by our customers in AMP5, which in turn will adversely impact on water and sewerage revenues from household and non-household customers in that period.

However, for the Final Business Plan the forecast billed water and sewage volumes (Tables B5.1 and B5.4) have been aligned with the forecasts and assumptions in the latest version of our Water Resources Management Plan and those of our inset water companies, and therefore contain no adjustment for any forecast impact of the current economic downturn.

Our understanding is that under the new Revenue Correction Mechanism, we will be compensated in AMP6 for any shortfall in revenue experienced in AMP5. Similarly, any over-recovery will be returned to customers. We would like to explore further with Ofwat the implications for the Revenue Correction Mechanism of the introduction of innovative tariffs during AMP5.

B.8.4 Other Non-Tariff Basket Revenue Streams

In section B.8.4 we discuss forecasts of other non-tariff basket revenue streams.

B.8.4.1 Water

Rechargeable Works (Ofwat Table B8 Line 10)

This revenue stream includes revenue:

- Associated with Section 421 deficits;
- From the hire of standpipes;
- From surveying and conveyancing; and
- From other network development activities.

For the Final Business Plan we have aligned 2008/09 and 2009/10 revenue with our internal forecasts. For 2010/11 to 2014/15 we have shown revenue remaining at 2009/10 levels.

Bulk Supplies (Ofwat Table B8 Line 11)

This revenue stream comprises seven bulk supply export arrangements to local water companies:
1. **Weir Wood, South East Water**: The revenue received is proportional to the running costs and any maintenance requirements. Revenue in 2007/08, and forecast revenue in 2008/09 and 2009/10, is exceptionally high due to an AMP4 refurbishment scheme increasing the amount paid by South East Water in these years. With no capital investment planned for AMP5, it has been assumed that revenue for 2010/11 to 2014/15 will return to historic levels;

2. **Walderslade, South East Water**: Water is supplied at a single unit volumetric rate. Revenue for 2008/09 and 2009/10 has been aligned with our internal forecasts. It has been assumed that revenue for 2010/11 to 2014/15 will remain at 2009/10 levels;

3. **Faberstown, Wessex Water**: Water is supplied at our standard metered tariff. Revenue for 2008/09 has been aligned with our forecast outturn, and revenue for 2009/10 has been forecast based on the average volume supplied over the last five years. It has been assumed that revenue for 2010/11 to 2014/15 will remain at 2009/10 levels;

4. **Belmont, South East Water**: The revenue received is proportional to the running costs. Revenue for 2008/09 and 2009/10 has been aligned with our internal forecasts. With no capital investment planned for AMP5, it has been assumed that revenue for 2010/11 to 2014/15 will remain at 2009/10 levels;

5. **Deal High, Folkestone & Dover**: Water is supplied between September and December each year at a single unit volumetric rate. Revenue for 2007/08 was atypical as Folkestone & Dover were permitted to continue using water from this source after December 2007 to compensate for the later delivery of one of its schemes. Revenue for 2008/09 and 2009/10 has been aligned with our internal forecasts. It has been assumed that revenue for 2010/11 to 2014/15 will remain at 2009/10 levels;

6. **Burham, South East Water**: The revenue received is proportional to the running costs. Revenue for 2008/09 and 2009/10 has been aligned with our internal forecasts. With no capital investment planned for AMP5, it has been assumed that revenue for 2010/11 to 2014/15 will remain at 2009/10 levels; and

7. **Darwell, South East Water**: The revenue received comprises a capital charge and a single unit volumetric rate. Revenue for 2007/08 was atypical as it included back-billing of the capital charge, and the volume taken by South East Water was significantly in excess of the 1 Ml/d upon which the agreement is based. Revenue for 2008/09 and 2009/10 has been aligned with our internal forecasts. It has been assumed that revenue for 2010/11 to 2014/15 will remain at 2009/10 levels.

In 2008/09 and 2009/10 there will be exceptional revenue for a bulk supply to CB&I. This supply is for hydro testing purposes in connection with new gas cylinders for the Isle of Grain terminal expansion project.

We have shared with South East Water, our revenue forecasts for 2008/09 to 2014/15 for the five exports to it.

**Other Appointed Business (Ofwat Table B8 Line 12)**

This stream comprises revenue from making connections to our water mains.

For the Final Business Plan we have aligned 2008/09 and 2009/10 revenue with our internal forecasts. For 2010/11 to 2014/15 we have shown revenue remaining at 2009/10 levels.

**Other Sources (Ofwat Table B8 Line 15)**
This stream comprises revenue from chargeable supply pipe repairs and replacement and other water efficiency activities.

For the Final Business Plan we have aligned 2008/09 and 2009/10 revenue with our internal forecasts. For 2010/11 to 2014/15 we have shown revenue remaining at 2009/10 levels.

**B.8.4.2 Sewerage**

**Rechargeable Works (Ofwat Table B8 Line 25)**

This revenue stream includes revenue:

- Associated with Section 98\(^1\) deficits;
- From surveying and conveyancing; and
- From other network development activities.

For the Final Business Plan we have aligned 2008/09 and 2009/10 revenue with our internal forecasts. A large scheme ends in 2008/09, resulting in a fall in forecast revenue for 2009/10. For 2010/11 to 2014/15 we have shown revenue remaining at 2009/10 levels.

**Other Sources (Ofwat Table B8 Line 29)**

This revenue stream mainly comprises revenue from the reception and disposal of cesspool and septic tank contents. It also includes revenue from the sale of sludge cake and granules.

For the Final Business Plan we have aligned 2008/09 and 2009/10 revenue with our internal forecasts. For 2010/11 to 2014/15 we have shown revenue remaining at 2009/10 levels.

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\(^{1}\) Under the Water Industry Act 1991 a sewerage undertaker has a statutory duty to comply with requisitions for water mains and sewers. Under our accounting policies, capital contributions from developers are taken to the Balance Sheet and released to the Profit and Loss account over a 12 year period. The amounts included here are these annuitised sums. It is not therefore meaningful to make any comparison between these sums and new development capital expenditure in any one year.