RWG Wholesale Tariff Simplification Subgroup

Good Practice Guide
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Simplification and harmonisation of metered consumption bands

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The purpose of this document is to recommend the simplification and alignment of the bands for wholesale metered volumetric charges with implementation commencing from 1st April 2026.

1. Introduction

The RWG Wholesale Tariff Simplification Subgroup (the "Subgroup") was established in 2021 to explore options for wholesale tariff structure harmonisation and simplification within the non-household market, with the aim of reducing complexity and improving the efficiency of operations across the market.

In summer 2022, the Strategic Panel also identified the simplification of the wholesale tariff landscape as one of the top priorities for improving the effectiveness of the non-household market.

The Subgroup issued a consultation on 10 November 2023 which asked market trading parties to consider a number of options for changing the wholesale tariff landscape, specifically in relation to harmonising and simplifying the bands for wholesalers' metered volumetric charges.

In the process of producing this consultation, the PA Consulting report which was commissioned by the Subgroup in 2022 was considered to help refine and inform the proposed options.

2. Background

Historically, each wholesaler has developed its own tariff structure in response to regulatory principles and their own system dynamics, resulting in different approaches and little commonality between regional tariff structures. This has led to a high degree of tariff complexity within the non-household market, with c. 9,000 tariff elements in CMOS.

Alongside the aims of reducing complexity and improving the efficiency of operations across the market, there is still the requirement to provide a framework within which wholesalers can set charges that align with Ofwat's charging principles[1]. Subject to managing any impacts on the cost reflectivity of charges, the overall benefits of simplifying tariff structures include:

- Creating a more consistent tariff landscape across the market which will help establish a single, national market, rather than regional hubs;
- Reducing the complexity and confusion felt by national and multi-site customers in the face of different tariff structures in different wholesale regions;
- Greater perceived fairness across the market for similar customers in different regions;
- Reducing systems and administration costs for retailers, in turn enhancing their ability to compete at a national level as well as reducing the potential for erroneous tariff application for customers;
- More consistent messages to customers about the need, and options, for managing their water consumption;

[1] Ofwat's charging principles are set out in their Wholesale Charging Rules.

- Greater opportunities for retail tariff innovation; and
- Simplification of the CMOS tariff arrangements.

One of the options for simplification that might have the greatest effect within the market is the alignment and simplification of bands for volumetric charges. Following several rounds of industry consultation there is general agreement that alignment and simplification is a good idea, but concern was expressed over the potential impact on customers of changing such key elements of the wholesale charging structures, especially in regions that currently have more complex structures.

The Subgroup considered it required technical support and expertise to help refine options and explore the potential impacts, so in autumn 2022 the Subgroup commissioned a piece of work by PA Consulting ("PA"), funded by the Strategic Panel's Market Improvement Fund, to assess the incidence effects of options for harmonising the band thresholds for volumetric charges. The PA report was published in April 2023 and presented to the industry by PA Consulting themselves in a webinar that is available on the Subgroup's webpage on the MOSL website[2].

The first phase of the subsequent consultation was issued in May 2023 and asked trading parties to consider the introduction of a common consumption band threshold at 0.5 Ml to align with 'Group 1' customers defined within the Retail Exit Code ("REC") – the retail price controls.

The second phase of the consultation issued in November 2023 asked wholesalers in particular to assess for themselves the specific impacts on their own customer base of each proposed metered tariff structure option. This would provide a more detailed and wholistic view than that which the PA report produced, as subtleties of existing company-specific charging structures could be taken into account, such as supplementary/standing/breakeven charges and other charges that may be applied within metered tariffs.

3. Consultation and feedback

The options that the second phase of the consultation sought feedback on were as set out below.

- **Option 1:** REC structure – thresholds at 0.5 Ml and 50 Ml

- **Option 2:** 'Tariff basket' structure – thresholds at 0.5 Ml, 50 Ml, 100 Ml and 250 Ml

- **Option 3:** Intermediate A – thresholds at 0.5 Ml, 5 Ml, 10 Ml, 20 Ml, 50 Ml, 100 Ml and 250 Ml

[2] The PA Consulting webinar is available at the following link: RWG Tariff Simplification sub-group

- **Option 4:** Intermediate B – thresholds at 0.5 Ml, 5 Ml, 15 Ml, 30 Ml, 50 Ml, 100 Ml and 250 Ml

- **Option 5:** Single consumption band with no thresholds

Support was clearly directed at simpler structures that still have distinctions for large users. As such, option 1 and option 2 were ranked the highest and formed the shortlist from which a final recommendation would be chosen.

The more disaggregated structures seen in option 3 and option 4 were generally considered overly complex amongst both wholesalers and retailers. In many cases, these options would introduce more complexity than is currently the case, especially by those wholesalers who have started the simplification journey.

The single consumption band option, whilst supported by some wholesalers as being seen to take us towards a structure that promotes water efficiency in the absence of more innovative structures such as Rising Block Tariffs, is generally deemed insufficiently cost-reflective and too impactful on (an albeit small number of) large user customers.

A more detailed report on the responses to the consultation was published on the MOSL website on the RWG Tariff Simplification sub-group page[3] on 17 June 2024.

4. Regulatory barriers and other challenges to implementation

Feedback from wholesalers in particular set out several barriers to a common structure working in practice or being widely adopted.

1. The first concern was around **cost reflectivity**. Most wholesalers mentioned that this would be forgone to varying degrees depending on which option was adopted. Wholesalers would have to diverge from what they've deemed to be cost reflective for many years.

