



## **Water Services Regulation Authority**

Water Industry Act 1991 Section 8(3)

Proposal by the Water Services Regulation Authority (Ofwat) to vary the Appointments of SSE Water and Thames Water as water and sewerage undertakers.

### **The Site**

SSE Water has applied to be the water and sewerage undertaker for a development consisting of 322 household properties called Park Views, in Epsom (the Site). The Site is at present within the Water Supply Area and Sewerage Services Area of Thames Water.

### **The proposal**

Ofwat proposes to:

- (i) vary the Appointment of SSE Water as a water and sewerage undertaker by adding the Site to its Water Supply Area and its Sewerage Services Area; and
- (ii) vary the Appointment of Thames Water as a water and sewerage undertaker by excluding the Site from its Water Supply Area and its Sewerage Services Area.

### **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.

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<sup>1</sup> The legal framework for new appointments is set out in the Water Industry Act 1991 (WIA). Section 7 of the WIA 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.

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 believe we must 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 that:

customers whose supplier is changed should be no worse off than if they had remained with the existing appointee; and

Ofwat must be satisfied that a potential new appointee will be able to finance the proper carrying out of its functions as a water and/or sewerage undertaker.

We clarified these two policy principles in our [guidance](#) for applicants in February 1999, and again in our January 2009 [policy letter](#). We are currently consulting on revised policy and process for new appointments and variations.

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**

SSE Water has applied to be the water and sewerage undertaker for the Site under the unserved criterion set out in section 7(4)(b) WIA91.

## **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. SSE Water submitted a report (from an independent professional advisor appointed by it) which verified the Site as unserved for water and sewerage.

Although the Site currently receives a temporary supply of water from Thames Water to supply show homes, SSE Water has told us that it will disconnect this supply of water prior to Ofwat granting it its variation. SSE Water would then make the connection to these show homes using its own infrastructure rather than via infrastructure owned by Thames Water. We consider that as long as a temporary connection of water from an existing appointee is

disconnected prior to Ofwat granting an appointment variation, a site will still be classed as unserved. Therefore, we consider that this 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 the Site have not directly chosen SSE Water to be their supplier is not a position unique to new appointments – very few customers in England and Wales are able to choose their water supplier<sup>2</sup>.

Recognising this, our assessment of applicants' proposals includes analysis of their 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**

Initially, SSE Water will receive a bulk supply of water from Thames Water. Later in 2010, SSE Water will terminate the bulk water supply agreement with Thames Water and instead receive a bulk supply of water from Sutton and East Surrey Water. Sewerage from the site will be discharged into Thames Water's sewers.

SSE Water proposes to offer customers on the Site an initial 3% discount on both the water and sewerage volumetric charges of Thames Water. The fixed elements of the water and sewerage charges will be set at the same level as those for Thames Water. The WaterSure tariff will be available to those customers that apply and qualify for it<sup>3</sup>.

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<sup>2</sup> The only customers that can choose their supplier are non-households that consume more than 50MI per year. In England they can choose to switch through either the new appointment or water supply licensing route. In Wales non-household customers who consume more than 50MI per year can choose to switch using the water supply licensing route. In Wales non-household customers who consume more than 250MI per year can choose to switch using the water supply licensing route or the new appointment route. We estimate that there are approximately 2,200 non-household customers in England and Wales who consume in excess of 50MI per year.

<sup>3</sup> Through the WaterSure scheme, households on meters who receive certain means tested benefits or tax credits, and are either responsible for three or more children under the age of 19, or have a medical condition which requires significant additional use of water, can apply to pay no more than the average household bill for their region.

Having considered SSE Water's 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 supplied by Thames Water.

Currently, SSE Water's conditions of appointment provide that SSE Water's price limit is set by reference to the charges of the previous providers for each of its sites. In this case, SSE Water may not charge customers on the Site more than Thames Water's charges. We consider that, given SSE Water's 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 SSE Water's conditions of appointment allows us to set a specific price limit for SSE Water. 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 2014.

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

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

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

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

- the statutory requirement of the GSS Regulations;
- 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, H and I of its conditions of appointment to publish debt, leakage and customer Codes of Practice. We have assessed SSE Water's Codes of Practice, and are content that these are of an approvable standard. The Consumer Council for Water, the independent public body that represents water and sewerage consumers in England and Wales, is also content with Ofwat's assessment of SSE Water's Codes of Practice.

## **SSE Water's voluntary standards**

We have also made a detailed check of SSE Water's voluntary service standards, including where it enhances the statutory GSS provisions, as part of approving SSE Water's Codes of Practice. We require that SSE Water matches or exceeds Thames Water's own standards (except where there is reasonable justification for not doing so).

