

New appointments and variations – a statement of our policy

About this document

This document sets out our policy regarding new appointments and variations. In particular, it sets out the principles against which we will assess applications for new appointments and applications to vary appointments ('variations') and our position on a number of key issues. Together, this document and our '[New appointments and variations – a statement of our process](#)' replace the policy we first issued in 1999 (and updated in January 2009).

In March 2010, we published 'New appointments and variations – a consultation on our policy'. We have used the consultation responses along with views aired at a stakeholder workshop held on 14 May 2010 to finalise our policy. Alongside this document, we have published all the responses to the consultation and a summary of those responses, explaining how we have taken them into account in finalising our policy. These responses can be found on our [website](#).

This statement of policy is consistent with our legal duties, which are set out in the Water Industry Act 1991 (WIA91). In drafting this policy, we have had regard to the sustainable development schemes and the social and environmental guidance (SEG) issued by the UK and Welsh Assembly Governments.

Throughout this document, we use the term 'new appointments' to refer to new appointments and 'variations' of appointments as appropriate, unless otherwise specified.

This document should be read alongside our [statement of process](#) and '[New appointments and variation applications – the terms of reference for independent professional advisors providing site status reports](#)'. It should also be read alongside our [principles on how we approach bulk supply pricing](#) as bulk supplies play a key role in the new appointments and variations process.

Contents

Foreword	3
1. Introduction	5
2. Our aims	8
3. Market reform	12
4. Reviewing our policies	13
5. Qualifying criteria for a new appointment	14
6. The principles we will use to assess applications	20
7. Our position on key issues	28

Foreword

The water and sewerage sectors have come a long way since privatisation in 1989. Over the past 22 years, the water companies have invested almost £90 billion in the industry, which has resulted in:

- higher standards of service;
- greater efficiency;
- improved drinking water quality; and
- greater compliance with environmental standards.

The challenges that now face the industry and its regulators have changed very significantly from those which confronted us in 1989. They include climate change and population growth, which pose a real risk to the services we receive each day. We can no longer rely on doing things as they have been done before.

To ensure that drinking water is delivered safely and wastewater removed securely, and that the environmental improvements required in legislation are delivered, we need fresh approaches. We need to develop sustainable solutions to secure the critical services upon which almost 55 million people rely every day across England and Wales.

The UK and Welsh Assembly Governments are currently reviewing Ofwat's responsibilities. The UK Government has also said that it will publish a White Paper on water policy in summer 2011. We welcome the review.

So that we are best placed to meet the challenges of the future, we are seeking to encourage more innovation through competitive pressure in water and sewerage services. We consider that properly harnessed, market forces could help deliver the sustainable solutions we need. This view was shared by the [independent review of competition and innovation in water markets](#) (the 'Cave review')

While we await these developments, there are still opportunities to make greater use of new appointments and variations which are currently the primary vehicle with which competitive pressure can be applied to existing appointees.

The customers of new appointees have experienced benefits such as price discounts and enhanced service levels. Some new appointees have brought with them innovative solutions to deliver environmental benefits. In other cases, the threat of a competitor entering the market has itself challenged existing appointees to 'raise their game'.

In preparing this policy, we have taken into account the Government's principles for sustainable development (set out in 'Future Water') and the Welsh Assembly Government's sustainable development scheme, 'One Wales: One Planet'. We envisage that this policy will give effect to those documents by encouraging the use of new appointments which will result in real benefit for consumers, the environment and the economy as a whole. We have also had regard to the sustainable development schemes and the social and environmental guidance (SEG) issued by the [UK Government](#) and [Welsh Assembly Government](#). We will continue to have regard to these when we make our final decisions.

We will keep this policy under review in response to further developments in the sectors, as well as changes in legislation and the wider regulatory framework.

Most importantly, we will work to make sure that we implement our policies with regards to new appointments and variations to ensure that we act in the best interests of consumers, both now and in the future.

Regina Finn
Chief Executive

1. Introduction

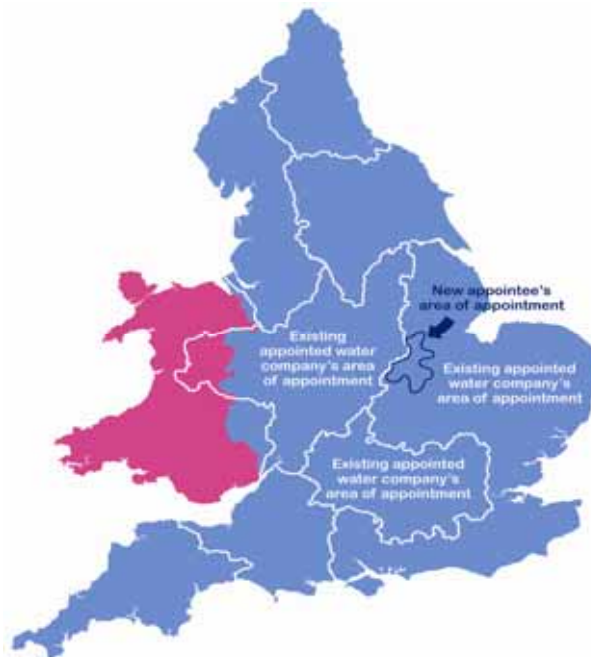
Most customers in England and Wales currently receive their water and sewerage services from one of 22 appointed monopoly water and sewerage and water only suppliers that were in existence when the sectors were privatised. We call these suppliers 'existing appointees'.

A new appointment or a variation involves one company replacing another as the appointee for a specific geographic area. Under certain criteria, it allows some customers to choose a different supplier.

- A **new appointment** occurs when we appoint a company for the first time to provide water and sewerage services, water only or sewerage only services for a specific geographic area.
- A **variation** occurs when an existing appointed company asks us to vary its existing appointment so that it can extend the areas to which it provides services.

