

# **Flood and Water Management Bill**

## **Impact Assessment - concessionary schemes for surface water drainage charges for community and voluntary groups and social tariffs for domestic customers**

**Last updated: 28 January 2010**

## Summary: Intervention & Options

Department /Agency:  
**DEFRA**

Title: **Impact Assessment of concessionary schemes for surface water drainage charges for community and voluntary groups and social tariffs for domestic customers**

Stage: **Pre-consultation**

Version: **1**

Date: **28 January 2010**

Related Publications:

Available to view or download at:

<http://www.defra.gov.uk>

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**What is the problem under consideration? Why is government intervention necessary?** Four water companies have changed the basis for surface water drainage charges for non-domestic customers from rateable value to surface area for impermeable land, because Ofwat identifies this as the fairest basis. This has led to such large increases in bills for some community / voluntary groups that they face contraction or closure. Ofwat interprets concessionary schemes for such groups as unduly preferential or discriminatory and prohibited under the Water Industry Act. In addition to the issue outlined above, Ofwat routinely rejects charges schemes which include social tariffs that introduce cross subsidies for other customers. This is outlined in the annex of IA. Government intervention is required to provide Ofwat with assurance that it would be lawful to accept such social tariffs and concessionary schemes.

**What are the policy objectives and the intended effects?**

To enable water companies to grant concessionary SWD charge schemes for selected community groups. This would allow them to continue charging customers by site area thus incentivising a more sustainable approach to dealing with surface water runoff whilst considering affordability concerns of specific community groups that play a valuable role in the community to ensure they are not threatened with closure. The policy objective for the issue outlined in the annex of this IA is to allow water companies the flexibility to bring forward charges schemes that include social tariffs designed to reduce charges for customers that would have difficulty in paying water and sewerage bills in full.

**What policy options have been considered? Please justify any preferred option.** A range of legislative and non legislative options have been considered (see evidence base). All options apart from i) do nothing and ii) allow companies to bring forward concessionary charges schemes for affected groups, have been discarded. Option ii) is preferred because it allows the companies a flexible approach to implement a scheme reflecting local circumstances and ensure that community groups will not face unaffordable water bills. For the issue outlined in the annex of this IA, policy options considered were the same and option ii) to provide for social tariffs for domestic customers in the Flood and Water Management Bill is preferred because it offers companies a flexible approach that would enable them to set social tariffs where they feel it would be appropriate to do so within their own customer bases.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** To be reviewed by water companies as they carry out impact assessments.

**Ministerial Sign-off** For Final proposal/implementation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:

.....Date:

## Summary: Analysis & Evidence

Policy Option: ii)	Description: Enable water companies to grant concessions for community and voluntary groups
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups'				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 5px;"><b>One-off</b> (Transition)</td> <td style="width: 30%; text-align: center; padding: 5px;"><b>Yrs</b></td> </tr> <tr> <td style="padding: 5px;">£ Not known</td> <td></td> </tr> </table>		<b>One-off</b> (Transition)	<b>Yrs</b>	£ Not known	
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<b>Average Annual Cost</b> (excluding one-off)						
£ 0 (cost transfer)						
<b>Total Cost (PV)</b>	£ Not known					
<p>Other <b>key non-monetised costs</b> by 'main affected groups' There may be some loss in incentives for voluntary groups to install SUDS; costs of implementing concessionary schemes for water companies.</p>						

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Community and voluntary groups will benefit from reduced surface water drainage charges.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 5px;"><b>One-off</b></td> <td style="width: 30%; text-align: center; padding: 5px;"><b>Yrs</b></td> </tr> <tr> <td style="padding: 5px;">£ Not known</td> <td></td> </tr> </table>		<b>One-off</b>	<b>Yrs</b>	£ Not known	
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£ Not known						
<b>Total Benefit (PV)</b>	£ Not known					
<p>Other <b>key non-monetised benefits</b> by 'main affected groups' Community and voluntary groups not faced with contraction of services. Faster delivery of area based charging. Charging schemes with narrower bands providing improved incentives to reduce impermeable areas. Uptake of SUDS incentivised for other customers.</p>						