Examples of where SSE Water will offer improved customer service compared with Thames Water include:

- SSE Water will offer unlimited free leak detection and a free leak repair service on household customer supply pipes, as compared with Thames Water which offers free leak detection but only a subsidised repair service. (However, for a new build site leakage should be less likely which makes it an easy option for SSE Water to offer an improved policy).
- SSE Water will make higher GSS payments in a number of areas, for example offering £50 for low pressure compared with Thames Water's £30.
- SSE Water offers some additional standards, for example, it will pay £35 if they refer a debt to a debt collection agent which proves to be unfairly pursued, or if the agent acts improperly. SSE Water will also pay £150 if it issues a Court Claim in error.
- SSE Water's opening hours are at least as good as Thames Water (Thames Water offers 8-8 Monday to Friday and 8-1 on Saturday) whereas SSE Water offers 8-8 Monday to Friday and 8-2 on Saturday and both have 24 hour lines for emergencies.

However, SSE Water does not propose to match Thames Water in some ways, for example:

- SSE Water does not currently provide information in other languages (although it does offer an interpreter service). Thames Water offers many of its leaflets in a range of languages, an interpreter service for customers for whom English is not their first language, and a sign language interpreter for customer visits.
- SSE Water does not offer as extensive a range of payment options, although the range it does offer is adequate. SSE Water has signalled its intention to expand this range in future.

- SSE Water offers more limited ways for customers to contact them than Thames Water. For example Thames Water has a 24 hour automated billing line, offers 24 hour availability of textphone and typetalk service, and offers a voicemail service for customers to leave meter readings.

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

Having considered SSE Water's 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.

### **Thames Water's existing customers**

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

We have looked at this potential impact by comparing how much Thames Water might have expected to receive in revenue from supplying the Site directly, with the revenues it might expect from supplying the Site indirectly via supplies to SSE Water. The calculation necessarily depends on a range of assumptions about what revenues **might** have been received and incurred, and what the customer base in Thames Water's area **might** have been if it had supplied the Site. There are clearly difficulties involved in quantifying the effect on Thames Water and it is necessary to use a simplified set of figures. However, we believe the **potential** effect amounts to approximately £0.015 per annual bill for each of Thames Water's estimated 5.3m billed customers when the Site is fully built out in 2013. If Thames Water had provided the bulk supply on a permanent basis this impact would reduce to approximately £0.003 per annual bill. However, because Sutton and East Surrey Water will provide the permanent bulk supply of water, this results in the effect being approximately £0.015 per annual bill.

This takes no account of potential cost savings by Thames Water (from dealing with SSE Water as a single customer for the site rather than many

customers individually) or of offsetting additional benefits to customers that arise from the new appointments mechanism. Thames Water's customers will not, therefore, automatically see their bills increase by this amount. We have expressed the effect in 'per bill' terms to try and quantify the possible effect in an easily understandable way. In this case, we consider this potential effect is outweighed by the benefits of granting this variation. We set out the wider benefits we believe stem from the new appointments and variations regime in our consultation document on our revised [policy](#).

Sutton and East Surrey Water will receive revenue from SSE Water that it would not normally have earned as it is not the existing appointee. Sutton and East Surrey's shareholders will benefit from any profit made from bulk supply revenue until 2014, at which point we may set Sutton and East Surrey Water price limits which would result in lower bills to its customers.

### **Developer choice**

Ofwat takes into consideration the choices of the site developer. In this case, the Site developer has said that it wants SSE Water to be the water and sewerage undertaker 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 the EA and DWI have told us that they are content for us to consult on this application.

### **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.

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

Overall, we consider that customers on the Site will be at least no worse off served by SSE Water 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 the proper carrying out of functions**

We have a statutory duty to ensure that efficient appointees can finance the proper carrying out of their functions. When a company applies for a new appointment or variation to serve a site we therefore consider the financial position of the appointed company as a whole (which may include other areas of appointment) and the financial position in respect of the specific site.

We have conducted these assessments in respect of SSE Water's application to serve this Site and are satisfied that it would, operating efficiently, be able to finance the proper carrying out of its functions across its appointed business and on this Site, if its application were to be granted.

## **Conclusion and next steps**

In assessing SSE Water's 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, while both SSE Water and the Site in its own right are financially viable. We have also considered the effects of granting this variation on Thames Water's existing business.

We are therefore minded to grant the appointment for water and sewerage services on the basis of 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 writing to Dan Mason, Senior Competition Case Officer, Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA so as to be received no later than 20 April 2010. Submissions can also be emailed to:

[daniel.mason@ofwat.gsi.gov.uk](mailto:daniel.mason@ofwat.gsi.gov.uk)