Figure 1 below illustrates an example of how a new appointee's area of appointment could relate to that of existing appointees.

Figure 1 Example of the geographic relationship between new appointments and existing appointees¹



Source: Ofwat

¹ This example is not intended to represent the true scale of a new appointee's area of appointment and is for illustrative purposes only.

Under section 7(4)(b) of the WIA91, we can appoint a new water only, sewerage only or water and sewerage company. We may grant a new appointment or variation in cases where:

- an area does not contain any premises that receive services from an appointed water or sewerage company (it is 'unserved');
- a customer uses (or is likely to use) at least 50 million litres of water a year (in England) or 250 million litres of water a year (in Wales) at each of its premises and wants to change its supplier (a 'large user'); or
- the existing appointed company agrees to transfer part of its area to a different company (a transfer by 'consent').

1.1 The process for approving applications

Alongside this document, we have also published our process for assessing applications for new appointments and variations. The assessment process covers:

- applying for a new appointment or variation;
- an explanation of each of the application steps and the key issues associated with each step; and
- the interactions that usually occur between applicants and existing appointees during the application process. This includes the timescales in which we expect existing appointees to respond to applicants' requests for information and vice versa.

The process we will apply is set out in figure 2 below. It is also set out in more detail in our statement of process.

Figure 2 Application process for new appointments and variations²

Stage	Indicative timing	Key stages and applications
1	Applicant's discretion	Pre-application
		<ul style="list-style-type: none"> Preliminary discussions between applicant, Ofwat and other key stakeholders (Environment Agency, Drinking Water Inspectorate, Defra and Consumer Council for Water). Applicant to begin negotiations with existing appointee for bulk supply/discharge agreement (if applicable). Applicant commissions independent adviser to produce report on whether a site is served (if applicable).
2	Up to 15 days	Application submissions and pre-assessment
		<ul style="list-style-type: none"> Ofwat to confirm receipt of application and check completeness. Applicant serves 'application notices on relevant stakeholders and publishes them on its website and in local and national newspapers.
3	Up to 40 days	Ofwat begins assessment of application in line with its policy principles
		Approval from Environment Agency and Drinking Water Inspectorate
		Applicant to provide details of bulk supply/discharge price and non-price terms to Ofwat (if applicable)
4	Up to 15 days	Recommendation to Ofwat Board New Company Appointments Committee
5	At least 28 calendar days	Public consultation
		<ul style="list-style-type: none"> Applicant to conclude negotiations with existing appointee for bulk supply/discharge terms and provide Ofwat with copies of signed agreements (if applicable).
6	Up to 10 days	Board Committee final decision
	Up to 110 days	Appointment is granted or refused

² For further information, please read the whole of our process statement. We will not 'start the clock' until we receive a complete application.

2. Our aims

A number of market-related developments have informed this policy.

In March 2010, we published '[Delivering sustainable water – Ofwat's strategy](#)', which set out our long-term approach to regulating the water and sewerage sectors in England and Wales. As part of this, our market reform project will help us to build on what the regulated monopolies have achieved in the past 22 years. Markets can play an increased role in these sectors.

As part of its structural reform plan, Defra has committed to publishing a Water White Paper in summer 2011. The Water White Paper will focus on the future challenges facing the sectors, including:

- maintaining water supplies;
- keeping bills affordable; and
- reducing regulation.

The Cave review's final report recognised the need for the sectors to meet future challenges and the role that markets can play in this. It advocated a step-by-step approach to reform. It also recommended changes to the water supply licensing framework that, if implemented, would eventually supersede the new appointments framework as it currently exists.

The Cave review recognised that new appointments represent an important mechanism for enabling market entry. We support the Cave review's recommendation to reduce entry barriers where this does not reduce the protection customers receive. We consider that introducing a binding framework of regulated access for new appointees, and common codes and systems for supply would help to reduce such barriers. We will develop these as our market reform project progresses.

These changes would ensure that customers would be no worse off than if they were served by the existing supplier over the long term. We have taken all these recommendations into account in developing this policy and also in developing our separate [process statement](#).

Interest in new appointments has increased significantly in recent years. This has raised a number of issues that have challenged our existing policies and process. We have also taken these into account in finalising our policy.

In developing our policy, we have a number of specific aims. These are outlined below.

2.1 Protecting consumers' interests

We have a legal duty to protect the interests of consumers, wherever appropriate by promoting effective competition between companies providing or connected with providing water and sewerage services.

In some circumstances, new appointments allow alternative suppliers to compete with the existing appointee to provide services to a particular area.

A High Court judgment endorsed our approach of using new appointments and variations to further competition³. The Court interpreted section 2(2)(b) of the WIA91 to mean that our primary method of protecting consumers must be by promoting effective competition. Where this is not appropriate, we should use other means⁴.

New appointments provide challenge to existing appointees. This drives efficiencies, stimulates innovation and reveals information. They have the potential to benefit all customers, including through:

- lower prices;
- improved service;
- a better range of products and services;
- environmental benefits; and
- greater choice of supplier for developers and large user customers.

Examples of benefits delivered to date include the following.

- There have been cases in which a new appointee provided solutions that meant that significant new capital investment was not necessary. This provided benefits for both the environment and to customers through reduced bills.
- In one case, a new appointee provided services using more environmentally sustainable, on-site methods of treatment and discharge.
- In other cases, customers are paying volumetric charges that are between 5% and 13% lower than they would have done if they had been served by the existing appointee, while receiving comparable levels of service.

³ R (on the application of Welsh Water Limited) v Ofwat [2009] EWHC 3493 {Admin}.

⁴ Paragraphs 16 and 17 of the judgment.

When deciding whether to grant a particular new appointment, we must ensure that customers are protected. We must also consider the potential impact of our decision on all of the existing appointee's customers and ensure that services are maintained.

