

Water Services Regulation Authority

Water Industry Act 1991 Section 8(3)

Proposal by the Water Services Regulation Authority (Ofwat) to appoint Severn Trent Services (Water and Sewerage) Ltd (“Severn Trent Services”) as a sewerage undertaker, and to vary the appointment of Thames Water Utilities Limited (“Thames Water”) as a sewerage undertaker.

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 appoint Severn Trent Services as a sewerage undertaker and to vary Thames Water’s appointment as a sewerage undertaker.

The Site

Severn Trent Services has applied to be the sewerage undertaker (sewerage company) for a development consisting of 3,850 new household properties and an existing MoD base at Wellesley, in Aldershot (the Site). The Site is presently within the sewerage services area of Thames Water.

The proposal

Ofwat proposes to:

- (i) grant a sewerage only appointment to Severn Trent Services; and
- (ii) vary the appointment of Thames Water as a sewerage company by excluding the Site from its sewerage services area.

By means of this appointment (and the consequent variation of Thames Water’s appointment), Severn Trent Services 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 legislation¹, provides an opportunity for entry and expansion into the water

¹ The legal framework for new appointments is set out in the Water Industry Act 1991 (WIA91). Section 6 of the WIA91 sets out the criteria for making a new appointment and

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

The application

Severn Trent Services applied to be the sewerage company for the Site under section 6 and section 7(4)(b) of the Water Industry Act 1991 (WIA91) (the unserved criterion).

section 7 of the WIA91 sets out the criteria for varying an existing appointment. Section 8 sets out the procedure for making that appointment or variation.

Under section 6 WIA91, an applicant for an appointment as a water or sewerage company must be a limited company and it must not hold a water supply licence. We confirm that we are satisfied that Severn Trent Services is a limited company, and does not hold a water supply licence.

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. Severn Trent Services provided us with the factual background to the site, and told us it has a private sewerage network (owned by the MoD) and no sewerage assets owned by Thames Water. Severn Trent Services also provided us with a letter from Thames Water stating that it did not own any assets on the Site. 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 supplier².

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 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

Severn Trent Services proposes to operate an on-site sewage treatment works.

² 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.

Severn Trent Services proposes to charge customers an amount that is 2.5% less than the fixed and volumetric charge for sewerage services charged by Thames Water.

Having considered Severn Trent Services' 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 Thames Water.

If we grant this application, Severn Trent Services would become a new appointee. It would therefore need to be governed by a set of Conditions of Appointment like other new appointees and incumbent undertakers. It is likely that we would initially suspend certain Conditions – in particular, we propose suspending most of Condition B with the effect that Severn Trent Services will not be subject to its own price control. Instead, as with other new appointees, we propose inserting transitional provisions into Severn Trent Services' Condition B to the effect that it may not charge more than Thames Water.

We intend to hold an industry-wide consultation later this year on licence condition changes that are considered necessary to give effect to retail market opening in 2017. If we grant this application and Severn Trent Services' Appointment comes into effect prior to that wider industry process, Severn Trent Services will be consulted as part of that process with a view to amending its Conditions of Appointment to give effect to retail market opening.

Customers on the Site - levels of service

Severn Trent Services will be subject to the same customer service level requirements as other sewerage appointees.

With regard to service levels, we have reviewed Severn Trent Services' proposed service levels and compared these to the performance commitments of Thames Water. Based on this review we are satisfied that customers will be offered an appropriate level of service by Severn Trent Services and that overall customers will be 'no worse off' being served by Severn Trent Services instead of by Thames Water.

Guaranteed Standards Scheme (GSS) compliance and base service levels

Severn Trent Services has submitted information about its proposed service levels under:

- the GSS Regulations³;
- 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 Thames Water and the sector as a whole.

Codes of Practice

Every appointee is required under conditions G, and I of its conditions of appointment to publish debt and customer Codes of Practice (and water appointees are also required under condition H to publish a leakage Code of Practice). We have assessed Severn Trent Services' draft Codes of Practice, and are content that customers on the Site would be no worse off than if they had been served by Thames Water.

