

**EXPLANATORY MEMORANDUM TO
THE WATER INDUSTRY (PRESCRIBED CONDITIONS) (AMENDMENT)
REGULATIONS 2007**

2007 No. 2457

1. This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of Her Majesty.
2. **Description**
 - 2.1 The purpose of this instrument is to empower water undertakers to meter in designated areas of serious water stress, to manage demand for water by making compulsory metering of households by water undertakers possible in those areas where there is a proven case for doing so.
3. **Matters of special interest to the Joint Committee on Statutory Instruments**
 - 3.1 None.
4. **Legislative Background**
 - 4.1 The Water Industry Act 1999 gave household customers for the first time the ability to choose the basis on which they are charged. Under sections 144A and 144B of the Water Industry Act 1991 (which were inserted by sections 6 and 7 of the Water Industry Act 1991), people using water in their own homes have the following rights:
 - The right to continue to pay on an unmeasured basis if they are already doing so in their present homes; or
 - The right to choose to pay on a measured basis, with the option of reverting to unmeasured charging within 12 months.
 - 4.2 The right of a household customer to remain on an unmeasured basis may be set aside where the conditions in the Water Industry (Prescribed Conditions) Regulations (SI No. 3442) are not satisfied in relation to the customer's premises, namely where the principal use of the premises is not as the customer's home, the customer uses water for purposes which are non-household, or discretionary and high volume or where his premises are in an area of water scarcity, as determined by the Secretary of State in accordance with regulation 3.
 - 4.3 This instrument amends the Water Industry (Prescribed Conditions) Regulations 1991 to allow water undertakers to meter premises in which, or in part of which, a customer has his home where those premises are in an area of serious water stress, as determined under new regulation 4 and are subject to a programme of metering in the relevant water undertaker's water resources management plan.
 - 4.4 Water undertakers are required to prepare water resources management plans under section 37A of the Water Industry Act 1991.

- 4.5 Where an undertaker's metering proposals were not clearly supported by the assessment, or an undertaker was outside a designated area of water stress, the Secretary of State would be able to exercise his powers under Section 37B (7) of the WIA91 to direct an undertaker to remove the metering proposals from its draft plan.

5. Extent

- 5.1 This instrument extends to England and Wales, but does not apply to any water or sewerage undertaker whose area is wholly or mainly in Wales.

6. European Convention on Human Rights

- 6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- 7.1 There are two broad methods of charging for water – on an unmeasured or measured (metered) basis. Unmeasured charges are based upon property rateable values, many of which have not been reviewed since 1973. A measured charge, based predominantly on actual consumption of water, is the method of charging which can influence the demand for water. In the right circumstances, it gives the customer an incentive to reduce water wastage, something which no unmeasured charge currently can do. It is therefore the charging option which offers the greatest incentive for improving water efficiency, reducing damaging water abstractions and safeguarding the water environment.
- 7.2 These customer rights were balanced against environmental considerations, as some uses of water, even in the home, may use very large quantities for non-essential purposes. At the time there was an acknowledgement that there was a case for water undertakers being able to charge by volume where there are such uses, notwithstanding the new customer rights. The Government introduced the Water Industry (Prescribed Conditions) Regulations on 1 April 2000 under sections 6 and 7 of the Water Industry Act 1999 (Copy of the Regulations available at annex A). These regulations set aside the right of a customer to remain charged on an unmeasured basis where customers use water for purposes which are either non-household or are discretionary and high volume.
- 7.3 The 'areas of water scarcity' provisions set aside the right of a customer to remain charged on an unmeasured basis where the Secretary of State has determined an area to be an area of water scarcity. Such an area would only provide an undertaker with additional powers to install meters where the undertaker had demonstrated that other steps had been taken to meet or manage demand for water, and were insufficient to address a deficiency in supply. The right to remain on an unmeasured charge was not to be set aside unless there was a proven exceptional case for doing so, and following a consultation by the Secretary of State on an undertaker's application. Under the regulations Ofwat, the Environment Agency and relevant consumer bodies are statutory consultees. Only one water undertaker, Folkestone and Dover Water Services, has applied for, and been granted, area of water scarcity status, and may therefore compulsorily meter its customers. Other undertakers have indicated that the administrative burden and the uncertainty associated with the process have been a barrier to their applying.