If the customers that an applicant wishes to serve are not able to choose their water and sewerage service supplier, we must be satisfied that they will receive a level of service and price at least as comparable to those they would have had if they continued to be supplied by the existing appointee for that area.

We need to check that the company:

- has both the ability and the resources to meet its legal duties and responsibilities to deliver services; and
- will deliver acceptable standards of service to the customers it has applied to serve.

New appointees have the same duties and responsibilities as the existing appointees for their specified area. We must be satisfied that the new appointee has the appropriate skills and competencies to comply with its legal duties. And it is for the companies to ensure that they are meeting both their legal obligations and their customers' expectations.

The Drinking Water Inspectorate (DWI) must also be satisfied that an applicant has the appropriate knowledge, skills and competencies required before an appointment is granted. The DWI has published a [guidance document](#) that sets out how it will assess an applicant's competency to supply water through its supply system for domestic purposes.

2.2 Sustainable water and sewerage services

Under section 2(3)(e) of the WIA91, we have a legal duty to contribute towards sustainable development. We take account of the potential economic, social and environmental impacts of a new appointment. We also work with all appointees to provide sustainable water and sewerage services over the long term.

By embedding sustainability within our policies, and encouraging the sectors to take sensible and measured steps to safeguard the future, we can meet the new challenges we all face, including increased water scarcity and a growing population. We explained how we intend to do this in our [strategy](#).

To achieve this, we need to encourage the best possible use of our valuable water resources and ensure that water and sewerage services are provided in the most efficient way. Markets can help to do this in three ways. They:

- drive down costs;
- improve the ways scarce resources are allocated; and
- encourage companies to find better ways of doing things.

New appointments provide an important way in which competing companies can enter the sectors. They also allow those already present to expand into other geographical areas, providing the existing suppliers with a challenge as a result. In this way, new appointments highlight the benefits of markets, and can help us to achieve sustainable water and sewerage services.

2.3 Clarity for stakeholders – a transparent policy and an efficient process

It is important to have a clear policy on new appointment applications so that stakeholders can engage with us constructively. We have had such a policy in place since 1999 and this has proven reasonable and robust. But it is time to update that policy to reflect our experiences and feedback from stakeholders involved in the new appointments framework.

As interest in new appointments has increased, applicants have asked us to go beyond our previous guidance and say more about:

- how we will assess their applications;
- who takes decisions about their proposals; and
- when we require different pieces of information.

Other stakeholders have also asked us to clarify aspects of our approach and their role in the assessment. In this document, we have sought to provide answers to many of those questions.

3. Market reform

This chapter describes how the new appointments regime relates to future market reform.

While the current regulatory framework has delivered much for the sectors since privatisation, the challenges we all face are different in nature and scale from those of the past. So, it is important that it is flexible enough to adapt to help the sectors meet these challenges.

As the experience of the past two decades has shown, effective regulation can achieve a great deal. But we think that appropriately harnessed market forces also have an important part to play if we are to continue to protect consumers' interests, and ensure safe and reliable water and sewerage services over the long term.

In our 2007 and 2008 reviews of competition, we considered wider reforms to the frameworks available to enable competition in the sectors. In 2009, the Cave review proposed that the current system of licences be reformed to bring about a new framework, including a more disaggregated licence structure. We support these reforms, which would change substantially the new appointments and variations framework in its current form.

In September 2009, the Welsh Assembly Government and the previous UK Government consulted on the implementation of the Cave review's recommendations. Defra has committed to produce a Water White Paper in early summer 2011, with the possibility of subsequent legislation. We shall need to adjust our programme as necessary during the coming year to take account of its outcome and the changing policy context for England set by the forthcoming White Paper.

4. Reviewing our policy

We are committed to reviewing our policies to ensure that they remain fit for purpose. This chapter sets out how, and when, we will carry out a review of our policy.

Interest in new appointments has increased significantly in recent years. This has raised new and complex issues that challenged our policy and process. We have produced our revised policy and process statement in response to these challenges to ensure that they remain robust and sustainable. We will keep them under review and ensure we take account of developments in market reform as appropriate. We will also review our policy and process statement in light of the wider review we are carrying out on how we regulate the sectors in the future.

We currently expect to review our policy and process in 2014. This should allow us to take account of any changes in Government policy and legislation, as well as changes to the way we regulate.

5. Qualifying criteria for a new appointment

5.1 The applicant

Applicants must specify under which criterion they are applying for a new appointment. If an applicant considers that the proposed area of appointment ('the site') may qualify under more than one criterion, it must make clear under which criteria it is applying. It must also make clear which other criterion or criteria it believes applies and why.

We will consider if the application meets the requirements of the relevant criterion or criteria when we make our assessment. We will not grant an application that does not fall under one of the following criteria.

- The unserved criterion.
- The large user criterion.
- The consent criterion.

We discuss each of these in more detail below.

5.2 The unserved criterion

Most applications made under this criterion have been for undeveloped (greenfield) sites. But some have been for sites that are undergoing redevelopment (brownfield sites).

The legislation does not distinguish between the two types of sites. But in practice different considerations apply in relation to a brownfield site as opposed to a greenfield site.

Our [process statement](#) sets out the information that we require from applicants in order to assess if a site is unserved. The decision whether to grant an application made under the unserved criterion rests with us.

