

Company Social Tariffs: Consultation on guidance to water and sewerage undertakers and the Water Services Regulation Authority under Section 44 of the Flood and Water Management Act 2010

October 2011

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This document/publication is also available on our website at: www.defra.gov.uk/consult/2011/10/26/social-tariffs/

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Purpose of this consultation

Introduction and background

1. Section 44 of the Flood and Water Management Act 2010 enables water and sewerage undertakers in England and Wales to include social tariffs in their charges schemes. It enables undertakers to reduce charges for individuals who would otherwise have difficulty paying their bill in full. It explicitly allows for cross-subsidy between individuals.
2. Section 44 requires the Secretary of State to issue guidance to undertakers which operate wholly or mainly in England and to the Water Services Regulation Authority (Ofwat). Both undertakers and Ofwat are required to have regard to this guidance. Welsh Ministers have identical powers to issue guidance to undertakers which operate wholly or mainly in Wales and to Ofwat.
3. This consultation invites views on the Secretary of State's draft guidance to undertakers which operate wholly or mainly in England. Its purpose is to provide a framework within which undertakers can bring forward company social tariffs under Section 44 to assist households who would otherwise struggle to pay their bills. This assistance should complement other measures that undertakers use to tackle water affordability problems.
4. The consultation is aimed at water only companies and water and sewerage companies that operate wholly or mainly in England, any companies considering market entry, groups and organisations representing vulnerable and low income individuals, household and non-household customers.
5. A list of the organisations that have been approached directly for views accompanies this consultation document and is available alongside this consultation document at the Defra web site www.defra.gov.uk/consult/2011/10/26/social-tariffs/. However, we welcome views from any interested party and individual.

How to contribute

6. We welcome comments on any aspect of this draft guidance in relation to how company social tariffs can be introduced and operated successfully and fairly. However, there are a number of specific issues on which we invite comment:
 - (i) arrangements for bringing forward company social tariffs;
 - (ii) how to ensure that customers' views are taken account of;
 - (iii) which households should benefit;
 - (iv) what concession to offer; and

- (v) what level of cross-subsidy is acceptable.

7. An assessment of the impact of company social tariffs was included in the Impact Assessment for the Flood and Water Management Act. This guidance was developed using evidence gathered from the consultation on Affordable Water: The Government's proposals following the Walker Review of Charging. We now need to consider the costs and benefits of this guidance. It is standard practice to prepare and publish an impact assessment for all new policies. We would like to use the evidence gathered through this consultation on the costs and benefits of the approach taken by this guidance to allow us to complete and publish an assessment of the impact of this guidance. Respondents should note that, as an assessment of the impact of company social tariffs themselves has already been completed, we want to gather evidence of the impact of the approach taken by this guidance. There are a number of specific issues on which we invite comment:

Questions for water companies

- (vi) Do you consider that it may be cost-beneficial to your company to include a tariff in your charges scheme?
- (vii) Do you plan to include a social tariff in your charges scheme?
- (viii) Please outline the likely costs to your company of creating a social tariff. Please only indicate costs that you would not normally incur in the course of designing a charges scheme and that are only associated with bringing forward a social tariff. Where possible, please show a breakdown of the costs.
- (ix) Please outline the likely benefits to your company of creating a social tariff.

Questions for organisations which represent water customers

- (x) Please outline any costs to your organisation imposed by the approach of this guidance.
- (xi) Please outline any benefits to your organisation or other groups from the approach set out in this guidance.

8. The closing date for written responses to this consultation is 17 January 2012. Responses should be sent to:

Consultation on Social Tariff Guidance
Water Charging and Economic Regulation Team
Defra

Department for Environment, Food and Rural Affairs

Area 2C Ergon House
Horseferry Road
London
SW1P 2AL
Email: Socialtariffs@defra.gsi.gov.uk
Telephone: 0207 238 5261

9. It would be helpful if email respondents would provide their name and/or the organisation they represent.

Confidentiality

10. In line with Defra's policy of openness, at the end of the consultation period copies of the responses we receive will be made publicly available through the Defra Information Resource Centre, Lower Ground Floor, Ergon House, 17 Smith Square, London SW1P 3JR. They may also be published in a summary of responses to this consultation.