**Key Assumptions/Sensitivities/Risks** Assumptions: cross subsidy by other customers for voluntary/community organisations will be small; may not be acceptable to other customers; concessions could provide narrower charge bands and encourage and accelerate implementation. Risks: companies are not obliged to give concessionary charges

Price Base Year N/A	Time Period Years N/A	<b>Net Benefit Range (NPV)</b> £ Not known	<b>NET BENEFIT (NPV Best estimate)</b> £ Not known
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What is the geographic coverage of the policy/option?	England and Wales				
On what date will the policy be implemented?	Apr 2010				
Which organisation(s) will enforce the policy?	Ofwat				
What is the total annual cost of enforcement for these organisations?	£ 0				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ not known				
What is the value of changes in greenhouse gas emissions?	£ none				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro N/A</td> <td style="width: 25%; text-align: center;">Small N/A</td> <td style="width: 25%; text-align: center;">Medium N/A</td> <td style="width: 25%; text-align: center;">Large N/A</td> </tr> </table>	Micro N/A	Small N/A	Medium N/A	Large N/A
Micro N/A	Small N/A	Medium N/A	Large N/A		
Are any of these organisations exempt?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of £ unknown	Decrease of £ unknown	<b>Net Impact</b> £ unknown

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

Whilst the main body of this IA refers to the issue of surface water drainage charges for community groups, we have identified a further issue of the limited scope for water companies to bring forward charges schemes including social tariffs for specific groups of customers that introduce cross subsidies between groups of customers. The scope of this IA has therefore been widened to address this issue in the Flood and Water Management Bill. A summary of this is included in the annex of this IA.

### The problem

Surface water drainage (SWD) charges are the charges that water and sewerage companies levy for the removal and treatment of rain water that falls on properties' roofs, yards, car parks etc and through drains into public sewers so that it can be discharged back into a watercourse.

Historically many voluntary and community premises did not have to pay SWD charges, or paid a very low charge. This was because SWD charges were based on rateable value (RV) whereby customers both domestic and non-domestic were charged on the basis of the rateable value of their property as assessed by the Valuations Office and these groups were either exempted from local non-domestic rates under Schedule 5 of the Local Government Act 1988 benefitted from mandatory or discretionary relief or simply had very low rateable values. In other words, there was an exemption or concession by proxy from SWD charges for these organisations. The cost of paying the SWD charges of these groups was met by other domestic and non domestic customers in companies' operating areas.

To date, four of the ten water and sewerage companies in England and Wales (Northumbrian Water, Severn Trent Water, United Utilities and Yorkshire Water) have switched to site area charging for SWD for non-domestic customers and Ofwat is encouraging other companies to follow suit. Under this scheme of charging, companies levy a charge for SWD according to the impermeable site area of individual premises, with bands of charges applying to areas of different size.

Companies when devising charging schemes have opted for a variety of charging structures, in particular Severn Trent have set a concessionary scheme for some organisations: including, community centres and religious buildings, among others. This proposed charging scheme reflects the historical system of providing concessions or exemptions for these groups and therefore should not be seen as new cross subsidies.

Site area charging for SWD is favoured by some companies and the regulator because it is the most cost-reflective way of charging for SWD – the larger a site area the greater the cost of removing and treating surface water (although to date no figures are available of the actual cost per unit for removing and treating surface water). It provides an incentive to reduce surface water run-off as a means of reducing bills. Permeable areas do not count towards a site area thereby encouraging customers to install sustainable drainage systems. Further, as with the rateable value method of charging, any customer that does not make use of public sewers does not have to pay any SWD charges and non domestic customers are entitled to a proportional discount if some of the surface water from their property does not drain into a public sewer.

The Government supports site area charging. However, in some parts of the country the switch to site area charging has resulted in community premises with large site areas, such as churches, village and community halls, community amateur sports clubs, properties owned by scout and guide associations and other voluntary and community groups facing substantial and unaffordable increases in their water bills. For example, St Luke's church in Thornaby, Teeside, has seen its water bill increase from £70 to £600 because of the move to site area charging by Northumbrian Water.