7.4 The Water Saving Group, chaired by Phil Woolas, identifies practical ways in which Defra, the industry, regulators and customer representatives can work together to encourage the efficiency use of water in households. One key consensus to emerge is that water metering drives more water efficient behaviour. Evidence shows that a metered household uses around 10% less water than an unmetered household.

7.5 The Water Saving Group's specific proposal was to use powers under the Water Act 2003 to direct companies in areas defined by the Environment Agency as areas of 'serious water stress', predominantly in the South East of England, to consider compulsory metering as an option, alongside alternative and complementary measures, in their new statutory water resource management plans which they must submit to the Secretary of State. This instrument enable companies to place the costs and benefits of metering in the context of alternatives such as the provision of new reservoirs.

7.6 Under the Water Act 2003 and regulations:

- the Secretary of State, the Agency, Ofwat and CCWater will all be statutorily consulted in the process of preparing statutory WRMPs;
- the undertaker will have to indicate in a consultation response how it will take into account consultees' views on all aspects of the draft plan, including its metering proposals;

ultimately, however, it would be for each undertaker to decide whether or not to include, in its final WRMP, a programme for introducing compulsory metering.

7.6 Where after consultation and submission, a company's final water resource management plan adopted compulsory metering, the company would become empowered to meter any premises. Companies which adopt compulsory metering would be expected to consider the impact on the affordability of water bills, particularly for vulnerable customers. This offers the best way to allow accelerated water metering alongside other measures, as part of integrated long-term planning in areas where resources are under pressure.

7.7 Water undertakers have started to prepare draft water resources management plans under section 37A of the Water Industry 1991. The Secretary of State will under his powers in section 37A(3)(d) direct water undertakers whose areas have been determined to be areas of serious water stress to consider compulsory metering under new regulation 4 of the Regulations.

7.8 Since these regulations were drafted, public support for metering as a method of charging has risen. The drought in 2004-2006 has raised the profile of compulsory metering as being a practical approach to conserving water resources in the long term, particularly in areas of serious water stress. To this end, the Water Saving Group (WSG), chaired by Phil Woolas, developed a proposal to accelerate metering in areas of water stress. There is wider Government support for this proposal, which would replace the existing 'areas of water scarcity' provisions. Defra consulted on these amendments in January 2007, we received 58 responses, the majority of which were positive.

8. Impact

8.1 A regulatory impact assessment is attached to this memorandum.

9. Contact

- 9.1 Helena Busby at the Department for Environment, Food and Rural Affairs Tel: 020 7238 8040 or e-mail: helena.busby@defra.gsi.gov.uk can answer any queries regarding the instrument.

Final Regulatory Impact Assessment on accelerating metering in areas of serious water stress

1. Purpose and intended effect

Objective

1.1 Where compulsory metering is a cost effective solution to managing demand in areas of serious water stress, to accelerate the installation of water meters by water companies in households, to encourage the efficient use of water, reduce demand, and assist in long term resource saving.

Background

1.2 The Government remains concerned about the long term implications of the current, and rising, pressure on water resources, particularly in parts of south east and east England¹. Household use of these precious resources is increasing and it is important that customers and companies contribute to environmental objectives and that companies identify and implement the optimal way to deliver their supply demand balance.

1.3 The Government believes that water companies need to be able to demonstrate to their consumers that they are playing their part in managing demand. The majority of water companies are meeting their leakage targets and all water companies are raising the profile of their work in promoting water conservation. In these circumstances customers are likely to be more willing to play their part in saving water and protecting water resources.

