



## **Water Services Regulation Authority**

Water Industry Act 1991 Section 8(3)

Proposal by the Water Services Regulation Authority (Ofwat) to vary the appointments of Independent Water Networks and Southern Water as sewerage companies.

This notice is a consultation on this proposal. The consultation period will last for 28 days. Having considered any representations submitted in response to the consultation, Ofwat will decide whether or not to make the variations to these companies' appointments.

### **The Site**

Independent Water Networks Limited (Independent Water Networks) has applied to be the sewerage undertaker (sewerage company) for a development consisting of 1,500 household properties called Castle Hill, in Ebbsfleet (the Site). The Site is presently within the sewerage services area of Southern Water Services Limited (Southern Water).

### **The proposal**

Ofwat proposes to:

- (i) vary the appointment of Independent Water Networks as a sewerage company by adding the Site to its sewerage services area; and
- (ii) vary the appointment of Southern Water as a sewerage company by excluding the Site from its sewerage services area.

By means of these variations, Independent Water Networks will become the provider of sewerage services for the Site.

## Policy for new appointments and variations

The new appointment and variation mechanism, set out in primary law<sup>1</sup>, provides an opportunity for entry and expansion into the water and sewerage sectors by allowing one company to replace the existing appointee as the provider of water and / or sewerage services for a specific area. This mechanism can be used by new companies to enter the market and by existing appointees to expand their businesses.

When considering applications for new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our statutory duty to protect consumers, wherever appropriate by promoting effective competition. In particular, in relation to unserved sites, we consider that we must ensure that the future customers on a site – who do not have a choice of supplier – are adequately protected. When assessing applications for new appointments and variations, the two key policy principles we apply are that:

1. customers, or future customers, should be no worse off than if the site had been supplied by the existing appointee; and
2. Ofwat must be satisfied that an applicant will be able to finance the proper carrying out of its functions as a water and/or sewerage company.

We clarified these two policy principles in February 2011 when we published our 'New appointments and variations – a statement on our [policy](#) and [process](#) for new appointments and variations'. In November 2012, we published '[Statement on our approach for assessing financial viability of applications for new appointments and variations](#)'. This states that we will adopt a company-based assessment of financial viability, rather than a detailed site-based assessment, where it is appropriate to do so.

When we assess whether customers will be no worse off as a result of the appointment, we not only consider the customers on the site but also the generality of customers. These include not only the customers of the existing provider but also customers more generally across England and Wales, who

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<sup>1</sup> The legal framework for new appointments is set out in the Water Industry Act 1991 (WIA91). Section 7 of the WIA91 sets out the criteria by which an appointment or variation may be made. Section 8 sets out the procedure for making that appointment or variation.

in our view benefit from the effective operation of the new appointment and variation mechanism.

## **The application**

Independent Water Networks has applied to be the sewerage company for the Site under the unserved criterion set out in section 7(4)(b) Water Industry Act 1991.

## **Unserved status of the Site**

To qualify under the unserved criterion, an applicant must show that at the time the appointment is made, none of the premises in the proposed area of appointment is served by the existing appointee. Independent Water Networks submitted a report (from an independent professional advisor appointed by it) which verified the Site as unserved for sewerage services. We shared this report with Southern Water, which agrees that the site is unserved. Having considered the information that we have received about the Site, we are satisfied that the Site is unserved.

## **Protecting customers**

Ofwat acts to protect consumers, especially those who are unable to choose their supplier. In assessing applications to supply new development sites, Ofwat acts on behalf of end-customers who are not yet on site, to protect their interests. The fact that future customers on a site have not directly chosen their supplier is not a position unique to new appointments – very few customers in England and Wales are able to choose their supplier<sup>2</sup>.

Recognising this, our assessment of an applicant's proposals includes analysis of its plans to ensure customers will be at least no worse off in terms of their annual bills and levels of service than if they had been supplied by the

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<sup>2</sup> The only customers that can normally choose their supplier are non-household customers that consume at least 5MI per year and are supplied by a company that is wholly or mainly in England (and at least 50MI for companies wholly or mainly in Wales) and satisfy the Water Supply Licensing (WSL) eligibility criteria. Those non-household customers that consume at least 50 MI in England (and at least 250 MI in Wales) can switch suppliers under either the WSL regime or under the new appointments regime.

existing appointee. We will continue to protect customers on the Site by regulating the new appointee's prices and service levels.