2. The second concern was around **customer impact and fairness**. These were referenced by many wholesalers as a regulatory barrier as they are likely reasons for customers to complain about the implementation of a new structure that could lead to Ofwat being asked to provide a determination on a charging dispute.

Another challenge raised in the consultation feedback was the timeline to implementation, namely would there be sufficient time for wholesalers to start the process of implementing phased changes for the start of the 2025/26 charging year.

The final point of note from the feedback was around the existence of multiple linked agendas. With simplification/harmonisation, water efficiency and tariff innovation agendas,

[3] https://mosl.co.uk/groups-and-forums/industry-groups-forums/retailer-wholesaler-group/tariff-sub-group

there is a need to consider if one can be achieved without jeopardising the others and if there is a hierarchy of agendas to guide the collective future plans of the wider industry.

5. Ofwat engagement, support and endorsement

Whilst the majority of market participants agree with and are supportive of working towards harmonisation and simplification of metered tariff structures, there is understandable caution amongst wholesalers due to the magnitude and regulatory impact of the changes that would result from moving to a common metered tariff structure.

Given the significance of the regulatory barriers and other challenges noted above, the Subgroup and the tariff workstream lead on the Strategic Panel have discussed with Ofwat the potential ways in which sufficient support and assurance could be given by the regulator to enable a successful and universal implementation of the recommended best practice.

Ofwat do not consider that either the wholesale charging rules or Licence Condition E prevent or prohibit wholesalers from pursuing tariff simplification or harmonisation relating to consumption bands for metered wholesale tariffs. Ofwat have committed to consider if it is proportionate to amend their wholesale charging rules to clarify these points and make other minor changes, such as providing more clarity on non-household charging trials.

Ofwat sets out its view in an open letter to wholesalers[4] published on 16 October 2024. The following extract summarises Ofwat's position.

> *"We do not consider either our wholesale charging rules or Licence Condition E to prevent or prohibit wholesalers from pursuing tariff simplification or harmonisation relating to consumption bands for metered wholesale tariffs.*
>
> *As set out in the June Report, Ofwat's charging rules are high-level and allow wholesalers flexibility and ability to innovate when setting their charges. In particular, wholesale charging rules 13 to 17 set out the range of principles against which wholesalers must strike a balance in setting wholesale charges, including fairness and affordability, environmental protection, stability and predictability, transparency and customer-focused service, as well as long-run cost-reflectivity.*
>
> *Licence Condition E concerns undue preference and discrimination in charges. It sits alongside the requirement to comply with the charging rules and companies must assure themselves that they apply consistent principles and approaches to the calculation of charges for different classes of customers."*

6. Good Practice Recommendation

[4] Business retail market - Open letter regarding RWG best practice guidelines and wholesale charging rules, Ofwat, October 2024

The alignment of metered volumetric consumption bands across the whole market would significantly reduce the complexity and disparity in the existing tariff landscape, though it is acknowledged that the journey to full implementation by all wholesalers will require a transition period that will likely take multiple charging years to mitigate against significant customer bill impacts.

Taking into account the feedback from the consultation, the Subgroup **recommends that metered volumetric consumption bands are aligned to the following structure, with implementation commencing from 1st April 2026:**

- **Option 2: 'Tariff basket' structure – thresholds at 0.5 Ml, 50 Ml, 100 Ml and 250 Ml**

With one of the lowest overall and net bill impacts, an implementation timeline that can seemingly be delivered within one AMP period and sufficient levels of simplification and cost-reflectivity, this option jointly received the most support amongst wholesalers.

As option 2 contains the structure set out in option 1, it has been deemed a solution that satisfies all parties who expressed a preference for either option 1 or option 2. By setting the same unit rates for two or more bands in option 2, a wholesaler could operate as per option 1. As such, option 2 has been put forward as the best practice structure.

For clarity:

- the same unit rate can be used across multiple consumption bands if an even simpler structure is in use or proposed for use by the wholesaler;

- the same structure is being recommended to apply across water, wastewater and trade effluent metered tariff structures; and

- due to large user tariffs being maintained as an option in the proposed best practice structure, supplementary site-based fixed charges should still be used where necessary.

7. Implementation timelines

Acknowledging the point in the 2025/26 tariff cycle that this Good Practice Guide is being published, the Subgroup recognises that there is not sufficient time for wholesalers to start to implement these recommendations for the 2025/26 charging year. It is also recognised that, depending on wholesalers' existing tariff structures, full implementation of the recommendations may take several charging years in order to mitigate the bill impacts on existing customers.

Nevertheless, the Subgroup would still encourage wholesalers to commence preparatory works as soon as possible, so that the phased implementation process (and alignment to the recommended tariff structure) can begin as soon as practically possible during AMP8 and in time for the start of the 2026/27 charging year.

Based on the feedback from wholesalers during the consultation process, there was a consensus that full implementation of the recommended tariff structure should be achievable within one AMP period. As such, this Good Practice Guide is recommending that the new structure should be fully implemented for all SPIDs in the market by the start of the 2030/31 charging year.

During the phased implementation process, as new tariff codes will need to be created in CMOS and SPIDs will need to be moved between tariff codes, appropriate planning on the part of wholesalers will be of significant importance, as will ensuring effective and timely communication with retailers.

A non-code change request was raised with MOSL to allow for the future dating of tariff-related changes in CMOS. The capability for future dating tariff-related changes was made available in the December 2024 CMOS release and as such, is now functional to assist with a phased implementation commencing at the start of the 2026/27 charging year.