1.4 A measured charge, based on actual consumption of water, is the only current method of charging which can have a direct effect on the demand for water. In the right circumstances, it gives the customer an incentive to reduce water wastage, something which no unmeasured charge can do. It is therefore the only charging method which offers any scope for improving water efficiency, reducing water abstractions and therefore enhancing the environment. There may also be cost savings for water customers generally if the effect of metering can defer the need for expensive investments by water companies, for example in new resource schemes. This is one of the reasons why cost-effective metering is endorsed by the economic regulator.

Rationale for government intervention

Drivers for action

1.5 Water is a basic essential of life, and securing a sufficient supply of clean drinking water is essential to public health, and yet the resources we have access to are becoming depleted by increasing demand and the pressures of climate change. Of particular concern is the level of resources in the relatively dry areas in the South East of England.

1.6 To reflect these concerns, Defra set up the Water Saving Group (WSG) to identify practical ways in which Defra can work with key water industry stakeholders to encourage the efficient use of water in households. Its members are Defra, the Communities and Local Government (CLG) department, the economic regulator Ofwat,

¹ 'Water Resources for the Future – A strategy for England and Wales' – Environment Agency, March 2001

the Environment Agency, the Consumer Council for Water, representatives from water companies, Water UK and Waterwise.

1.7 The WSG believes that metering has a role to play in encouraging households to become more water efficient, and that water companies in areas subject to serious water stress should consider compulsory metering alongside other options for managing demand. Metered customers pay according to the water that they use, which gives a household a financial incentive to save water. Metering typically saves around ten per cent of household water consumption. Delivering that saving could make all the difference to cost effectiveness and public acceptability of the other measures that companies will need to take to provide a secure supply and abate demand.

Current regulatory framework

1.8 Under the Water Industry Act 1999 people using water in their own homes have rights including the rights:

- to continue to pay on an unmeasured basis in their present homes if they are already doing so; or
- to choose to change to paying on a measured basis, with the option of reverting to unmeasured charging after 12 months.

1.9 These customer rights were balanced against environmental considerations, as some uses of water, even in the home, may use very large quantities for non-essential purposes (for example, garden watering using sprinklers). At the time there was an acknowledgement that there was a case for water companies being able to charge by volume where there are such uses, notwithstanding the new customer rights. These exceptional circumstances in which companies operating in England continued to have powers to compulsorily meter customers were set out in the Water Industry (Prescribed Conditions) Regulations 1999.

1.10 Under these powers a company can apply for all or part of its supply area to be designated an area of water scarcity, which widens a company's powers to charge customers in its area according to the quantity of water that they use. It sets aside in that area the right of customers, under the Water Industry Act 1999, to remain on an unmeasured basis of water charging in their current homes, while using water only for normal household purposes. To date only one company, Folkestone and Dover Water Services, has applied for and been granted area of water scarcity status. Other companies have indicated that the administrative burden and the uncertainty associated with the process have been barriers to their applying.

1.11 Since these regulations were drafted, support for metering as a method of charging has risen. The drought in 2004-06 raised the profile of compulsory metering as being a practical approach to conserving water resources in the long term, particularly in areas of serious water stress. To this end, the WSG developed a proposal to accelerate metering in areas of serious water stress. This would replace the existing 'areas of water scarcity' provisions explained above.

1.12 Water metering is growing across England and Wales (1992 – 3 per cent of households metered; 2007 – 30 per cent of households metered), but we need to accelerate its growth in areas where water resources face long-term stress.

2. Consultation

Within Government

2.1 The WSG is made up of all the major stakeholders within the water industry: Government, the Environment Agency, Ofwat, Consumer Council for Water, Water UK, water companies and Waterwise. They are responsible for the development of this proposal. Since the proposal was developed Defra has liaised with other Government Departments prior to this consultation.