### **Customers on the Site - price**

Independent Water Networks proposes to construct, own and operate an on-site sewage treatment works and sewerage network.

Independent Water Networks proposes to offer customers a 5% discount on the volumetric charge for sewerage services compared to that of Southern Water, while matching Southern Water's fixed sewerage charge.

Having considered Independent Water Networks' pricing proposals, we are satisfied that customers will be at least no worse off in terms of their annual bills than if they had been served by Southern Water.

Currently, Independent Water Networks' conditions of appointment provide that Independent Water Networks' price limit is set by reference to the charges of the previous appointee for each of its sites. In this case, Independent Water Networks may not charge customers on the Site more than Southern Water's charges for sewerage. We consider that, given Independent Water Networks' small size, this represents a more proportionate way of regulating its prices than subjecting it to a full bespoke price review as we do for larger companies. However, condition B of Independent Water Networks' conditions of appointment allows us to set a specific price limit for Independent Water Networks. This condition is temporarily suspended but we will activate it when we consider it is appropriate to do so. This is unlikely to be before 2019.

### **Customers on the Site - levels of service**

Independent Water Networks is subject to the same customer service level requirements as other sewerage appointees.

## **Guaranteed Standards Scheme (GSS) compliance and base service levels**

Independent Water Networks has submitted information about its proposed service levels under:

- the GSS Regulations<sup>3</sup>;
- our service indicators; and
- its own company standards.

We have assessed these planned levels of service and are satisfied that they match or exceed those typically achieved by Southern Water and the sector as a whole.

## **Codes of Practice**

Every appointee is required under conditions G, H and I of its conditions of appointment to publish debt, leakage and customer Codes of Practice. We have assessed Independent Water Networks' Codes of Practice, and are content that these are of an approvable standard and that customers on the Site would be no worse off than if they had been served by Southern Water.

## **Independent Water Networks' voluntary standards**

We have also made a detailed check of Independent Water Networks' voluntary service standards, including where they enhance the regulatory GSS provisions, as part of reviewing Independent Water Networks' Codes of Practice. We require that Independent Water Networks matches or exceeds Southern Water's own standards (except where there is reasonable justification for not doing so).

Examples of where Independent Water Networks will offer improved customer service compared with Southern Water include:

- enhanced GSS standards in a number of areas, for example responding to billing enquiries within 5 working days or will make a £35 payment compared with Southern Water's £25 payment; and

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<sup>3</sup> The Water Supply and Sewerage Services (Customer Service Standards) Regulations 2008

- some additional standards, for example, Independent Water Networks will make a provision of up to £50 per day for alternative accommodation to customers who experience internal sewer flooding and have to move temporarily due to ill health.

However, Independent Water Networks does not propose to match Southern Water in some ways, for example:

- Independent Water Networks currently has no charitable trust fund. Charitable trusts are set up on a voluntary basis by companies to assist those in financial difficulty. Southern Water does have a charitable trust fund; and
- Independent Water Networks offers more limited ways for customers to contact it than Southern Water. For example, Southern Water has a variety of telephone numbers including Freephone, 0845 and 0300 numbers whereas Independent Water Networks has one single local rate telephone number.

While the areas in which Independent Water Networks does not propose to match Southern Water are not statutory or appointment requirements, we have explained to Independent Water Networks that these areas must be kept under review as its customer base expands. Independent Water Networks has committed to do so. As a minimum, we will review these three years after the most recent approval as part of the re-approval of Codes of Practice. As Independent Water Networks extends into different existing appointees' areas, all Codes will be assessed against other existing appointees' policies and we will request improvements we judge are required as its customer base grows.

Having considered Independent Water Networks' overall proposed service levels, and compared them with those of Southern Water, we are satisfied that customers on the Site will receive a level of service that is comparable with the level of service they would have received had they been served by Southern Water.