11. **If you do not consent to this, you must clearly request that your response be treated as confidential.** Any confidentiality disclaimer generated by your IT system in email responses will not be treated as such a request. Respondents should also be aware that there may be circumstances in which Defra will be required to communicate information to third parties on request, in order to comply with its obligations under the Freedom of Information Act 2000.

12. Copies of consultation responses to personal callers or in response to telephone or email requests will be supplied by the Defra Information Resource Centre (020 7238 6575, defra.library@defra.gsi.gov.uk). Wherever possible, personal callers should give the Centre 24 hours notice of their requirements. An administrative charge will be made to cover any photocopying and postage costs.

Code of practice on written consultations

13. This consultation is being undertaken in accordance with the Better Regulation Executive guidance on written consultation as set out at: <http://www.berr.gov.uk/files/file47158.pdf>.

14. If you have any comments or complaints about the consultation process, as opposed to comments about any of the issues in this consultation paper, please address them to:

Ian Hill
Defra Consultation Co-ordinator
Area 7C, Nobel House
17 Smith Square
London SW1P 3JR

Next steps

15. All the responses received by the deadline will be analysed. We will publish the final guidance together with a summary of the responses received in time to enable companies to undertake the necessary customer engagement and impact assessment with a view to including any company social tariff in charges schemes from 2013/14 onwards.

DRAFT GUIDANCE TO WATER AND SEWERAGE UNDERTAKERS AND THE WATER SERVICES REGULATION AUTHORITY IN RELATION TO SOCIAL TARIFFS UNDER SECTION 44 OF THE FLOOD AND WATER MANAGEMENT ACT 2010

1. Introduction

1.1 Section 44 of the Flood and Water Management Act 2010 enables water and sewerage undertakers in England and Wales to include social tariffs in their charges schemes. It enables undertakers to reduce charges for individuals who would otherwise have difficulty paying their bill in full. It explicitly allows undertakers to introduce cross-subsidy between individuals.

1.2 It requires the Secretary of State to issue guidance to undertakers which operate wholly or mainly in England and to the Water Services Regulation Authority (Ofwat). Section 44 states that this guidance must, in particular, include factors to be taken into account in deciding whether one group of customers should subsidise another. It also requires the Secretary of State to have regard to the need to balance the desirability of helping individuals who would have difficulty in paying in full with the interests of other customers.

1.3 This guidance meets this requirement and both undertakers and Ofwat are required to have regard to this guidance. It sets the framework within which an undertaker can bring forward a social tariff if it chooses to do so and sets out the factors that Ofwat should consider when exercising its power to approve undertakers' charges schemes. It should be read in conjunction with Ofwat's guidance to undertakers on charges schemes and the Government's guidance to Ofwat on charges schemes¹.

2. Bringing forward company social tariffs

2.1 The Government is clear that setting the policy and legislative framework for social issues, including water affordability, is its responsibility. At the same time, it is firmly of the view that undertakers are best placed to take decisions around the design of company social tariffs as part of their charges schemes so that they can take account of local circumstances, needs and the views of their customers. The Government wants to see undertakers take a more proactive role in responding to the needs of their customers and by developing and implementing local solutions to local problems.

2.2 Section 44 of the Flood and Water Management Act enables an undertaker to include a social tariff in its charges scheme. Section 44 is an enabling provision and the Government is clear that it is for undertakers to decide whether to bring forward a company social tariff. The Government's view is that social tariffs can form part of a coherent package of effectively targeted support to enable customers to pay their bills, encompassing help with metering,

¹ Current guidance is set out in: Water Industry Act 1999 – Delivering the Government's Objectives, DETR, 2000 (Product Code: 99EP0883).

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payment methods, debt advice and water efficiency. Social tariffs have the potential to deliver a wide range of benefits to undertakers and their customers, including:

- assisting low income households who would otherwise struggle to pay their bills in full;
- helping to prevent new cases of bad debt arising as a consequence of non-payment of water bills that may be unaffordable, and helping to resolve the existing problem of bad debt;
- enabling undertakers to design social tariffs that are tailored to address local affordability problems and local affordability risks;
- protecting low income households from unaffordable bills that may arise in areas with high levels of optant metering (as high levels of optant metering can create affordability problems for households that choose to remain unmetered);
- protecting low income households from unaffordable bills where an undertaker that has been designated an area of serious water stress has chosen to bring forward universal metering to help ensure a supply-demand balance; and
- reputational and financial benefits by delivering good customer service and by placing a greater focus on the needs and views of customers.