5.2.1 What the legislation says

We can grant a new appointment under this criterion if none of the premises in the proposed appointment area are:

- supplied with water by means of a connection to a distribution main of the existing water company (in the case of an application to supply water); or
- drained by means of a public sewer or lateral drain of the existing sewerage company (in the case of an application to discharge sewage).⁵

In this case:

- ‘served’ means served by the existing appointee. A site will not be served if it receives water or sewerage services from someone other than an appointed water or sewerage company. For example, a developer may provide sewerage services to the site by way of a private sewerage system including on-site sewage treatment works. This will not render the site served;
- it is not enough for premises to be capable of being supplied with water or drained – there must be an actual supply of water or actual drainage for the premises to be supplied. For example, if a developer installs sewerage pipes that will drain to a public sewer of the existing appointee, this will not render the site served if the pipes are plugged until after the appointment is made;
- our assessment is based on whether the site contains premises that are served **at the time the appointment is granted**. Knowing that a site contained premises that were served in the past may help us to identify the existence of on-site assets. This applies particularly to disused sites that are redeveloped over time. But it is not directly relevant to our decision on whether the site is served at the time the appointment is made; and
- it is possible that premises are served for one service (such as sewerage) but unserved for the other.

5.2.2 The meaning of ‘premises’

The WIA91 does not define ‘premises’, so must take its meaning from the legal context in which it appears. In *Roao Thames Water Utilities Ltd v Water Services Regulation Authority*⁶, the court held that in the context of section 7(4) of the WIA91 premises must be understood broadly as meaning “buildings or part of buildings and/or land.”

⁵ Sections 7(4)(b) and 36 of the WIA91 and see section 219 of the WIA91 which defines the terms ‘drain’, ‘lateral drain’, ‘sewer’, and ‘public sewer’.

⁶ CO/6799/2010 at paragraph 19. This matter is on appeal.

Examples of different premises

- The 'premises' of a farming business might comprise a group of farm buildings with or without the attached farmland.
- The 'premises' of a small firm or company might comprise one or two rooms on an upper floor of a much larger building.
- The 'premises' of a large corporation might consist of the entirety of a large office block and the adjacent car park.

From the above examples, it is clear that what constitutes 'premises' may change over time. So, for example, a large building that comprises more than one premises may be bought by a single corporation and may become one premises. Similarly, a development site may constitute one premises during the development and a number of separate premises afterwards.

If it can be demonstrated that there is a connection to an existing appointee's network somewhere within the applicant's proposed area of appointment, the whole site will be served unless the applicant chooses and is able to carve out of the appointment area the premises served by that connection. If an applicant redraws a site boundary to exclude served premises, the remainder of the site may be regarded as unserved if no part of the remainder benefits from a relevant water or sewer connection.

We will refer to the description of the premises as contained in the relevant conveyance or planning permission to determine the boundaries of served premises. We will also consider ownership or occupation, and the purpose of the premises. Finally, we will consider the extent of the land or buildings that benefit from a water or sewer connection.

5.2.3 Greenfield sites

It is usually relatively straightforward to determine if a greenfield site is unserved. But we will still need to make sure that the site has no connections and is not served, even if there are no buildings on it.

So, a greenfield site may be served if:

- the surface water drains into the existing appointee's lateral drain; or
- It is farmland that the existing appointee supplies with water (for example, by irrigation or to supply a cattle trough).

On new developments, it is usual for underground pipes to be installed before houses are built. Depending on the timing of the appointment, this may render a greenfield site served. But while many developers will lay a pipe network before we have finished processing an application, they will ensure that the network does not connect to the existing appointee's infrastructure until after the appointment has been made so as not to jeopardise the unserved status of the site.

If a connection from the existing appointee's infrastructure is made 'live' before an appointment is made, that may render the premises served (for example, a permanent connection to a show home or site office).

A temporary supply of water from the existing appointee (for example, installed to facilitate the construction process or supply a site office), will not in itself mean a site is served. This also applies to temporary drainage.

5.2.4 Brownfield sites

We will take a common-sense approach to determine if a brownfield site is served. We will consider all relevant factors in determining the state of affairs on the site. For example, we will take into account when the site stopped receiving services from the existing appointee and the reason (or reasons) for this. We will also consider if buildings on the site have been demolished and if pipes have been disconnected.⁷

If buildings are demolished and all existing connections removed, those premises will be unserved. In the case of extensive refurbishments (for example, if the shell of a building remains), the premises will be unserved if all pre-existing connections are removed.

But even if buildings are demolished, a site may be served if a water connection is available for use on the remaining land. It may also be served for sewerage purposes if surface water drains either directly or indirectly through an intermediate drain or sewer to a public sewer or lateral drain of the existing appointee.

As with greenfield sites, a temporary supply of water from the existing appointee, installed to facilitate the construction process, will not mean the site is served.

5.2.5 Surface water drainage at unserved sites

We consider that premises will be served for sewerage purposes if surface water drains into a drain or private sewer, which then discharges into the existing

⁷ R oao Thames Water Utilities Ltd v Water Services Regulation Authority CO/6799/2010 paragraph 24. This matter is on appeal.

appointee's lateral drain or a public sewer. This is regardless of whether the lateral drain or public sewer is on- or off-site.

Similarly, we consider that premises will not be served for sewerage purposes if there is no on-site infrastructure to drain surface water and it goes directly into the ground or runs off the premises via a hard surface (such as a road).

5.3 The large user criterion

A company may apply for a new appointment to serve a customer that uses (or is likely to use) at least 50 million litres of water a year (in England) or 250 million litres of water a year (in Wales) at each of its premises (a 'large user') and wants to change its supplier and the customer concerned consents to the appointment.

Typically, the customer is a large industrial user but in a recent judgment⁸ the court accepted that a development site may qualify under the large user criterion if it can be shown that:

- the site can be regarded as a single premises, served by the existing appointee;
- the developer, as customer of the existing appointee, consents to the appointment; and
- the premises are, or are likely to be supplied with at least 50 million litres of water in a 12-month period.

The same threshold levels apply to new appointments for sewerage services, in terms of the volume of water supplied, not the amount of effluent discharged.

Our [process statement](#) sets out the information we require from applicants in order to assess whether an application meets the large user criterion.

5.4 The consent criterion

This criterion applies when an existing appointee consents to transfer a specific part of its supply area to another appointee. The 'other' appointee could be a new or existing appointee, whose existing area of appointment could be varied to include this additional area.