The problem was particularly acute in United Utilities' (UU) operating area where, under UU's original proposals, many community premises in the North West would have seen bills running well into four figures. After pressure from Ministers and affected stakeholders, the company imposed a moratorium on SWD charges for 2009/10 for faith buildings, community amateur sports clubs (and similar clubs) and properties owned by scout and guide associations. UU has recently been working on a revised SWD charges scheme for non domestic customers for 2010/11.

Based on these proposed charges, the Church of England has estimated that a move to site area charging nationally for SWD would cost it £4 million per annum. The Scout Association has said that it could cost the scout movement £1.5 million. These are very significant sums of money for the organisations affected and could threaten the long-term viability of many volunteer-led organisations throughout England and Wales if site area charging for SWD is introduced by all water and sewerage companies.

Ministers' view is that a degree of cross-subsidy paid for by other water customers would be justified and acceptable in these circumstances if proposed by a company, particularly as the switch to site area charging is unwinding an existing cross-subsidy rather than creating a new cross-subsidy. In addition, the degree of cross-subsidy is small and in many cases will be reduced compared to RV charges. Further, increasing the flexibility of charges may avoid unnecessary difficulties faced when implementing the new charges, such as those experienced by UU, which has slowed down implementation of area charges.

When it switched to site area charging for SWD in 2001/02, Severn Trent Water introduced a concessionary scheme for community premises in its operating area. This places community premises in a lower band than would otherwise be the case if they were charged the full amount according to their impermeable site area. Places of public religious worship had been charged according to a notional rateable value of zero, which effectively meant they were exempt. Severn Trent's band of charges 2009/10 is set out in Table 1.

**Table 1: Severn Trent Water's SWD charges for non-household customers**

<b>Band</b>	<b>Chargeable area (m2)</b>	<b>Charge £ per year</b>
1	Up to 20	9.33
2	21 – 99	49.69
3	100 – 199	99.36
4	200 – 299	155.70
5	300 – 499	248.84
6	500 – 749	394.22
7	750 – 999	552.63
8	1,000 – 1,499	773.90
9	1,500 – 1,999	1,037.51
10	2,000 - 3,999	1,769.27
11	4,000 - 7,499	3,401.34
12	7,500 – 9,999	5,183.82
13	10,000 – 14,999	7,396.39
14	15,000 – 19,999	10,367.63
15	20,000 – 24,999	13,339.85
16	25,000 – 29,999	16,313.33
17	30,000 – 34,999	19,256.36
18	35,000 – 39,999	22,394.01
19	40,000 – 44,999	25,503.84
20	45,000 – 49,999	28,616.82
21	50,000 – 99,000	44,727, 72
22	Over 100,000	105,709.54

Under this concessionary scheme, individual community premises are charged as if their chargeable areas are in band 3 covering 100-199 square metres (assuming their chargeable area is more than 100 square metres otherwise they will benefit from a lower charge by virtue of falling into band 1 or 2). Places of public religious worship do not have to pay anything.

Severn Trent has said that it would like to continue with its concessionary scheme which enjoys broad stakeholder support. However Ofwat, as the independent economic regulator for the water industry, has told Severn Trent that it cannot because, in its view, a concessionary scheme for community groups is unduly preferential and unduly discriminatory and social policy is the Government's responsibility. Defra's view is that current legislation and guidance already provides the flexibility to enable companies to operate concessionary schemes for community premises if they choose to do so and that Ofwat's interpretation of "undue" is overly restrictive. The wording of current legislation anticipates that there could be some discriminatory or preferential treatment that is "due". It is not an absolute prohibition rather a judgement to be made as to what would be appropriate/due under the circumstances. However, Ofwat is the independent economic regulator and it is for Ofwat to interpret legislation as it sees fit.

### **Rationale for Government Intervention**

Government intervention is needed to deal with an affordability problem for voluntary/community groups and a regulatory failure. The current legislation aims to ensure the best incentives are in place. However, there are benefits to voluntary/community bodies, not effectively provided by the market, and the potential large increases in costs experienced by these bodies may cause a contraction in this sector resulting in a loss of the benefits provided. In this context regulatory failure arises as, in Ofwat's view, the current framework restricts the use of concessionary schemes for voluntary/community bodies and may encourage wider area charge bands, and result in delayed implementation resulting in lost benefits from applying area based charging.