2.3 The Government expects all undertakers to consider the potential benefits from bringing forward and effectively promoting a company social tariff as part of its overall strategy for addressing water affordability and enabling customers to pay their bills. Where an undertaker chooses to include a social tariff in its charges scheme, Ofwat will ensure that the undertaker has had regard to this guidance as part of its approval of the undertaker's charges scheme.

2.4 Where an undertaker chooses to bring forward a company social tariff, it will need to consult its customers on its proposals and have regard to the responses it receives. The Government expects an undertaker's proposals for a company social tariff to have the broad support of its customer base. This includes broad support from households that will benefit from the social tariff and household and non-household customers where they will be asked to contribute to the cost.

2.5 Undertakers must also consult organisations that represent customers on proposals for a company social tariff and have regard to their views. This must include the Consumer Council for Water, which represents water and sewerage customers as a whole. An undertaker's approach to consulting its customers and its proposals should be broadly acceptable to these organisations. The Government expects undertakers that choose to bring forward company social tariffs to work closely with the Consumer Council for Water in relation to its approach to consulting with customers and its overall acceptability to customers.

2.6 Undertakers will need to have regard to all of the representations received and companies will need to demonstrate to Ofwat that this is the case. Undertakers will need to take decisions around what type of customer engagement to carry out and how best to carry this out. This will depend on an undertaker's proposals and should take account of the views of consumer representatives.

2.7 Whilst the Government is clear that any proposals must be acceptable to the generality of an undertaker's customers, it does not propose to specify thresholds of acceptability or other criteria for customer acceptance. These will need to be considered by undertakers in the design of individual company social tariffs and an undertaker's proposals for engaging customers and organisations that represent customers.

2.8 Undertakers' proposals for company social tariffs will need to be demonstrably evidence-based (including in relation to who has affordability problems or is at risk of affordability problems) and demonstrate compliance with this guidance. Proposals should also be transparent and easy to understand, both for undertakers and their customers. Proposals will need to be underpinned by an assessment of the impacts of any social tariff which will need to:

- identify which customers will benefit, the justification for assisting these customers and the concession that will be provided;
- identify which customers will provide the cross-subsidy and the magnitude of this cross-subsidy;
- explain why an undertaker is opting for a social tariff rather than other approaches (such as "win-win" tariffs designed to tackle bad debt which do not require a new cross-subsidy between customers);
- outline how the social tariff complements other measures that can tackle water affordability problems (such as payment plans to help households budget, offering or arranging debt advice for households who are struggling with their bills, advising households on whether a meter could reduce their bills and offering water efficiency support to low income metered households);
- note how the social tariff will interact with WaterSure;
- show how the undertaker proposes to communicate and promote its social tariff and to achieve its take-up by eligible households and how eligibility will be checked;
- demonstrate how the tariff will deliver a meaningful reduction in the bills of qualifying households;
- show that the bulk of the revenues raised are being used to lower the bills of qualifying households rather than on administering the tariff; and
- set out clearly the views of customers and their representative groups on the proposal and demonstrate that the proposed social tariff is broadly acceptable across the generality of customers.

2.9 The Government expects undertakers that choose to bring forward a company social tariff to liaise with customer representatives at an early stage in its design. Undertakers will need to demonstrate to Ofwat that they have had regard to this guidance. Engagement with customers will need to continue as the social tariff is implemented. The Government also expects undertakers to keep any social tariff under review, particularly in relation to its effectiveness in tackling local water affordability problems.

2.10 As part of the design of a company social tariff, undertakers should also take account of what neighbouring undertakers are considering or proposing around company social tariffs. This is particularly important to avoid confusing customers in areas of overlap between water only companies and water and sewerage companies, including in relation to taking account of customer views, the criteria for eligibility between water and sewerage customers and how the costs and benefits of a company social tariff are apportioned between water and sewerage customers.

2.11 The Government expects undertakers to keep any social tariff under review. It is for undertakers, in agreement with Ofwat, to decide how best to achieve this. The Government does not propose to require annual reporting on the performance of a social tariff although the Government would encourage undertakers to summarise and make available the results of any social tariff. Any changes to a social tariff will need to be broadly acceptable to customers and organisations that represent consumers. The Government will also keep this guidance under review.