### **Developer choice**

Ofwat takes into consideration the choices of the site developer. In this case, the Site developer has said that it wants Independent Water Networks to be the sewerage company for the Site.

## **Environment Agency (EA)**

We take the views of the EA into account before progressing to consultation on an application for a new appointment. It informed us that it is content for us to consult on this application.

## **Southern Water's existing customers**

In considering whether customers will be no worse off, we also looked at the potential effects of this variation on the prices that Southern Water's existing customer base may face.

The calculation necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on Southern Water's customers. It is therefore necessary to use a simplified set of figures. We have expressed the effect in 'per bill' terms to try and quantify the possible effect in an easily understandable way.

Broadly, we have assessed the potential magnitude of this impact by comparing how much Southern Water might have expected to receive in revenue from serving the Site directly, with the revenues it might expect from serving the Site indirectly via a bulk discharge agreement with Independent Water Networks. In this case, if we grant the variation to Independent Water Networks, Southern Water would not earn any bulk discharge revenue as IWN would carry out discharge itself. The lower bound of the range takes into account the benefit to Southern Water as a result of Independent Water Networks serving the site, by estimating the costs that Southern Water is likely to avoid, such as retail costs and capital and operating costs associated with the local network used to serve the Site. The upper bound of the range does not take these avoided costs into account. We look at these differences in revenue and costs over a hundred year timeframe to reflect the long life of the assets that will be used to supply customers at the Site.

In this case, we have calculated that if we grant the Site to Independent Water Networks, there may be a potential impact on Southern Water's existing customers of between £0.12 and £0.15.

We are comfortable that this range accounts for the uncertainty in the costs that may be avoided by Southern Water.

Further, this impact does not take into account the potential spillover benefits to customers arising from dynamic efficiencies achieved as a result of the competitive process to win new sites. We set out the wider benefits we believe stem from the new appointments and variations regime below.

### **Wider benefits**

The new appointment and variation mechanism provides a means for companies from outside the water and sewerage sectors to enter the market and for existing water and sewerage appointees to expand their businesses.

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers in different ways (such as developers of new housing sites and household and non-household customers). Examples of benefits delivered via the new appointment and variation mechanism include price discounts, better services, environmental improvements and innovation in the way services are delivered. Benefits can also accrue to the existing appointee's customers, because when that appointee faces a challenge to its business that challenge can act as a spur for it to raise its game.

These wider benefits that we believe stem from the new appointments and variations regime are set out more fully in our [policy statement](#).

### **Overall assessment of effect on customers**

Overall, we consider that customers on the Site will be at least no worse off being served by Independent Water Networks than they would have been had they been served by Southern Water. We consider that the potential effect on Southern Water's existing customers is very likely to be offset by the wider benefits of the new appointment and variation mechanism. We are therefore satisfied that customers would be no worse off as a result of our granting this variation.

### **Ability to finance and properly carry out its functions**

We have statutory duties to ensure that efficient appointees can finance the proper carrying out of their functions and to ensure that those functions are properly carried out. When a company applies for a new appointment or variation, it must satisfy us that it is able to carry out all of the duties and obligations associated with being an appointed water or sewerage company.



In this case, Independent Water Networks has satisfied us that it can finance its functions and that it is able to properly carry them out.

## **Conclusion and next steps**

In assessing Independent Water Networks' application for this variation, we have considered the general benefits of new appointments. We are satisfied that our key policy principles have been met in this case, as customers will be no worse off, and Independent Water Networks will be able to finance and carry out its functions. We have also considered the effects of granting this variation on Southern Water's existing business.

We are therefore minded to grant the variation under the unserved criterion. We are consulting on our proposal to do so.

## **Where to send submissions**

Any representations about, or objections to, this proposal should be sent in a single written submission to Richard Field, Senior Associate, Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA so as to be received no later than 17 February 2015. Submissions can also be emailed to:

[Richard.Field@ofwat.gsi.gov.uk](mailto:Richard.Field@ofwat.gsi.gov.uk)