Public Consultation

2.2 The 1999 Prescribed Conditions Regulations were last consulted upon in 1999 before they were laid before Parliament. Defra and the Welsh Assembly Government consulted on the approach to Water Resources Plans in January 2005².

2.3 We consulted on this approach and the partial Regulatory Impact Assessment on 31 January 2007. Any comments on the RIA have, as far as possible, been reflected in this final Regulatory Impact Assessment.

3. Options

Impact of no Government Intervention – option 1

3.1 Currently the number of metered households is rising at two per cent per year in England and Wales. Under the current regulatory framework metering is likely to continue to increase at this rate, with varying rates for each company. There are indications that the high public profile of water resources during the drought might have had a positive effect on metering uptake, however, it is too early to state the extent of this impact.

3.2 There is an option available to companies under the current policy, which is to apply for designation as an area of water scarcity. Once designated as such an area by the Secretary of State a company is able to compulsorily meter its customers. Only one company so far, Folkestone and Dover Water Services has applied for area of water scarcity status. We do not expect any more companies to apply for designation under the current regime, and therefore would not expect metering to accelerate faster than the current rate. Where a company did apply for area of water scarcity status we would expect its rate of installing meters to accelerate.

3.3 Under the do nothing option it would be open to companies to consider metering under current powers in their WRMPs, however, the additional benefits of being able to compulsorily meter customers would not be open to any companies even within areas of serious water stress, save within areas designated as areas of water scarcity.

Risks

3.4 This approach would not help water companies in areas of serious water stress to gain the additional benefits of compulsory metering in addressing the current increase in demand, except in areas designated as areas of water scarcity, or ensure that the relative merits in demand management of compulsory metering are fully considered and subject to public scrutiny compared to other supply and demand side options.

² 'Consultation on water company water resources management plan regulations' – January 2006

3.5 Some customers might revert to current levels of demand once they have become used to having their consumption metered; however metering does provide an incentive for behavioural change, as might innovative measured tariffs.

Amend current Prescribed Conditions Regulations – option 2

3.6 The WSG proposal would allow individual water companies in seriously water stressed areas (as designated by the Secretary of State on the advice of the Environment Agency) to introduce compulsory metering, where it forms part of their new Water Resource Management Plans (WRMPs). The WRMPs will set out companies' least cost solutions to their supply demand balance. The plans will be finalised before the next periodic review of water prices in 2009. The effect would be to absorb the water scarcity status process into the preparation of the WRMPs.

3.7 The effect of the amendment for a company within a designated area of serious water stress should be to:

- direct it to consider the cost of, and demand reductions associated with, metering as a demand management measure alongside other supply-side and demand-side options for maintaining an appropriate balance between the supply of and demand for water;
- extend its powers to charge households on a measured basis where there is a case to do so;
- leave it up to it to choose how to use these extended metering powers; and
- provide for costs and benefits of compulsory metering to be considered.

3.8 The amendments should not:

- force any water company to meter anyone;
- affect non-household premises;
- affect households not in an area of serious water stress; or
- end the option for customers to have a meter installed, at no cost to themselves, by a company.

Risks

3.9 While companies could have additional powers to meter under these proposals, they will not be forced to use them, and might not choose to do so. However a company whose plan clearly demonstrated the business case for metering could be subject to scrutiny and criticism if they decided not proceed.. To some (probably small) extent this could be mitigated by the fact that if a compulsory metering programme is within their water resource management plans customers might expect the company to use these powers and so decide to install a meter voluntarily. On the other hand, the unit cost of installing meters is lower when metering is introduced on an area basis rather than in response to individual volunteers.

3.10 Some customers might revert to current levels of demand once they have become used to having their consumption metered; however metering does provide an incentive for behavioural change, as might innovative measured tariffs.