### **Incentive issue**

The best incentives would be arrived at by charging everyone a different price – a price just high enough to equate the marginal cost of paying the additional charge with the marginal cost of reducing their exposure to the charge (e.g. by reducing their surface area). However this would be administratively impossible and a balance needs to be struck. Generally however a large number of narrow charging bands would be preferable to a small number of wide bands. The larger number of bands offer more potential for the charges to stimulate alternative, cost-reducing actions. There will be more firms closer to the edge of the next area band down who will be encouraged to reduce their area charges by investing in means of reducing their impermeable area.

Without the ability to offer concessionary schemes it is likely that companies would adopt a smaller number of wide bands rather than a larger number of narrow bands. This is because within the bands there can then be a degree of cross-subsidy such that those with affordability problems can be cross-subsidized by those who don't face such problems. However, while this reduces the affordability concerns it blunts the incentives on those without affordability problems as they are less likely to receive benefits from reducing their permeable area.

Government intervention is therefore needed to allow companies to continue to introduce charging schemes with keen incentives but with the flexibility to grant concessionary rates reflecting the circumstances of voluntary and community groups in their area. The correction of this regulatory failure would be expected to lead to more companies introducing charging schemes which have better incentive properties (i.e. matched more closely to the cost profiles of their customers) rather than having to adopt less incentive-based schemes in order to average out bill increases across customer groups.

### **Policy Objective**

The scope of this policy is to allow the flexibility to water companies to set their own concessionary charges schemes for SWD for voluntary and community groups.

Ministers want to legislate to enable all water and sewerage companies in England and Wales to be able to operate concessionary schemes for community groups for the purpose of site area SWD charges, and require Ofwat to allow companies to exercise their discretion in the design and operation of schemes.

Ministers want to amend the Water Industry Act 1991 to enable individual companies to be able to implement and operate indefinitely a concessionary scheme for community premises from SWD charges where charging is based on site area. The power for individual companies should be an enabling power. There is to be no legal obligation on companies to operate a concessionary scheme. However, Defra expects most companies will choose to make use of the option.

Defra is clear that all customers, including all community groups, should pay a positive charge where they have surface water run-off and are making use of public sewers. There should be no exemptions for any individual groups from SWD charges where surface water runs into public sewers so that financial incentives to reduce surface water run-off exist. In other words, all community premises should be placed at least in the lowest band for SWD charging purposes where they have site areas that drain into public sewers.

Whilst it will be for companies to decide how to structure their charges schemes and which groups to include in the concessionary schemes, Government will issue guidance on this identifying the types of groups companies may wish to include and that they must carry out impact assessments to ascertain whether or not concessionary schemes are necessary in their operating areas and make clear the expected cross-subsidy and the reasons why this is beneficial.

### **Affordability issue**

Affordability can best be judged on a site by site or case by case basis. It is not possible for example to say that all members of a group are likely to face affordability issues, just because some of them do. Circumstances will differ case by case. There is an absolute affordability issue and there is a transitional issue. Absolute affordability relates to the inability to pay a charge over a long period. Transitional affordability relates more to cash flow and difficulties in meeting rapid increases in costs because of the difficulty of adapting or raising revenues to cover the additional costs.

Affordability concerns differ according to different groups. With the class of non-households there are three types of groups:

Voluntary sector – scout and community groups, churches etc.

The public sector – schools, hospitals, government offices

The private sector - businesses

In the private sector affordability can be a concern, although typically not an economic one. Since if a private company cannot cover its costs (private and social) and goes out of business it is generally assumed that another company will be able to fill the market, providing the goods or services, hence there is no long term loss of welfare, although there may be short term costs. However government may still be concerned about impacts on particular businesses, especially where there is some economic objective to which the business contribute (e.g. regeneration of areas which are in economic decline).