3. Which households should benefit

3.1 The Government sees company social tariffs as an opportunity for undertakers to address local water affordability problems in light of local circumstances, needs and customer views. Social tariffs enable companies to go further than the national WaterSure tariff². Where a household is eligible for both WaterSure and a company social tariff, the Government would want to see undertakers apply the most generous reduction in bills under either scheme. Undertakers which provide a more generous reduction in bills through their social tariff for all those households eligible for WaterSure will no longer be required to make the WaterSure tariff available³.

3.2 The WaterSure tariff caps the bills of households that are metered, in receipt of qualifying means-tested benefits or tax credits and where the household either has three or more children living at home under the age of 19 or somebody in the household has a medical condition which necessitates a high essential use of water. It provides a basic safety net for qualifying households across England and Wales. Its aim is to ensure that vulnerable and low income households do not cut back on their essential use of water just because they are metered.

3.3 The Government recognises that WaterSure is tightly drawn in terms of which households benefit and that non-qualifying households can face water affordability problems. This can include unmetered households and other households who do not meet the eligibility criteria for WaterSure. Company social tariffs enable undertakers to go further and tackle local

² As prescribed through the Water Industry (Charges) (Vulnerable Groups) Regulations 1999, as amended.

³ The Government will need to amend the Water Industry (Charges) (Vulnerable Groups) Regulations 1999 to provide for this.

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water affordability problems in light of local circumstances, particularly in relation to which households have water affordability problems in their area.

3.4 The design of a social tariff will depend on a range of factors. These include the number of household customers that may be eligible for support relative to the total number of households in the undertaker's operating area, the structure and size of households in the undertaker's operating area, the proportion of households that are metered, actual water consumption, bill size and the willingness of non-qualifying households to subsidise qualifying households.

3.5 The Government's view is that these factors can only be taken account of in the design of an actual social tariff as part of an undertakers' charges scheme and that these factors will need to be considered as an integral part of an undertakers' assessment of the impacts of a social tariff. For this reason, this guidance does not propose which households should benefit under a company social tariff. Undertakers also need to consider these factors as a package (ie considering the variables such as those identified in paragraph 3.4 together) rather than deciding in isolation which households should benefit.

3.6 Options that companies may want to consider include all households in receipt of income-related means-tested benefits or tax credits, households with one or more children on a low income or in receipt of means-tested benefits, or households with an income below a particular threshold that live in properties with a low rateable value or a low council tax band. These considerations could apply both to metered and unmetered households.

3.7 An undertaker may wish to undertake individual assessments of affordability where it believes that certain households may struggle with their bill now or in the future. This could provide a means of targeting assistance more closely on specific groups or households at risk of water affordability problems. However, it may be more costly to implement.

3.8 Alternatively an undertaker may choose to use a more easily observable attribute of customers, such as being in receipt of a means-tested benefit as a passport to a company social tariff. The Government's view is that this is a decision for undertakers and that the approach taken should reflect (i) whether the scheme is effective in targeting assistance to households with water affordability problems, (ii) whether it offers value for money in terms of the balance between administration costs and efficiency of targeting those with water affordability problems and (iii) whether the scheme is acceptable to customers.

3.9 The Government's view is that any undertaker that chooses to introduce a universal metering programme across all or part of its operating area, or where metering reaches very high levels, should seriously consider including a company social tariff in its charges scheme⁴.

⁴ This is in addition to any transitional tariff or support that an undertaker brings forward as part of an area-wide roll-out of metering.

This would address long-term affordability issues that may arise from the elimination of the cross-subsidy inherent in charging for water according to the rateable value of a property. Without mitigating action there is a real risk that some households that previously found their water and sewerage bills affordable under RV-based charging will be at risk of significantly higher bills which could be unaffordable.

3.10 The Government would strongly encourage undertakers to look at opportunities for promoting greater water efficiency (for example, through water efficiency advice and the retrofitting of water efficiency devices) as an integral part of the introduction of a company social tariff. The cost of providing water efficiency advice or devices should be met by the generality of customers through the undertaker's charges scheme and not by individual households that benefit from the social tariff.

