
Variation of Albion Water's appointment to include Five Oaks Lane

On 22 October 2015, Ofwat began a consultation on a proposal to vary Albion Water's appointment of Albion Water to become the water and sewerage services provider for a development in Northumbrian Water's water supply area and Thames Water's sewerage services area called Five Oaks Lane in Chigwell (**"the site"**).

The consultation ended on 19 November 2015. During the consultation period, we received representations from three organisations, which we considered in making our decision. On 25 January 2016, we granted Albion 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, Albion Water applied to replace Northumbrian Water and Thames Water to become 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

Albion 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**”). Albion Water will serve the site by purchasing a bulk supply of water from Northumbrian Water, and by constructing a new sewage treatment works rather than discharging to the sewers of Thames Water.

Unserved status of the site

To qualify under the unserved criterion, an applicant must show that at the time the appointment or variation is made, none of the premises in the proposed area of appointment will be served by the existing appointee. Albion Water submitted a report (from an independent professional advisor appointed by it) which verified the Site as unserved for water and sewerage services. We shared this report with

Northumbrian Water and Thames Water, who both agree that the site is unserved. Having considered the information that we have received about the site, we are satisfied that the site is unserved.

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 the site demonstrates sufficient financial viability, and Albion Water has satisfied us that it can finance its functions and that it is able to properly carry them out.

Assessment of 'no worse off'

Albion Water will offer customers a 5% discount on the volumetric sewerage charges of Thames Water, while matching Thames Water's fixed sewerage charge and the water charges of Northumbrian Water.

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

Effect of appointment on Northumbrian Water's and Thames 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 Northumbrian Water's and 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 customers of Northumbrian Water and Thames 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 Northumbrian Water and Thames Water might have expected to receive in revenue from serving the site directly, with

the revenues they might have expected from serving the site indirectly via bulk services agreements with Albion Water. In this case, Thames Water do not earn any bulk discharge revenue as Albion Water will service the site via its own network. The lower bound of the range takes into account the benefit to Northumbrian Water and Thames Water as a result of Albion Water serving the site, by estimating the costs that Northumbrian 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-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 Albion Water, there may be a potential impact on the bills of Northumbrian Water's existing customers of between -£0.03 and -£0.02, while there is likely to be no impact on the bills of Thames Water's existing customers.

We are comfortable that this range accounts for the uncertainty in the costs that may be avoided by Northumbrian Water and Thames 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 Albion 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 Environment Agency, Thames Water and the Consumer Council for Water ("**CCWater**"). We considered these responses before making the decision to vary Albion Water's appointment. The points raised in the response are set out below.

Environment Agency

The Environment Agency made no objections to us granting this variation. It noted that it did have two previous concerns with this proposal (the potential for both river

contamination and flood risk), but these have both now been satisfactorily addressed by Albion Water.

Thames Water

Thames Water queried the charging proposals of Albion Water, asking Ofwat to clarify whether Albion Water's proposed 5% discount is based on the Thames Water sewerage tariff including or excluding the Thames Tideway Tunnel (TTT) element of Thames Water's sewerage charge. Albion Water's proposed 5% discount is based on the Thames Water sewerage tariff including the TTT element. Thames Water considers new appointees should offer discounts based on the Thames Water sewerage tariff excluding the TTT element, to discourage inefficient entry. We address this issue below.

CCWater

CCWater expressed concerns at how new appointees in Thames Water's area will charge and particularly queried whether charges of new appointees should provide a discount to customers to take into account the TTT element of Thames Water's sewerage charge.

All Thames Water's sewerage customers contribute to the cost of building the TTT (as charges are regionally averaged). A new appointee's charges are linked to the charges of the incumbent which means, in this case, Albion Water may not charge customers more than the charges of Thames Water, a charge that includes the TTT element.

Having considered CCWater's and Thames Water's representations on this issue, we consider that we should not depart from our existing policy in assessing whether to grant an application by a new appointee in Thames Water's sewerage services area. We currently assess applications based on whether customers in the area will be "no worse off" being supplied by the new appointee than they would have been had they been supplied by the previous company. Once granted, a new appointee is not subject to its own price control – instead its licence provides that it may not charge its customers more than the equivalent charge of the previous company. While we could subject a new appointee to its own price control, this is not considered proportionate given the small size of new appointees areas. Based on this approach, we do not require applicants to demonstrate cost-reflectivity and it would be inconsistent to make an exception for the TTT without reviewing the whole way we regulate new appointees.

Conclusion

Having assessed Albion Water's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to Albion Water's area of appointment to allow it to serve the site for water and sewerage services.