⁸ R oao Thames Water Utilities Ltd v Water Services Regulation Authority CO/6799/2010 paragraphs 26 to 36. This matter is on appeal.

Our [process statement](#) sets out the information we require from applicants in order to assess whether an application meets the consent criterion.

6. The principles we will use to assess applications

6.1 How we will apply our principles

If we are satisfied that the application meets one or more of the criteria set out in chapter 5, our decision whether to grant it will be based on our assessment of its merits. We will carry out the assessment in line with the policy principles set out below.

Each principle carries equal importance. When deciding if we will grant a new appointment or not, we will ensure that our decision fully reflects our consideration of each policy principle and meets our statutory duties.

6.2 Principle 1 – new appointees should be recognised as wholesale customers of and competitors to existing appointees (the ‘competitor principle’)

We recognise new appointees as direct competitors to existing appointees and treat them accordingly.

As well as being a competitor of the existing appointee, the new appointee is also a customer, but at a wholesale level.

This is because a new appointee will often rely on the existing appointee for a supply of water and sewerage services to the boundary of its area of appointment. In general, these services will be an important input into the services that the new appointee provides to its end customers.

The terms of wholesale supply that new appointees receive are likely to have a significant impact on their ability to compete with existing appointees. New appointees can take a number of different services from existing appointees and we note that adopting this principle affects a number of other policy areas.

The table below shows the position of new appointees in each of the affected policy areas and the implications of adopting the competitor principle. We have taken account of those implications in developing this policy.

The most significant area of policy that adopting the competitor principle affects is bulk pricing. We have reviewed the way we deal with bulk pricing and have published our final policy principles alongside this document.

Table 1 Implications of Ofwat adopting the competitor principle for key policy areas

Policy area	Current position	Implication of adopting the competitor principle
Conditions of appointment	New appointees are undertakers in their own right, and are subject to the requirements of the WIA91. All conditions of appointment are applied, although some may be suspended (for example, those related to full price controls) until we trigger them.	None
GSS regulations	As undertakers, new appointees are subject to GSS regulations and cannot pass on this responsibility (for example, to their bulk supplier).	None
Highway drainage charges	As undertakers, new appointees are responsible for charging customers for highway drainage in their own area. They do not pay highway drainage charges to the existing appointee as an end-use customer would. Section 7.4.2 sets out our position on highway drainage charges.	None
Bulk services	The (regionally averaged) large user tariff is a sensible starting point for new appointees' negotiations with existing appointees on bulk pricing. We have not set out our policy on or methodology for determinations and we discuss this further in relation to bulk pricing in section 7.2.	Our approach to bulk supply pricing is addressed in our bulk pricing policy statement.
Surface water drainage charges	If any surface water from a new appointee's site enters into a public sewer then the new appointee must pay the surface water drainage charge to the existing appointee. We set out our position on surface water drainage charges in section 7.4.1.	Addressed in final bulk supply pricing policy statement and sustainable drainage work.
Infrastructure charges	New appointees that connect to an existing appointee's network are expected to pass on to the existing appointee any infrastructure charges they collect. We set out our position on infrastructure charges in section 7.3.	To be considered as part of a forthcoming review of funding for new connections.

6.3 Principle 2 – assessing applications on a site-by-site and company-wide assessment basis

Some stakeholders have argued that it would be more efficient for us not to apply detailed scrutiny to applications from a company for variations to its appointment. This would allow appointees to supply multiple sites across England and Wales without in-depth site-by-site scrutiny by us.

Others have also argued in favour of allowing a national appointment, similar to that used in other utility sectors, with applications assessed on a purely company wide-basis. We are not able to adopt this approach, as the WIA91 does not allow national appointments. It only allows for one appointee to replace another to supply **specific** geographic areas.

We will assess applications both on a site-by-site and company-wide basis. This represents the best way for us to meet our legal duties, striking the right balance and judging each application on its merits.

6.4 Principle 3 – ensuring that customers are no worse off and are adequately protected

In deciding whether to grant an application, we will consider the overall effect that a new appointment would have on **all** customers. We will assess the effect of each new appointment both on the end-customers on the site the applicant wishes to serve and on the end-customers of the existing appointee.

While household customers are unable to choose their supplier, we expect new appointees to be fully accountable to their customers and we will step in where they fail. Where necessary we will act in place of the consumer to ensure that their interests are safeguarded.

6.4.1 Customers on the site

We will protect the interests of consumers on the site by ensuring that they will be at least 'no worse off' by being supplied by the new appointee rather than the existing appointee. We will apply this test on an ongoing basis. In doing so, we will place particular weight on the effects on end-customers who are not able to choose their supplier.

6.4.2 Price

We will compare the existing appointee's charges scheme with the applicant's proposed charges scheme to satisfy ourselves that customers on the site will not pay a higher price for water and sewerage services on average than they would have done if the existing appointee supplied them.

We will take into account any social tariffs that the existing appointee offers when assessing if customers on the site will be no worse off overall. The new appointee should ensure that it offers such tariffs that are, on balance, on terms at least as favourable to the relevant customers as the existing appointee.

Along with other appointed water companies, new appointees are legally required to comply with the regulations under section 143 of the WIA91. This regulation states that charges schemes must comply with requirements to provide help to customers who may struggle to pay their bill.

The onus is on the new appointee to ensure that they include social tariffs within their charges scheme and to ensure that their published terms of such tariffs comply with the relevant regulations.

If an applicant does not offer as many tariff options as the existing supplier, this does not automatically mean that as a result customers will be worse off. This is because we do not consider it to be proportionate to expect new appointees to duplicate every service offering of the existing appointee as long as, on balance, we are satisfied that its customers will receive a service that is at least as comparable to that provided by the existing supplier.

