



Variation of SSE Water's appointment to include Emerson's Green Gateway

On 27 February 2015, Ofwat began a consultation on a proposal to vary SSE Water's appointment to become the water and sewerage services provider for a development in Bristol Water's water supply area and Wessex Water's sewerage services area called Emerson's Green Gateway in South Gloucestershire (**"the site"**). When fully built, the site will consist of 325 household properties. The consultation ended on 27 March 2015. During the consultation period, we received representations from three organisations, which we considered in making our decision. On 6 May 2015, we granted SSE Water a variation to its existing appointment to enable it to supply water and sewerage services to the site.

This notice gives our reasons for making this variation.

Introduction

The new appointment and variation mechanism, specified by Parliament and set out in primary legislation, allows one company to replace the current company 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 companies to expand into areas where they are not the appointed company. In this case, SSE Water applied to replace Wessex Water as the appointed water and sewerage company for the site.

A company may apply for a new appointment (or a variation of its existing appointment to serve an additional site) if any of the following three criteria are met:

- None of the premises in the proposed area of appointment is served by the existing appointed company at the time the appointment is made (the **"unserved criterion"**);
- Each premises is likely to be supplied with at least 50 mega litres per year (in England) or at least 250 mega litres per year (in Wales) and the customer in relation to each premises consents (**"the large user criterion"**);

- The existing water and sewerage supplier in the area consents to the appointment (“**the consent criterion**”).

When considering applications for new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our duty to protect consumers wherever appropriate, by promoting effective competition. In particular, in relation to unserved sites, we seek to ensure that the future customers on the 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:

1. Customers, or future customers, should be no worse off than if they had been supplied by the existing appointee; and
2. We 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.

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers (such as household and non-household customers and developers of new housing sites). Benefits can include price discounts, better services, environmental improvements and innovation in the way services are delivered.

Benefits can also accrue to customers who remain with the existing appointee, because when the existing appointee faces a challenge to its business, that challenge can act as a spur for it to improve its services. We believe the wider benefits of competition through the new appointments and variations mechanism can offset any potential disbenefits for existing customers that might arise. We consider these potential disbenefits in more detail below.

The application

SSE Water applied to be the water and sewerage services appointee for the site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). The site is an extension to a current site served by SSE Water called Emerson's Green. SSE Water proposes to serve the site by entering into a bulk supply agreement with Bristol Water and a bulk discharge agreement with Wessex Water.

Financial viability of the proposal

We will only make an appointment if we are satisfied that the proposal poses a low risk of being financially non-viable. We assess the risk of financial viability on a site-by-site basis and also consider the financial position of the company as a whole.

Based on the information available to us, we concluded that the proposal was at low risk of being financially non-viable.

We considered the impact of granting this variation on the financial position of the appointee as a whole. Having done this we are satisfied that granting this variation poses a low risk of a significant negative impact on the financial position of SSE Water.

Assessment of 'no worse off'

SSE Water will charge customers based on Bristol Water's and Wessex Water's existing metered water and sewerage domestic tariffs. SSE Water has Codes of Practice and a Charges Scheme, and we are satisfied that customers will be offered an appropriate level of service. As such, we consider that customers will be 'no worse off' being served by SSE Water instead of by Bristol Water and Wessex Water.

Effect of appointment on Wessex Water's customers

In considering whether customers will be no worse off, we also looked at the potential effects of this variation on the price that Bristol Water's and Wessex 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 customers of Bristol Water and Wessex Water. 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 Bristol Water and Wessex Water might have expected to receive in revenue from serving the site directly, with the revenues they might expect from serving the site indirectly via bulk supply and bulk discharge agreements with SSE Water. The lower bound of the range takes into account the benefit to Bristol Water and Wessex Water as a result of SSE Water serving the site, by estimating the costs that Bristol Water and Wessex Water are 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-lived assets that will be used to supply customers at the site.

In this case, we have calculated that if we grant the site to SSE Water, there may be a potential impact on the bills of Bristol Water's existing customers of between -£0.01 and £0.28, while there may be a potential impact on the bills of Wessex Water's existing customers of between £0.03 and £0.08 per year. We are comfortable that these ranges account for the uncertainty in the costs that may be avoided by Bristol Water and Wessex Water.

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.

Developer choice

We take into consideration the choices of the site developer. In this case, the developer said that it wanted SSE Water to be the water and sewerage company for the site.

Responses received to the consultation

We received three responses to our consultation, from the Consumer Council for Water ("**CCWater**"), Wessex Water and the Environment Agency ("**EA**"). We considered these responses before making the decision to vary SSE Water's appointment. The main points raised in the responses are set out below.

CCWater

CCWater noted that Wessex Water offers a social tariff, known as Assist, but SSE Water does not currently offer an equivalent. CCWater expects SSE Water to consider offering social tariffs as its customer base grows.

We have raised CCWater's concerns about social tariffs with SSE Water. It has told us that it is mindful of the 'no worse off' principle, and is keeping a watching brief on what other existing appointees are doing with respect to social tariffs. It says that, subject to further review, it may move towards social tariff arrangements similar in nature to existing appointees.

CCWater is also concerned about the impact that the growth of new appointments could have on water and sewerage companies' existing customers. It does not consider that the overall benefit of new appointments and variations to existing customers of the water or sewerage companies is clear.

While there may potentially be an impact in the short run, due to low capital maintenance associated with a new development, capital maintenance will rise as the assets on these new developments age. On average, an incumbent will have a mix of old and new assets and this would not materially change if the incumbent served new sites rather than a new appointee. We are therefore of the view that the potential cumulative impacts that concern CCWater will not arise or will not be material.

Wessex Water

Wessex Water considered that some of the issues we raised in our consultation notice regarding SSE Water's and Wessex Water's customer service provisions need to be clarified.

It is important to note that we carry out a full comparison of the Codes of Practice of the applicant and the existing appointee(s). We carry out over 50 comparison checks, but summarise the results of these in the public consultation document. We cannot mention the results of all the individual service level comparison checks in our consultation document.

Although there are circumstances where SSE Water's service level offerings are better than those of Wessex Water (and Bristol Water), there are also areas where SSE Water's service level offerings are not as good as Wessex Water (and Bristol Water). In the round, we are content that customers will be no worse off in terms of price and service being served by SSE Water rather than by Wessex Water (and Bristol Water).

Wessex Water also queried the benefits to customers of new appointments and variations, and considered Ofwat should carry out a review to quantify these.

New appointments and variations provide challenge to existing appointees. This drives efficiencies, stimulates innovation and reveals information. We are satisfied that 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:

- In some 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.
- There have been cases in which new appointees 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.
- New appointees have provided services using more environmentally sustainable, on-site methods of treatment and discharge.

EA

The EA made no objections to us granting this variation, although it made the point that SSE Water should ensure the Emerson's Green Gateway development is included in its Water Resources Management Plan (WRMP). We have reminded SSE Water of its statutory duty to prepare and maintain a WRMP.

Conclusion

Having assessed SSE Water's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to SSE Water's area of appointment to allow it to serve the site for water and sewerage services. This variation became effective on 7 May 2015.