

# What is a fair level of service in the water sector?

YOU, THE CUSTOMERS, DECIDE!

Most people consider that companies should provide a service to their customers that is fair. This is particularly true for essential services, such as water and sewerage. However, fairness can mean different things to different people. In this bulletin, we explore what “a fair level of service” in the water sector could look like and how the regulatory framework is set up in England and Wales to achieve that goal. We find that water companies are expected to draw on insights from customer engagement to decide how to balance more equal service or outcomes and a fair pricing regime

## What is a fair level of service in the water sector?

The concept of a fair level of service is a complex one in any business. This is particularly true for the water and sewerage sector, as the services it provides are essential for all households and businesses. As a result, we would not expect there to be one right answer to the question of what is a fair level of service in the water sector.

To illustrate this point, we consider some of the areas where the concept of fairness in the sector could be of relevance.

- *Different levels of core service:* Water and wastewater services are provided through regional and local networks, but not every customer on a local network receives the same level of service. For example, people living at the top of a hill may have to make do with lower water pressure while some parts of the network may be more susceptible to sewer flooding or supply interruptions. In this context, one concept of fairness would be for everyone to receive the same level of service even though this would require the water company to spend more on some customers than on others, e.g. to install extra pumps to increase pressure at the top of the hill. Another way of looking at fairness might be that the company should expend the same resources on all of their customers, who then accept the differences in service level as a consequence of their choice to live in a more difficult to supply location.
- *Different levels of service improvement:* Companies also have options for improving the levels of service, for example by investing more to clean up beaches or rivers. The majority of customers may place a value on such enhancements, but those valuations will vary. Judging what is a fair way of selecting which improvements to pursue may depend on the charging method that the company employs.
  - If the company can charge more to those customers who value the improvements the most, then this could be considered a fair approach.
  - If this is not possible, what alternative fair approaches does a company have? One option would be to pursue any improvement supported by at least half of its customers - or use a higher threshold.
- *A fair pricing regime:* Companies' charging schemes are governed by rules, for example that prices should be non-discriminatory. In practice, companies have met this requirement by adopting a uniform price that varies based on only a small number of observable characteristics. These include the level of water usage or the features of the customer's property, e.g. whether it has a sprinkler system or a swimming pool. The pricing method could be refined further based on the

service received or even the valuation attached to it. For instance, a customer at the top of a hill may pay less. This would still be consistent with a non-discriminatory approach but could also be considered fairer.

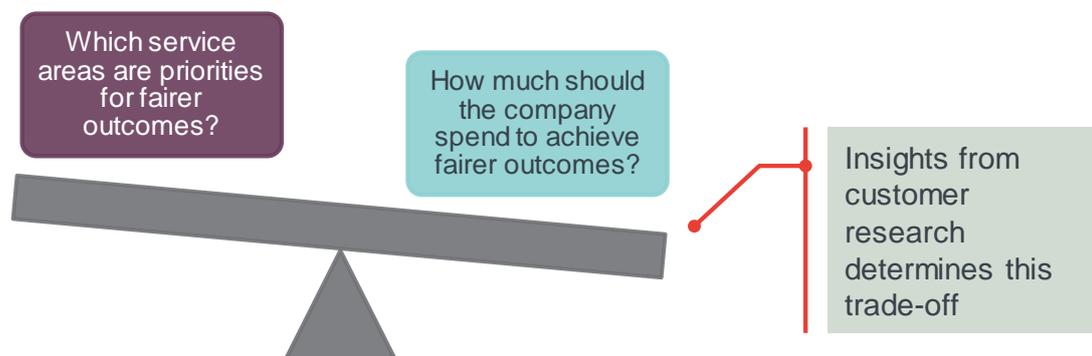
- *A fair approach to supporting customers who need extra help:* Some people have difficulty affording their water and wastewater bills while others find themselves in a position of vulnerability. Customers with health conditions or disabilities fall into this latter category, as do those who are particularly exposed in the event of service disruptions. Many believe that companies should provide extra help to these groups of customers through discounts for low-income families, extra services for people with disabilities and so on. However, the question remains: what level of additional support results in a fair balance across all customers? Should the willingness to pay of other customers to support these measures be taken into account?

The rest of this bulletin explores how the water sector currently approaches these fairness questions.

### Where should extra spending be focused?

As explained above, it can be very expensive to deliver the average level of service to some properties, even if they are paying the average price. In practice, this means there is often a small group of customers within any region who receive a level of service appreciably below the company average. An important question then becomes how much should water companies spend to bring about a quality improvement for this minority, given that the extra costs will be spread across the entire customer base. And if more money is spent to equalise the level of service, where should it be directed?.

Ofwat's view is that water companies should engage with their customers on these issues. The implicit assumption around fairness, therefore, is that because everyone pays for these supplementary costs it is customers who should decide where the extra spending goes.



Research insights are invaluable to help companies develop an approach to fairer outcomes that reflects customers' perspectives on questions such as:

- Which service areas should take priority?
- Is it preferable to target the small number who are most at risk, or to spread the improvement in service across a wider group?
- Does it make a difference if customers have a degree of control or choice over the risk that their service will be subpar (e.g. the buyer of a house at the top of a hill can reasonably have anticipated that their water pressure would be lower than average when they bought the house)?

Here are three examples of how these considerations play out in practice.

- *Case study 1: sewer flooding.* In most regions, a small subset of households are at greater risk of sewer flooding than others, with some facing a material risk of repeated inundations. This could be due to the topography of the area combined with a lack of network drainage capacity that is often very costly to address. To decide how much money to spend to tackle these problems and equalise the level of service, water companies are required to discuss the issues with their customers. Consequently, as part of their business planning process for the next investment period (2020-2025), companies engaged with their customers and stakeholders to decide how much to invest in this area. In particular, they designed research to estimate customers' valuations of the

impact of sewer flooding and their willingness to pay to reduce the risk of such occurrences, whether or not they were directly affected by the issue.

- *Case study 2: services for customers in vulnerable circumstances.* Some people in this category might need additional care and support during service disruptions like that caused in some regions by last year's freeze-thaw. Ofwat is encouraging water companies to provide extra help to customers who are particularly vulnerable to such interruptions in their water supply. While this issue is slightly different in principle from sewer flooding, the money question is the same: how much extra should water companies spend to improve services for this particular subset of customers? Again, firms are expected to engage with their customers and stakeholders to gauge their willingness to invest more in this area. Again, this raises issues of whether non-vulnerable customers are willing to pay more to support those who are.
- *Case study 3: social tariffs.* As explained above, broadly all households pay the same price per unit of water. The UK government decided that water companies should, subject to customer support, offer a discount to households that struggle to pay their bills. The cost of providing this "social tariff" is met by all the firm's other customers. That being the case, water companies consult their customers to decide whether to introduce social tariffs, the level of support and which groups should be eligible, e.g. pensioners and low-income families in receipt of benefits. Based on this research and on discussing the findings with relevant stakeholders, such as local debt advice charities and the Consumer Council for Water, firms then decide how much support to offer.

## Conclusion

There is no easy answer to the question of fairness in the provision of essential services such as water. Ensuring roughly the same level of service to every household and business may well require heavy investment and the costs and benefits of this investment may fall on different customers. Giving discounts to people on low incomes or providing extra support to vulnerable members of society is also an expensive undertaking. Sharing out the costs equitably is perhaps an impossible task. Some people are bound to feel they are bearing too much of the burden. But customer research that is carefully crafted to tease out how much people are prepared to pay for a "fair level of service" can help water companies strike an appropriate balance.

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