Public sector affordability is mainly a transitional issue. The public sector is funded by public revenues in any case and hence it is typically a question of who pays for the additional costs – the direct users of the services through charges or the general public. SWD charges are likely to

be a low part of public and private sector operating costs. This would not be the case for many community groups

Unlike with private and public sectors, voluntary sector affordability is different. The voluntary sector provides public benefits that cannot be provided by the market or effectively by the state. Increases in costs will necessarily lead to a contraction in this activity and hence a potential loss of public benefits.

## Options

A range of options have been considered, both legislative and non-legislative.

### Options Under Consideration

- i) Do nothing – Defra could contend that this is a matter for Ofwat and individual water companies to deal with and that there is no role for Defra in the setting of charges schemes. However, Ofwat has made clear that they will not allow concessions for any specific groups under the existing legislative framework. This would result in community and voluntary groups facing unaffordable bills, which would be exacerbated if other companies switched to site area charging but were not allowed by Ofwat to operate concessionary schemes for community groups. The other possible outcome is that other water companies are pressured by the weight of public outcry and refuse to switch to site area charging which is the preferred method as it incentivises customers to reduce surface water runoff. This option is non-preferred.
- ii) Provide for concessionary schemes – under this option, Defra would legislate to enable companies to introduce social tariffs for specific groups: this would require primary legislation. It would provide a legal basis for the type of concessionary scheme that Severn Trent currently operates but has been told by Ofwat that it must discontinue. This option would make it clear that concessionary schemes implemented by companies are not at odds with the legal requirement that schemes of charges are not unduly preferential or unduly discriminatory and Ofwat would be required to allow for such schemes. It would specifically enable companies to put community premises in a lower band for the purpose of SWD charges whilst leaving the design of individual schemes to individual companies which would maintain the current mechanism, whereby companies set charges schemes and Ofwat approve them, and would allow companies to reflect circumstances within their own operating areas (Defra would issue new guidance to specify which kinds of groups should benefit from concessionary schemes. This could be achieved through the 5<sup>th</sup> session Bill<sup>1</sup>). This is the preferred option will provide the key benefits discussed in the Impact Assessment and ensures rapid implementation with a high degree of certainty.

### Options considered and discarded

#### Non-legislative policy options

- iii) Write to Ofwat to clarify the current position – Defra's view is that current legislation and guidance already provides the flexibility to enable companies to operate concessionary schemes for community premises if they choose to do so, and for Ofwat to agree with them. However, this is not explicit in current Government guidance to Ofwat. Defra could write to Ofwat to state that, in Defra's view, current legislation and

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<sup>1</sup> The Government is introducing the Floods and Water Management Bill in the 5<sup>th</sup> session of Parliament. Further information on the scope of the Bill can be found at:  
<http://www.defra.gov.uk/environment/flooding/policy/fwmb/index.htm>

guidance allows for companies to bring forwards. However, Ofwat's view is that concessionary schemes count as undue preference or undue discrimination, which is not allowed for under a company's licence conditions. Defra's view is that Ofwat's interpretation of "undue" is overly restrictive. The wording of current legislation anticipates that there could be some discriminatory or preferential treatment that is "due". It is not an absolute prohibition rather a judgement to be made as to what would be appropriate/due under the circumstances. Ofwat have indicated that Ministers will need to legislate if they want Ofwat to allow for concessionary schemes. This is Ofwat's right as the independent economic regulator. This option is non-preferred due to Ofwat's stated position, that legislation is required to approve concessionary schemes .

- iv) Amend current guidance – Defra could formally amend its statutory guidance to Ofwat to explicitly say that it encourages social tariffs for community premises. This would require consultation and for the guidance to be laid before Parliament. Defra would have to indicate which groups it thinks should count as community premises (the Severn Trent scheme offers a good precedent worth considering for defining community premises that could be used). Ofwat is only obliged to "have regard to" guidance. It is not obliged to follow any guidance and does not support cross-subsidies because, in its opinion, these constitute "undue discrimination and undue preference" and social policy is the Government's responsibility. This option is non-preferred due to Ofwat's stated position, that legislation is required to allow concessionary schemes and that it has no choice under the law.
- v) Joint Ofwat/Defra statement – Defra could issue a joint statement with Ofwat along the lines that it supports site area charging for SWD in principle and point to the schemes that have been implemented successfully as good practice (eg Yorkshire Water). For this option to deliver, Ofwat would need to accept that companies can implement and operate concessionary schemes for community premises. Ofwat's position on concessionary schemes is set out above so this option would not achieve the desired outcome.