4. **What concession to offer**

4.1 The Government considers that undertakers should decide what concession to offer in any social tariff in light of local considerations and local circumstances. In deciding what concession to offer, an undertaker will need to consider a range of factors. These include the factors identified in paragraph 3.4 together with the ease of understanding and uptake for eligible customers, the level of water stress in the undertaker's operating area and the need to encourage and incentivise water efficiency. Again the proposal will need to be broadly acceptable to an undertaker's customers and groups that represent its customers.

4.2 Undertakers will also need to consider whether a concession under a company social tariff is the best means of tackling water affordability problems in their operating area. The Government recognises that the picture around water affordability is extremely complex. Factors include household types and regional differences and the scope for some households to benefit from opting for a water meter. The Government therefore expects companies to consider any proposals for a company social tariff as part of a broader strategy and package of measures to improve water affordability such as offering water efficiency advice, measures to improve the management and payment of bills and advice to households on opting for a meter to lower their bill.

4.3 The Government would expect any concession offered as part of a company social tariff to be easy to understand, both in terms of how it would work and the savings it would deliver to eligible households. The Government would also expect any concession to provide a meaningful reduction in the bills of eligible households when compared to the overall costs of administering a social tariff.

4.4 Possible concessions that undertakers might choose to offer could include a percentage discount on bills for low income households, a free or discounted block of water for low income metered households, a free or discounted block of water per child for low income metered households with children, a flat rebate or a cap on bills (although the Government would prefer

not to see a cap on bills as the preferred concession for large numbers of qualifying metered households in areas of serious water stress).

4.5 Undertakers will need to consider what concession to offer as an integral part of the design of a social tariff and its wider charges scheme. As part of this process, undertakers will need to decide whether a concession should apply to water charges only, to water and sewerage charges or across the full range of charges that an undertaker levies.

4.6 Undertakers will also need to decide whether the cost of the cross-subsidy in a social tariff is to be provided by household customers only or whether the cost is to be shared across household and non-household customers. Undertakers will also need to decide whether the cost is met by both metered and unmetered households (which will be influenced by whether both metered and unmetered households are eligible for any social tariff). These are all decisions for undertakers to take in the design of their charges schemes. Again, the views of customers and organisations that represent customers will need to be taken account of.

5. An acceptable level of cross-subsidy

5.1 The Government is clear that there is a balance to be struck between the desirability of helping households with water affordability problems and the interests of other customers who would be required to provide the cross-subsidy. This will need to be carefully considered in an undertaker's assessment of the impacts of any proposed social tariff.

5.2 The Government's view is that this balance can only be struck in the design of an actual social tariff and charges scheme, where an undertaker will need to consider a proposed level of cross-subsidy and its acceptability to customers alongside the type of, and number of, households that it proposes to assist with their bills and expected uptake.

5.3 As part of an undertaker's consultation with its customers and organisations that represent customers on the design of a social tariff, an undertaker will need to be clear what level of cross-subsidy is proposed, who will pay and what effect this will have on the bills of households that receive assistance under the social tariff. The proposed level of cross-subsidy will need to be broadly acceptable to the generality of customers (and considered as part of a package to include which households should benefit and what concession to offer).

5.4 Research undertaken by the Consumer Council for Water⁵ (CCWater) has found that customers may be willing to make some contribution through water bills to address affordability issues, providing the total amount is manageable. For most who participated in CCWater's 2010 research, this was found to be up to about £2 to help low income households from a total of no more than around £5 to help a range of customer groups.

⁵www.ccwater.org.uk/upload/doc/Cross_subsidies_and_Social_tariffs_FINAL_8_June_2010.doc

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5.5 The Government's view is that a charge of up to 1.5 per cent of the average annual household water bill across England and Wales would be a reasonable amount of cross-subsidy to expect non-qualifying households to provide under a company social tariff⁶. But undertakers will still need to justify their specific proposals and in light of evidence around their acceptability to customers. Any cross-subsidy in excess of this amount would need to be clearly justified and supported by those customers that would be providing the cross-subsidy. This cross-subsidy is in addition to that under WaterSure.

⁶ This is not a fixed monetary amount but, for illustrative purposes, would be around £5 based on the average bill level for 2011/12.