The new appointee is required to submit its charges scheme to us each year for approval and, if necessary, alert us to any changes. The onus is on the applicant to keep this under review and demonstrate how they continue to ensure customers are no worse off while their charges are compared to the existing appointee.

Dŵr Cymru

Dŵr Cymru returns part of its profits to its customers through a 'customer dividend'. In assessing applications for new appointments within that company's area of appointment, we will take the customer dividend into account to ensure that customers on the site will be no worse off. If any other existing appointees put similar arrangements in place, we will take these into account when assessing applications for new appointments in their areas.

6.4.3 Service

New appointees' customers should benefit from prices and levels of service that are **at least comparable to those** that they would have received had the existing appointee supplied them. We will take a balanced approach when we assess applications for new appointments.

The applicant should provide evidence to us that customers would be, overall, 'no worse off' as a result of us granting an appointment. This does not mean we require new appointees to duplicate every service offering of the new appointee.

6.4.4 A higher price for a higher level of service

In our view, a better standard of service for a higher price is not inconsistent with the 'no worse off' principle. We would not accept such a proposal on a speculative basis (for example, for an application made under the unserved criterion where there were no existing customers).

But we may grant such applications in cases where there was clear evidence of customer support, along with a clear statement from the applicant as to how they would deliver the proposed service. The applicant would need to ensure that its application complies with our other policy principles, for example financial viability.

For applications made under the large user criteria where no household customers are affected, we expect contractual arrangements to be in place to ensure that new appointees would deliver the higher standard of service on offer.

6.4.5 The cumulative effect of new appointments on existing customers of the existing appointee

Some of the existing appointees created at privatisation have argued that granting a succession of new appointments, particularly for new housing developments, has a negative impact on the bills of those customers who remain with them.

Their argument is based, in part, on the assumption that customers on these new developments are initially cheaper to supply than their existing customers (excluding the capital costs of installing infrastructure). As end-prices to customers are regionally averaged, those on the new developments make a relatively high net contribution to the existing appointee's revenues. As a result, price limits are likely to be lower than they would have been had a new appointee served the customers.

The extent to which the existing appointee's revenues are affected depends not only on that appointee's foregone revenues (the margin between the bulk supply price and the retail price) but also on the costs that an existing appointee will avoid if not supplying a site (for example, the on-site capital expenditure and retail costs).

We will consult on this issue and consider it further as part of our review of charging for new connections.

6.5 Principle 4 – financial viability

Under section 2(2A)(c) of the WIA91, we have a duty to ensure that efficient companies can finance their functions. To fulfil this duty, we will consider the financial risk associated with each site for which we receive an application, combined with the cumulative viability of those sites we have previously allowed the new appointee to supply.

Applicants must demonstrate to us the:

- financial viability of each site it applies for;
- impact of each site on the company as a whole; and
- risks it has taken into account in reaching its conclusions included within its application, as well as the impact of those risks should they be brought to bear.

For applications offering both water and sewerage services, we will look at the viability of individual services to assess any potential cross-subsidy issues. We are unlikely to grant an application if it appears that one service is viable while the other is not (for example, the water service is only viable when the sewerage service supports it).

Applicants for new appointments may bring innovative approaches, for example in the form of new business models. When we assess financial viability, it is important for us to understand the applicant's underlying business model. We may need to adapt the way in which we assess financial viability in light of particular business models.

Because every application is unique, and because financial viability is multi-faceted, it would not be appropriate for us to use a single 'hurdle' rate in our assessment. By a single 'hurdle rate', we mean that we would not state a specific figure (for example amount of profit) that a site would need to meet in order for us to consider it financially viable or non-viable. We would lose the flexibility to make judgements

about proposals that inevitably involve factors not apparent from consideration of a single measure of an applicant's financial performance and position.

Instead, we will refer to a number of factors when we assess financial viability. We will assess the overall financial risk associated with the application (and the appointee as a whole) and form a view based on the total package presented to us. This includes assessing both the specific characteristics of each proposal and the applicant's underlying business model. In doing so, we will require the applicant to provide commentary to us that fully explains how it proposes to recover its likely start-up costs and over what period.

We will look closely at the assumptions underpinning financial projections in an application and the interaction and relationship with the applicant's business model. We expect an applicant to provide explanatory commentary to substantiate why its assumptions are reasonable.

We will take the risk profile of each site into account when reaching our view of whether we consider the site to be sufficiently financially robust.

6.6 Financial security

When we consider the financial position of the applicant we need to be satisfied that it will have continued access to sufficient resources to fulfil its duties and obligations. This includes the availability of external and group finance, and the financial security or guarantees that are in place to protect the appointee's customers.

Our assessment of financial viability will ensure that the (reasonably) projected costs of operating the site will be covered by the (reasonably) projected revenues but we will also need to be satisfied that the new appointee has access to a sufficient level of finance to deal with any unexpected cost pressures.

The level of financial security should be linked to the forecast operating costs for the business. We will use the following formula for calculating the minimum level of financial security required from new appointees in the future:

One year's annual operating costs required to supply the number of connections the business is projected to have in two years' time (as included in granted applications and proposed and current applications) = minimum level of financial security.

As their business develops, new appointees are responsible for continually monitoring the minimum level of financial security they need to ensure they meet our

requirements. The level of security required will increase over time as the new appointee's number of connections increases.

Operating costs include bulk supply costs. This is because the bulk services that new appointees purchase from existing appointees are an essential component of the operation of the new appointee's business.

We have previously accepted a Parent Company Guarantee (PCG) or bond as appropriate mechanisms for providing financial security and will continue to do so.

We will consider alternative mechanisms for providing financial security based on the applicant's specific circumstances and the application in question. The new appointee should explain to us how its proposed approach provides an appropriate level of financial security. We would also need to consider the business model adopted, along with any use of associated companies to provide services.