## Legislative options

- vi) Require Ofwat to do more than "have regard" to Defra guidance – Defra could change the requirement on Ofwat from "have regard to" its guidance to "must act in accordance with" its guidance. The latter is typically used in the case of financial regulators (eg the Financial Services Authority) whereas the former is used when issuing Government guidance to independent economic regulators. The provision to "have regard to" Government guidance is currently specified in primary legislation so it would need to be amended in relation to its applicability to guidance on SWD charges. However, any strengthening of the duty on Ofwat to follow Defra's guidance would compromise the role of Ofwat as an independent economic regulator. The Government is clear that it wants to maintain independent economic regulation, consequently this option is non-preferred.
- vii) Grant exemptions for selected groups –No groups have ever been exempted in law from paying SWD charges (churches etc were only ever exempted from non-domestic rates, which were used by companies as a proxy for SWD charges). Defra is clear that all groups should potentially have to pay a positive charge so that there is an incentive to tackle surface water run-off. Under this option a decision would need to be made in terms of which groups to grant concessions to. This option is non-preferred as it is seen as too strong resulting in no financial incentives for voluntary and community groups to reduce surface water run-off without providing offsetting benefits. Also, companies should be able to design schemes that reflect local circumstances and stakeholder views.

- viii) Legislate to enable water companies to set a tariff based on specified circumstances - this could be achieved through regulations. Section 143A of the Water Industry Act 1991<sup>2</sup> enables the Secretary of State to make regulations prescribing conditions with which any charges scheme must comply (this provision was used to make the Vulnerable Groups Regulations to assist vulnerable households on meters). It empowers the Secretary of State to “*make provision as to the matters by reference to which charges may be fixed and as to methods and principles to be adopted in calculating and imposing charges*”. This could be used to specify criteria which companies must use in establishing a charge. Carefully formulated, this could allow social tariffs for non-household, non-business customers (eg for those with low incomes but a large SWD bill). Defra would have to specify a framework and criteria for which lower charges would apply although the scheme would be implemented and run by the companies. However, it would place a huge burden on companies as they would have to operate the scheme. This option is non-preferred as whilst it would provide the benefits highlighted for water company identified concessions, it could increase regulatory burdens for water companies and delay implementation of area based charging.
- ix) Place an affordability duty on Ofwat –Such a duty would require Ofwat to take account of groups’ ability to pay their water bills when approving companies’ schemes of charges. Defra would also have to issue new guidance to Ofwat on how Defra expects it to implement any new duty. It would be impractical to place such a duty on Ofwat only in relation to SWD charges for non domestic, non business customers. Consequently, this option is non-preferred: it deals with a wider set of issues than dealing with surface water drainage and these issues are beyond the scope of this Impact Assessment.

## **The Base case**

Base case is that companies continue to introduce area based charges but are not allowed to introduce concessionary schemes. This limits the ability of the companies to take account of the affordability of those facing the charges and it could force them to adopt wider band ranges which have a limited incentive on charge payers or leave community and voluntary groups with unaffordable bills. The current legislation is considered to involve a regulatory failure which is giving rise to both a negative affordability issue and preventing the development of charging system with adequate incentive properties and delaying the implementation of area based charging.

## **Costs and Benefits of Preferred Option**

### **Benefits**

Enabling water companies to set their own concessionary schemes for affected groups will allow flexibility for each company to reflect the circumstances within its own operating area. For example, water companies that have already set reasonable charges schemes for SWD that have not caused affordability concerns, may not feel it is necessary to offer concessionary schemes. However, where it is difficult to introduce area charges without concessions this will ensure area based charging can still be introduced and the related benefits, as set out below, will be realised.