Annex A: Legal basis

Section 44 – Flood and Water Management Act 2010 – Social tariffs

- (1) An undertaker's charges scheme under section 143 of the Water Industry Act 1991 may include provision designed to reduce charges for individuals who would have difficulty paying in full.
- (2) Subsection (1) includes schemes which have the effect of subsidisation by other persons.
- (3) The Water Services Regulation Authority's powers in connection with the approval of schemes (and its other powers under the 1991 Act) are subject to subsections (1) and (2).
- (4) The Minister must issue guidance in respect of subsections (1) and (2) which must, in particular, include factors to be taken into account in deciding whether one group of customers should subsidise another; for which purpose the Minister shall have regard to the need to balance the desirability of helping individuals who would have difficulty paying in full with the interests of other customers.
- (5) Undertakers and the Authority shall have regard to any guidance issued by the Minister under subsection (4).
- (6) "The Minister" means—
 - (a) in the case of an undertaker whose area is wholly or mainly in England, the Secretary of State, and
 - (b) in the case of an undertaker whose area is wholly or mainly in Wales, the Welsh Ministers.

Annex B – Illustrative examples of a possible company social tariff

The example below sets out two examples of what a company social tariff could potentially look like based on modelling by Ofwat.

They are illustrative only to highlight the possible costs, benefits and impacts of a company social tariff. They do not form part of this guidance and should not be viewed as inferring that these approaches are the type of company social tariffs that the Government thinks undertakers should bring forward.

The examples are based on a fictional water company with “average” attributes using the Family Resources Survey. The modelling assumes:

- a company with two million households, all with the same supplier for water and sewerage (ie a mid-sized water and sewerage company);
- the profile of these households (and benefits eligibility) is the same as the average profile for England;
- 40 per cent of households are metered;
- average standing and volumetric/rateable value charges for 2011/12;
- the average bill is £415, with the average metered customer paying £333 and the average unmetered customer paying £453;
- the unmetered and metered standing charges are £112 and £86 respectively (for water and sewerage);
- the price per £ of rateable value is £1.84 and the price per m³ is £2.83 (for water and sewerage); and
- only household customers pay for the social tariff

Example A – a 25 per cent discount on bills for all metered households in receipt of income-related benefits⁷

Criteria	
Efficiency of targeting	<p>Of the 2 million households in this fictional company, around 96,000 are eligible for the tariff.</p> <p>15% of the eligible households (15,000) spend more than 5% of their disposable income on water and sewerage bills.</p>
Cost	<p>£3.50 per ineligible household (or 0.8% of the average bill).</p> <p>Total cost - £7 million.</p>
Benefit for eligible households	<p>Average discount of £70.</p> <p>The average discount for single person, two person, three person and four (or more) person households would be £50, £82, £105 and £129 respectively.</p>
Impact on affordability for eligible households	<p>About 7,000 fewer households would be spending more than 5% of their disposable income on water and sewerage bills.</p>
Impact on affordability for non-eligible households	<p>Around 3,000 additional households would spend more than 5% of their disposable income on water and sewerage bills.</p>

⁷ Income support, income-based job-seekers allowance, income-based employment and support allowance, housing benefit, council tax benefit, and/or the guaranteed element of pension credit.

Example B: a 20 per cent discount on bills for metered households with one or more children in receipt of income-related benefits⁸.

Criteria	
Efficiency of targeting	<p>Of the 2 million households in this fictional company, around 20,000 are eligible for the tariff.</p> <p>32% of the eligible households (7,000) spend more than 5% of their disposable income on water and sewerage bills.</p>
Cost	<p>£0.90 per ineligible household (or 0.2% of the average bill).</p> <p>Total cost - £1.8 million.</p>
Benefit for eligible households	<p>Average discount of £86</p> <p>The average discount for two person, three person and four (or more) person households would be £68, £83 and £104 respectively.</p>
Impact on affordability for eligible households	<p>2,500 fewer households would be spending more than 5% of their disposable income on water and sewerage bills.</p>
Impact on affordability for non-eligible households	<p>Less than 1,000 additional households would now spend more than 5% of their disposable income on water and sewerage bills.</p>

⁸ Income support, income-based job-seekers allowance, income-based employment and support allowance, housing benefit, council tax benefit, and/or the guaranteed element of pension credit.