Severn Trent Services' voluntary standards

We have made a detailed check of Severn Trent Services' voluntary service standards, including where they enhance the regulatory GSS provisions. We require that Severn Trent Services matches or exceeds Thames Water's own standards (except where there is reasonable justification for not doing so).

Examples of where Severn Trent Services will offer improved customer service compared with Thames Water include:

- Severn Trent Services will take on responsibility for maintaining and repairing private pumping stations prior to 1/10/2016, which is the date set for the transfer of ownership of private pumping stations to undertakers. Thames Water does not propose to take on responsibility before 1/10/2016.
- If there is sewer flooding from customer drains, Severn Trent Services and Thames Water will spend up to two hours investigating and clearing any blockages for a fixed-fee. If the problem recurs within 14 day, Severn Trent Services will clear it again for free, whereas Thames Water will only clear it again for free if the problem recurs within seven days.
- Severn Trent Services will provide an approval decision on new sewer connections within 12 days, whereas Thames Water takes 14 days.
- Customers requiring a new sewer connection are required to give Severn Trent Services five days' notice of the day they want the

³ The Water Supply and Sewerage Services (Customer Service Standards) Regulations 2008

connection to be made, whereas Thames Water requires 14 days' notice.

However, Severn Trent Services does not propose to match Thames Water in some ways, for example:

- Severn Trent Services' call centre opening hours are five hours per week shorter than those of Thames Water.
- Severn Trent Services does not offer a social tariff (except for Watersure) while Thames Water offers the WaterSure Plus tariff.
- Severn Trent Services does not have a charitable trust fund, while Thames Water does.

While the areas in which Severn Trent Services does not propose to match Thames Water are not statutory or appointment requirements, we have explained to Severn Trent Services that these areas must be kept under review as its customer base expands.

Having considered Severn Trent Services' overall proposed service levels, and compared them with those of Thames 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 Thames Water.

Developer choice

Ofwat takes into consideration the choices of the site developer. In this case, the Site developer has said that it wants Severn Trent Services 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.

Thames Water's existing customers

In considering whether customers will be no worse off, we also looked at the potential effects of this appointment on the prices that Thames 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 Thames 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 Thames 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 Severn Trent Services. In this case, if we grant the appointment to Severn Trent Services, Thames Water would not earn any bulk discharge revenue as Severn Trent Services plans to service the Site via its own network. The lower bound of the range takes into account the benefit to Thames Water as a result of Severn Trent Services serving the Site, by estimating the costs that Thames 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 Severn Trent Services, there may be a potential impact on Thames Water's existing customers of between £0.08 and £0.10.

We are comfortable that this range accounts for the uncertainty in the costs that may be avoided by Thames 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 Severn Trent Services than they would have been had they been served by Thames Water. We consider that the potential effect on Thames 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, Severn Trent Services has satisfied us that it can finance its functions and that it is able to properly carry them out.

In February 2011, we published 'New appointments and variations – a statement on our policy'. This includes a statement on our policy on the minimum level of financial security required based on the following formula:

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.

In line with all other water and sewerage companies, Severn Trent Services will procure legally enforceable undertakings from its Ultimate Controller which will remain in force for as long as it retains its Appointment. These undertakings provide that all necessary resources, (which includes management and financial resources, personnel, and fixed and moveable

assets), will be made available to Severn Trent Services to enable it to comply with its obligations under the Act and its conditions of appointment.

Severn Trent Services considers that an approved internal loan facility provides sufficient funding to cover project set up costs, initial operating costs and our financial security requirements. The internal loan facility is intended to be informally reviewed at an operational level every quarter with a formal review every five years to ensure that it is sufficient.

Conclusion and next steps

In assessing Severn Trent Services' 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 Severn Trent Services will be able to finance and carry out its functions. We have also considered the effects of granting this variation on Thames 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 6 November 2015. Submissions can also be emailed to: Richard.Field@ofwat.gsi.gov.uk