Those groups that have been affected by disproportionate increases in bills will not face the threat of contraction of services to the community or potential closure but will still be asked to make a contribution to SWD charges. Consequent savings may encourage groups to install sustainable drainage systems where practicable and appropriate.

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<sup>2</sup> Full Act can be found online at: [http://www.opsi.gov.uk/Acts/acts1991/Ukpga\\_19910056\\_en\\_1.htm](http://www.opsi.gov.uk/Acts/acts1991/Ukpga_19910056_en_1.htm)

Elsewhere water companies may be encouraged to move over to area based charging more quickly as they are unlikely to face the problems faced by water companies that have implemented this system. This will allow more commercial customers to be charged under the “polluter pays” principle which will encourage take up of sustainable drainage systems and increase the pace of provision resulting in earlier benefit streams.

## **Costs**

Costs for customers are unknown although these are expected to be negligible. As water companies charge schemes vary so too will the cross subsidy arising as a result of this. The level of cross-subsidy does not result in additional costs but is a transfer payment between the different non-domestic bodies. They are in-line with historical practice for RV. This will mean that there are no significant additional costs to different user groups when implementing the scheme.

The costs for water companies to implement concessionary schemes will be assessed as part of their impact assessments for area charging proposals.

The decision regarding the type of organisations which will receive concessions will be for water companies to make. Defra expects companies to undertake detailed impact assessments on their proposals and to engage with relevant stakeholders, which will be made clear in departmental guidance issued to Ofwat. Severn Trent Water estimate the costs of moving towards a concessionary scheme of this nature to be in the region of £1m, however the costs for different water companies will vary depending on the nature of the scheme implemented, and therefore an overall one-off transitional cost is not estimated due to uncertainty.

## **Assumptions**

- The provision of charging will allow narrower charge area bands resulting in increased incentives on groups to reduce their permeable area.
- The provision of the option to implement concessionary charges will encourage and accelerate implementation of area based charging.
- Voluntary groups provide benefits to society that are not picked up within current funding mechanisms.

## **Conclusion**

Policy option ii) has been decided on because it is the most effective option considered that will allow water companies to introduce site area charging, which incentivises reducing surface water run-off, without increasing regulatory burden on Ofwat, whilst allowing companies the flexibility to offer concessionary charges to groups that add value to the community as they had previously benefitted from under the rateable value system of charging. They will therefore not face unaffordable SWD charges. It is likely that there will be a minimal cross subsidy for other customers under this system which already exists under the rateable value system.

A range of legislative and non-legislative options were considered, however because Ofwat will not allow for concessionary schemes within the existing framework, on balance a legislative option provides the best opportunity to deliver this policy.

## **Specific impact tests**

The recommended policy proposal will not impose any new cross-subsidy or burden on other non-domestic or domestic customers who traditionally paid the cross-subsidy for community and voluntary groups under the rateable value charging method. The proposals therefore have no effect on small firms, and do not raise any issues related to the environment, Legal Aid,

health, equality, human rights, or rural areas. The limited extent of competition in the water and sewerage industries means there is unlikely to be any effect on competition.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

### **Addendum: Impact Assessment for Social Tariffs**

During the Second Reading and Committee stage of the Flood and Water Management Bill, Ministers were pressed to provide additional support for household customers from unaffordable water bills - in addition to the support being provided for community groups from unaffordable surface water drainage charges. Ministers therefore brought forward a new clause at Report to enable companies to bring forward social tariffs to assist persons who would find it difficult to pay their bills in full.

The rationale for Government intervention is that the affordability of water and sewerage services for some households is becoming an increasing problem (not just for community groups), notably for those on low incomes and/or living in parts of England and Wales where the cost of water and sewerage services is relatively high. Bills have increased by an average of around 42 per cent in real terms since privatisation. Bills are highest in the South West, where 72 per cent of households in the lowest three income deciles spend more than 3 per cent of their disposable income on their water bills. Consequently those struggling to pay their water bills goes much wider than just community groups.

