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## **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, Affinity Water and Thames Water as water and sewerage companies at Bishops Stortford**

This notice is a consultation on this proposal. The consultation period will last for 28 days, at the end of which we will consider any representations submitted in response to the consultation and decide whether or not to make the variations to these companies' appointments.

## **The Site**

Independent Water Networks has applied to be the water and sewerage services company for a new mixed-use development, known as Bishops Stortford North, located at Bishops Stortford (“the Site”). The Site, when completed, will have 2,200 domestic connections and 5 commercial connections.

The Site is currently within the water supply area of Affinity Water and the sewerage services area of Thames Water. Independent Water Networks expects the first domestic property to be ready for occupation by April 2016.

## **The proposal**

Ofwat proposes to:

- (i) vary the appointment of Independent Water Networks as a water and sewerage company by adding the Site to Independent Water Networks' water supply and sewerage services areas;
- (ii) vary the appointment of Affinity Water as a water company by excluding the Site from its water supply area; and
- (iii) vary the appointment of Thames Water as a water and sewerage company by excluding the Site from its sewerage services area.

By means of this appointment (and the consequent variations of Affinity Water's and Thames Water's appointments), Independent Water Networks will become the water and sewerage supplier for the Site.

## **Policy for new appointments and variations**

The new appointment and variation mechanism, set out in primary legislation<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 say in the choice of supplier – are adequately protected.

When we assess applications for new appointments and variations, the two key policy principles we apply are that:

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

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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.

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

Independent Water Networks has applied to be the water and sewerage company for the Site under the unserved criterion set out in section 7(4)(b) Water Industry Act 1991(WIA91) (“the unserved criterion”).

## 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 water and sewerage services. Both Affinity Water and Thames Water agree that the Site is unserved.

Having considered the relevant information that we have received, 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 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 take a bulk supply of water from Affinity Water to supply the Site, and discharge both wastewater and surface water from the Site into Thames Water's sewers.

Independent Water Networks proposes to offer household customers on the Site a volumetric charge for water that is 5% lower than Affinity Water's. Charges for all other services supplied to the Site would be equivalent to the standard published corresponding charges of Affinity Water and Thames Water.

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 Affinity Water and Thames Water.

Currently, Independent Water Networks' Conditions of Appointment provide that Independent Water Networks' price limit is set by reference to the charges of the incumbents for each of its sites. In this case, Independent Water Networks may not charge customers on the Site more than Affinity Water's charges for the water supply and Thames Water's charges for sewerage services.

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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.

We consider that, given Independent Water Networks' small size, this capping represents a more proportionate way of regulating its prices than subjecting it to a full price review. We have, therefore, suspended those parts of Condition B of Independent Water Networks' Conditions of Appointment which allow us to set a price limit for Independent Water Networks. But we will activate these provisions when we consider it appropriate to do so.

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. Independent Water Networks 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**

Independent Water Networks will be subject to the same customer service level requirements as other water and sewerage appointees.

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

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

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

- the statutory requirement of the GSS Regulations<sup>3</sup>;
- our service indicators; and

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

- its own company standards.

We have assessed these planned levels of service and are satisfied that they match or exceed those typically achieved by Affinity Water, Thames 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.

## Independent Water Networks' voluntary standards

We have made a detailed check of Independent Water Networks' voluntary service standards, including where they enhance the statutory GSS provisions. We require that Independent Water Networks matches or exceeds Affinity Water's and Thames 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 Affinity Water and Thames Water include:

- enhanced GSS standards in a number of areas, for example responding to billing enquiries within 5 working days failing which it will make a £35 payment. This compare with Affinity Water's 5 working days and £20 payment and Thames Water's 10 working days and £30 payment; and
- 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 Affinity Water and Thames 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 customers in financial difficulty. Affinity Water and Thames Water do have charitable trust funds; and

- Independent Water Networks offers more limited ways for customers to contact it than Affinity Water and Thames Water. For example, Affinity Water and Thames Water have 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 Affinity Water and Thames 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.

Having considered Independent Water Networks' overall proposed service levels, and compared them with those of Affinity Water and 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 from Affinity Water and Thames Water.

## **Developer choice**

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

## **Environment Agency (EA) and Drinking Water Inspectorate (DWI)**

We take the views of these organisations into account before progressing to consultation on an application for a new appointment. Both EA and DWI are happy for us to do this consultation.

## **Affinity Water's and Thames 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 Affinity Water's and Thames Water's existing customers may face.

The calculation we used to make this assessment necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on Affinity Water's and 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 Affinity Water and Thames 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 a bulk discharge agreements respectively with Independent Water Networks. The lower bound of the range takes into account the benefit to Affinity Water and Thames Water as a result of Independent Water Networks serving the Site, by estimating the costs that Affinity Water and Thames 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 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 the bills of Affinity Water's existing customers of between -£0.03 and £0.07, and between £0.00 and £0.02 on the bills of Thames Water's existing customers.

We are comfortable that these ranges account for the uncertainty in the costs that may be avoided by Affinity Water and 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.

We have set out these wider benefits 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 Affinity Water and Thames Water. We consider that the potential effect on Affinity Water's and Thames Water's existing customers is likely to be negligible and in any event is 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.

In 'New appointments and variations – a statement on our policy,' which we published in February 2011, we included 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.

Independent Water Networks provided an unlimited keepwell agreement from its new owners Brookfield Utilities UK Limited (BUUK) in July 2013. Independent Water Networks have confirmed that this agreement is still in place and will cover this proposed new Site. BUUK continue to hold an investment grade credit rating with Moody's Investors Service.

## **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 two 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 the existing customers of Affinity Water and Thames Water.

We are therefore minded to grant the appointment 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 Samuel Okyere, Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA so as to be received no later than 14 December 2015. Submissions can also be emailed to: [samuel.okyere@ofwat.gsi.gov.uk](mailto:samuel.okyere@ofwat.gsi.gov.uk).