6.7 Principle 5 – operational viability

An applicant for a new appointment must demonstrate to us and the DWI that it will be technically and operationally able to fulfil the functions of an appointee.

This includes being able to exercise the duties imposed on all appointed water and sewerage companies under the WIA91. The applicant must demonstrate that it is capable of providing water and sewerage services to an acceptable standard as this is an important part of our decision whether to grant a new appointment.

We will not grant a new appointment unless we are satisfied that the new appointee will be operationally viable. Our [process statement](#) provides further information on the types of evidence that new appointees can provide us with to demonstrate their operational viability.

7. Our position on key issues

The applications that we have dealt with have been diverse. They have raised several key issues on which stakeholders have sought greater clarity. This chapter sets out our position on these issues.

7.1 Regulation of new appointees (appointment conditions, suspensions and future regulation requirements)

Once we approve a new appointment, the appointee becomes subject to the same duties and obligations that apply to all other appointed companies. These are set out in the WIA91 and in the company's conditions of appointment.

We seek to minimise the regulatory burden on the companies. Taking into account the size of some new appointees, we may suspend introducing some conditions of appointment wholly or in part until it is appropriate to introduce them fully. We will not suspend any condition of appointment if we considered that doing so was not in the interests of consumers.

We expect all appointees to take full accountability for complying with their obligations to customers and the environment and to demonstrate that is the case. We will take action if we find a company is not meeting its obligations or fulfilling its customers' expectations.

7.2 Bulk services and bulk agreements

New appointees that lack their own water source or their own treatment works will need to purchase bulk supplies of these services from the existing appointee so that they can supply their customers.

Previously, existing appointees have offered a range of tariffs, including those based on:

- the relevant large user tariff;
- the full standard volumetric tariff; or
- a bespoke 'retail-minus' approach to avoidable cost.

We have reviewed the way we deal with bulk pricing, and following consultation, we have published a final [policy statement on bulk supply pricing](#) alongside this document.

If the applicant and the existing appointee cannot agree on terms for a bulk supply of water, under section 40 of the WIA91, the applicant may approach us for a determination. Similarly, under section 110A of the WIA91, an applicant may approach us for a determination of a bulk discharge agreement.

7.3 Infrastructure charges

Under section 146 of the WIA91, all appointed companies can charge for first-time connections to their water and sewerage network for household customers.

Condition C of an appointee's conditions of appointment sets out how these infrastructure charges are calculated, and we set an upper limit on them. The purpose of these charges is to fund enhancements of the appointee's network (not including the treatment plants or assets further upstream) to meet extra demand over time because of new connections.

Generally, infrastructure charges are dealt with in bulk supply agreements, with new appointees agreeing to levy such charges on their customers and pass them through to the existing appointee. We support this approach in that it is generally the existing appointee that owns the relevant network that may need to be enhanced.

The WIA91 does not explicitly set out the timing of infrastructure charge payments. Our view is that we consider infrastructure charges are payable to the new appointee when supply is made available – that is, when the first time connection is made. The timing of the payment of the amount equivalent to infrastructure charges by the new appointee to the existing appointee should be covered within bulk supply agreements.

We are reviewing funding for new connections, and will consider the outcomes from that work as appropriate.

7.4 Surface water and highway drainage charges

7.4.1 Surface water drainage

Water and sewerage companies have to remove and process the water that falls on properties and then flows directly or indirectly into public sewers, which are their responsibility. This is known as surface water drainage.

The companies can levy a charge for surface water drainage, which covers the cost taking away and treating surface water that runs from properties into the company's drains. This includes water that flows through gutters or that runs into the road and ends up in a company-owned sewer.

If any surface water from premises within the new appointee's site boundary enters into a public sewer owned by the existing appointee, then the new appointee must pay a cost-reflective surface water drainage charge to the existing appointee (the charge must reflect the actual costs incurred of providing the service). The new appointee should also pay surface water drainage charges if the water enters the existing appointee's sewer through a private sewer or drain, or through a section of a public sewer that the new appointee owns.

The applicant and existing appointee should negotiate any cost-reflective adjustment to the surface water drainage charge.

It is not relevant for the purpose of surface water drainage charging if the water enters directly or indirectly⁹ a public sewer owned by an existing appointee.

We welcome innovative and more sustainable approaches from all appointees to address surface water drainage. We consider that if the drainage system that the new appointee installs results in less surface water entering the existing appointee's sewers, this should be recognised in the price paid for the service.

7.4.2 Highway drainage

The Highways Agency and local authorities are responsible for managing the drainage of run-off from motorways and the road network effectively. Both existing and new appointees are usually responsible for the highway drainage in their own area of appointment. So, new appointees are responsible for charging customers for highway drainage in their own area or areas of appointment.

⁹ In the same way as it is not relevant to our assessment of whether a site is unserved.

In general, new appointees should not pay highway drainage charges to the existing appointee. But there may be circumstances where it is appropriate for them to do so, for example if their site encompasses an existing road.

We would not accept an application from an applicant who has clearly redrawn the site boundary to exclude roads, solely to avoid paying highway drainage charges.

7.5 Applications by associated companies

An application from an associated company would occur when a subsidiary company (of an existing appointee) applied for a new appointment.

Although there are no prohibitions to this effect within the WIA91, we consider that allowing applications from associate companies may increase the risks to both customers and to the competitive process.

Allowing associated companies to apply for an appointment within the area of the existing company may allow an existing appointee to use the new appointment mechanism to depart from its standard tariffs. As a result, they may gain an advantage over or deter new entrants by offering non-competitive tariffs.

We think that existing appointees should compete with new appointees based on their regional price and service offerings (and in the case of unserved sites on the price of and services involved in installing new infrastructure).