As with concessionary schemes for community groups from surface water drainage charges, a range of legislative and non legislative options have been considered. The options were broadly the same for social tariffs for persons as for community groups. A further option – the revision of the Government's WaterSure tariff – was also considered. Under this option, Defra would make further regulations under S143A of the Water Industry Act 1991 to provide support for financially disadvantaged households. However, these could only apply across the whole of England and Wales and would not be able to apply just to some companies' operating areas and reflect company-specific problems where water affordability is a particular problem.

The Government's view is that companies should have some flexibility to complement WaterSure in light of local circumstances, the meter penetration rate and the views of its customers. This would be lost if we only relied on WaterSure and any changes that might be made to WaterSure post the Walker Review or any of the other options. Consequently, as with concessionary schemes for surface water drainage charges, our preferred option is to enable companies to operate social tariffs with the Ministers issuing guidance to companies which they are required to have regard to.

There would be cross-subsidy from a companies' customer base to subsidise low income domestic customers who qualify. However, the amount of cross-subsidy will depend on any actual scheme brought forward by companies. Low income domestic customers who are struggling to pay their bills would find that their bills are more affordable. The actual benefit would depend on the detail of any scheme.

Ministers will issue comprehensive guidance to companies on social tariffs. This will be issued following consultation on Anna Walker's recommendation around water affordability following publication of her final report on charging for household water and sewerage services on 8 December 2009.

As with concessionary schemes for surface water drainage charges, a detailed impact assessment for social tariffs for household customers will only be able to be undertaken when an individual scheme is brought forward by a company. The Government's guidance will make it clear that companies must consult their customer base and undertake an impact assessment in the design of both concessionary schemes for community groups and social tariffs. It will also cover whether schemes are necessary, who we think should benefit and what constitutes

an affordable charge and an acceptable level of cross-subsidy. Ofwat, as the economic regulator of the water industry responsible for approving charges schemes, will ensure that companies have had regard to the Government's guidance.

Financial support for households is currently provided through the Government's Vulnerable Groups Regulations (known as the WaterSure tariff). This provides assistance for metered households receiving a means-tested benefit, and either suffer from a prescribed medical condition which causes substantial increase in use of water or have three or more dependent children under the age of 19. Non-metered households can investigate if they can save money by installing a water meter. Some water companies also have charitable trusts and hardship funds that can assist customers. Our consultation will include Anna Walker's proposed changes to WaterSure and her proposals to provide additional assistance to low income households. Ministers want to ensure that companies are able to complement WaterSure by providing social tariffs for customers who would find it difficult to afford to pay their bill in full.

Because of the flexibility that the proposed option allows for, it is difficult to assess the costs for companies and the cross subsidy for other customers, though our guidance will make clear that we expect all companies to carry out impact assessments and consult with customers and CC Water in order to assess what an acceptable cross subsidy might be. Some schemes may have a positive effect on recovery of bad debt and so unwind an existing cross subsidy. We consider that there are also wider social and environmental benefits in taking this policy forward by lessening the financial burden of water bills for customers with affordability concerns. In addition to this, this policy will allow the rate of metering to continue to increase without disproportionately affecting bills for those customers that do not or cannot switch to a meter.

In addition to this it is difficult to predict the administrative costs for water companies. We do not think that admin burdens would differ greatly from those for SWD concessionary schemes, but as with the other costs and benefits, because schemes will vary between companies therefore so too would the application processes and evidence that companies would need to process. We intend to provide more information where possible when this IA is updated. We would also expect companies to assess this in the design of social tariffs as these costs would likely be passed onto the wider customer base.

The risks are that there may be pressure on companies to bring forward social tariffs whereas these might be best addressed at a national level using existing regulation-making powers. There is also a risk that more households might choose not to pay their bills in an effort to benefit from a company's social tariff. Some customers may also be unhappy that different companies could operate different schemes. There are also questions about who should pay for cross-subsidies and the acceptability of these to other customers. These issues will be addressed in the Government's consultation on Anna Walker's final report. Ministers also want to take the opportunity of the Bill to give companies the power to operate social tariffs given that affordability of bills is an issue now for some customers and it is uncertain when another legislative opportunity could present itself.