Implementation and delivery plans

3.11 Under the Water Act 2003 and regulations in preparation:

- The Secretary of State, the Environment Agency, Ofwat and the Consumer Council for Water will all be statutorily consulted in the process of preparing statutory WRMPs; and
- The company will have to indicate in a consultation response how it will take into account consultees' views on all aspects of the draft plan, including its metering proposals;

3.12 Following the Direction by the Secretary of State a company within an area of serious water stress must include a case for compulsory metering. The Secretary of State has powers to modify WRMPs. Following his assessment of its draft WRMP, the Secretary of State would be able to exercise his powers³ to direct a company to not include the metering proposals in its published final WRMP, where those proposals were not considered to be an appropriate means of maintaining the supply-demand balance.

4. Costs and Benefits

Sectors and Groups affected

4.1 Both options will have an impact on costs for water companies within an area of serious water stress, and could affect water prices charged to customers.

4.2 The unit cost of a meter, for creating a space and fitting that meter is on average £200, however this can change from company to company and according to the type of property being metered.

4.3 The costs, and benefits, associated with metering that are spread across all the metered customers include:

- The cost of the meter and its installation;
- The customer-related operating costs of metering (such as meter reading, billing and account management); and
- The value of benefits received by metered customers but not by unmetered customers (such as the cash flow effect of paying bills in arrears).

Costs

Option 1

4.4 Administrative costs would arise for companies applying under the existing areas of water scarcity area provisions.

4.5 Unit cost of installing meters will remain higher where there is no compulsory metering programme.

4.6 Possible additional resources might be needed sooner than under option 2.

Option 2

4.7 The main additional costs are of additional meters. These costs will be balanced against the costs of alternative potential additional resource requirements for each company. For each company these costs will be different and it is not possible for us to assess this

³ Under s37B(7) of the WIA 1991

balance at this stage, however companies will be able to take full account of these costs in considering the business case for metering in their WRMPs.

- 4.8 A programme of compulsory metering, only in the greater south east (Essex, Thames Valley & London, Kent, Sussex), would involve metering around 5 million more properties from 2010. Ofwat estimates that the total cost of metering those households that are currently unmetered in areas of serious water stress within England could be as much as £1 billion, although much of this metering would take place anyway under the continuation of current regulatory arrangements, albeit over a longer timescale. The costs of the programme would be met by each water company's customers (see 4.18 for the cost burden split), and spread over a period of time, according to the companies' WRMPs. On the other hand, new supply side measures such as reservoirs can themselves require expenditure of hundreds of millions of pounds and the extent to which these can be offset or deferred by securing demand reductions through metering is a matter for individual WRMPs. The WRMP approach will enable these costs to be considered on a company by company basis.
- 4.9 There may also be higher costs for customers with relatively high water use, who move to a metered basis of charging, but do not qualify for protection under the means-tested regulations to protect vulnerable groups. However, other customers changing to a meter will pay less.
- 4.10 There may be other administrative costs associated with considering the case for metering, however, as these are subsumed within the WRMP process these would be less than those applying for area of water scarcity status as a separate exercise.
- 4.11 There will be environmental and social costs associated with the manufacture, installation and use of metering including the travel and associated energy and congestions costs of visiting properties and undertaking meter reading.

Benefits

Option 1

- 4.12 Metering will continue to increase at the current rate, pending additional companies applying for water scarcity status.

Option 2

- 4.13 Retaining a regional variation to metering policy – different combinations of water supply and demand measures including metering might be appropriate to cope with different levels of water stress.
- 4.14 Ensuring public scrutiny - proposals for compulsory metering in water company areas will be open to public scrutiny.
- 4.15 Examining the case for metering in a holistic way - water metering can make a valuable contribution to reducing demand and achieving a sustainable supply-demand balance. But the case for compulsory metering needs to be considered in the context of broader considerations of resource availability and demand management options in company areas.
- 4.16 Reducing regulatory burdens – the existing water scarcity area status process would be abolished and replaced into the new statutory WRMPs that each company must prepare.