7.6 Applications by existing appointees

We encourage existing appointees to utilise the new appointments framework to expand the areas to which they supply water, sewerage or water and sewerage services. The threat to other appointees of losing their customers to competitors seeking to supply sites within their area of appointment should spur them to become more competitive. This brings with it the prospect of benefits for consumers that arise from better services, lower costs and prices, efficiency savings and innovation.

We will apply the same policy principles that we would use when considering an application from a new appointee to ensure that we meet our legal duties.

Our process will not distinguish between applications made by an existing or new appointee. But our information requirements will differ slightly. For example, we would not require information from an existing appointee on its financial security or

operational viability, other than for site-specific details if the site it wishes to supply is not nearby geographically. The information requirements we require from new and existing appointees is set out in our [process statement](#).

7.7 Infrastructure standards

Once we have granted a new appointment, the appointee is responsible for the quality of the infrastructure that is laid at that site. If the applicant does not adopt the water mains and service pipes, then current legislation prevents those mains and pipes from becoming connected to the supply system¹⁰.

The applicant is required to ensure that any infrastructure it lays on a site is laid in accordance with the construction standards of UK Water Industry Research (UKWIR) for the water industry.

To carry out such work, contractors can be accredited under the Water Industry Registration Scheme (WIRS) requirements. Under the scheme, Lloyd's Register carries out technical assessments of the service providers who elect to be accredited for contestable works associated with installing water infrastructure. Further details about WIRS can be found on [Lloyd's Register's website](#).

We do not require the contractors that existing appointees use to be WIRS accredited. This is because they are able to run their own accreditation exercises. If a new appointee was able to demonstrate to us that it was able to run its own accreditation scheme then we would allow them to do so. But, we want to be sure that infrastructure is laid to an appropriate quality. So, it must be constructed to **at least** the industry standards.

Any infrastructure laid that will come into contact with water must comprise only of materials that have been approved for use for such purposes. This is a requirement of Regulation 31 of [The Water Supply \(Water Quality\) Regulations 2010](#).

The DWI manages the Regulation 31 process and carries out technical audits of site assets and water quality compliance data, both of which may be influenced by sub-standard infrastructure. The applicant is required to liaise with the DWI throughout the process.

Some existing appointees have been reluctant to take over responsibility for the infrastructure should an applicant fail to obtain a new appointment. This is because, in their opinion, it would put customers at risk and it may not be contractually

¹⁰ Section 51D of the WIA91 - Prohibition on connection without adoption

straightforward to remedy problems. We consider that it would be unreasonable for existing appointees not to take over responsibility for infrastructure that had been laid in accordance with the industry standards.

7.8 Competition for new appointments

We do not publish any details of the site until we consult on the application. But public notice is served by the applicant under section 8 of the WIA91.

Some stakeholders have suggested that we should assess a number of applications to serve a site. This is so that we pick the one that offers the best deal for customers. This argument is most frequently made in relation to applications under the unserved criterion, where the choice of supplier is routinely made (and has to be made, because there are no end-customers on the site) by the developer.

We will not adopt this approach when assessing applications because developers already hold this form of competition when they choose between new and existing appointees. We have limited means of requiring developers to accept our choice and because of this, the developer may choose to supply that site under a different appointee.

We think this would favour the existing appointee rather than new applicants. This is because the existing appointee would be the only bidder already able to supply the site (having the legal duty to do so).

But we will include more details about the site and developer (subject to their consent) on our website when an application reaches the consultation stage.

7.9 If an appointee's business fails

Should an appointee's business fail, the special administration process that applies to all appointees will come into force.

If a court makes a special administration order because an appointee's business has failed, a special administrator will be appointed to manage the affairs, business and property of the appointee in accordance with sections 23-25 of the WIA91 with the purpose of either rescuing the business or transferring the business of the appointee to another company.

7.10 Abortive and non-abortive costs associated with new appointments

Existing appointees may incur costs when dealing with new and potential appointees. If a new appointment is not granted, the costs that the existing appointee incurs are known as 'abortive' costs. Existing appointees should bear such costs. We consider that they should also bear the costs of dealing with applicants in cases where a new appointment is granted (non-abortive costs).

This is because we consider that both abortive and non-abortive costs stem from the risk of losing business to a new appointee, which is a normal business risk that the existing appointee should bear.

7.11 Security and Emergency Measures Direction

The Security and Emergency Measures Direction (SEMD) places an enforceable duty on the companies to keep up to-date plans to ensure the provision of essential water and sewerage services at all times. For water services, this includes using alternative means to provide consumers with a minimum supply in the event of an unavoidable failure of a piped supply. For sewerage services, it means guarding against and dealing with discharges from sewers into water bodies that may be used for abstraction or where aquatic life may be adversely affected.

The plans should also cover discharges on to land where they may cause pollution or affect the amenities of the area. To help delivery of the SEMD, the UK Government periodically issues guidance that the companies must follow. Current guidance states that the minimum supply of water must be 10 litres of drinking water per person per day or, in the case of a prolonged incident, 20 litres per person per day. This is normally delivered to consumers in bottles or from tankers at nearby locations. This compares with average consumption of about 150 litres of water per person per day during normal conditions.

All appointed companies are required to prepare a statement each year to confirm that the requirements of the Direction are being met.

The SEMD follows from Section 208 of the Water Industry Act 1991, which is enforceable by the Secretary of State. In meeting these requirements, applicants will need to have two persons security cleared and submit annual compliance reports, both through Defra.

Once appointed as a water company, the applicant will also become a responder under the Civil Contingencies Act. This confers other statutory duties, and details should be obtained from the [Cabinet Office](#).



Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7699

Website: www.ofwat.gov.uk
Email: enquiries@ofwat.gsi.gov.uk
February 2011

© Crown copyright 2011

You may reuse this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/> or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU or email psi@nationalarchives.gsi.gov.uk.

This publication is also available on our website at www.ofwat.gov.uk. Any enquiries about this publication should be sent to the above address.