Companies would be relieved of the need to make a separate case for being areas of serious water stress because the responsibility for designation would rest with the Secretary of State, on the advice of the Environment Agency.

4.17 Scope for economies of scale - The present unit cost of £200 is that for an individual meter when either a householder opts to have one or when a company selectively meters a customer; economies of scale would be achieved for large scale zonal metering programmes, and there may also be offsetting long-term savings from deferred or cancelled investment on supply side measures.

4.18 The WRMP approaches allows companies to assess the company specific costs and benefits of metering, and compulsory metering in areas of serious water stress. These may include:

- Effect on resources - If a ten per cent demand reduction can be maintained by householders this could either defer, or obviate the need for, major new, and expensive, resources projects such as reservoirs. In addition there could be some increase in levels of service (for example improved leakage detection, possible decrease in the number of restrictions) shown by companies as demand reduces.
- Effect on the environment - less demand could lead to less abstraction, and less resultant environmental damage in those areas. In addition there may be some gains in saving energy costs in that if companies need to treat and pump less water, and waste water, then this could reduce the amount of energy that companies use. Ultimately this could help reduce the carbon footprint of those companies and assist in mitigating climate change.

For each company the benefits of the effect on resources and the environment above will be different, and it is not possible for us to assess the extent of these benefits at this stage, however companies should take full account of these benefits in their WRMPs.

5. Small Firms Impact Test

5.1 The amended Regulations will have an impact on costs for water companies within an area of serious water stress, and may generate pressure on water prices charged to customers. Only one small firm, Cholderton Water, is likely to be affected in that they will be required to consider metering in their WRMP.

6. Competition Assessment

6.1 Application of the competition filter indicates that a simple competition assessment is appropriate in this case as little or no effect on competition is likely as a result of the proposals.

6.2 There are currently 24 vertically integrated, incumbent water companies in England and Wales. Ten of these provide water and sewerage services, while the remaining 14 provide only water services. In areas where a water only company provides water, a water and sewerage company provides the sewerage service. All 24 companies are statutory companies, with duties and responsibilities set out in primary and secondary legislation. Companies must also comply with conditions set out in their Instruments of Appointment, including observing price limits set by Ofwat applying to charges for the majority of their customers.

- 6.3 Companies are appointed for a specific geographic area, and undertake (either directly or sometimes by contracting out) every aspect of the provision of water services, i.e. ownership and control of the operation of abstractions, reservoirs, pumping stations, treatment works and all elements of the public water distribution network.
- 6.4 These features of the water industry limit the scope for direct market competition. Ofwat's regulatory regime is incentive based and decisions on price setting are informed by a comparative competition framework which compares the performance of each company and sets prices on the basis of the best performing company. The effectiveness of the regulatory framework in providing companies with incentives to improve their efficiency and be innovative is generally accepted to be more limited than market competition where that is possible.
- 6.5 The Water Act 2003, which received Royal Assent on 20 November 2003, extended the opportunity for competition within the England and Wales water supply industry so that water non-household customers with an annual consumption of at least 50 megalitres are eligible to switch supplier. To date six businesses have applied for a combined licence which will allow them to retail water to customers and introduce water into water companies' supply systems for this purpose. As only householders will be affected by this proposal, likewise no licensees will be affected.

7. Enforcement, sanctions and monitoring

- 7.1 Where a company's metering proposals were not clearly supported by the assessment, to meter or not to meter, or a company was outside a designated area of serious water stress, the Secretary of State would be able to exercise his powers under Section 37B (7) of the WIA91 to direct a company to remove the metering proposals from its final plan.
- 7.2 Ofwat and the Environment Agency will scrutinise the cost – effectiveness of companies' WRMPs and have responsibility for ensuring that water companies' charges schemes and practices comply with the regulations.
- 7.3 Government will monitor and keep under review the effect of the direction and the operation of the regulations.