
Proposal by the Water Services Regulation Authority (Ofwat) to vary the appointments of Independent Water Networks Limited (“IWN”) and Severn Trent Water Limited (“Severn Trent”) as water companies

Water Industry Act 1991 Section 8(3)

This notice is a consultation on this proposal. The consultation period will last until 15 April, 2016. Having considered any representations submitted in response to the consultation, Ofwat will decide whether or not to make the variations to these companies' appointments.

The site

On 13 August, 2012 IWN was granted a variation to its appointment to provide water services to a new development site in Oakham, Rutland. IWN has now applied to vary its appointment to include an extension to that site. The extension, called Oakham Phase 2 (**the Site**), consists of 469 household properties and is, at present, within the Water Supply Area of Severn Trent.

The proposal

Ofwat proposes to:

- vary the appointment of IWN as a water company by adding the Site to its Water Supply Area; and
- vary the appointment of Severn Trent as a water company by excluding the Site from its Water Supply Area.

By means of these variations, IWN will become the water supplier 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 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:

- customers, or future customers, should be no worse off than if the site had been supplied by the existing appointee; and
- 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.

¹ 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.

The application

IWN has applied to be the water company for the Site under the unserved criterion set out in section 7(4)(b) Water Industry Act 1991.

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. The Site predominantly consists of green-field land used for agricultural and recreational purposes and IWN has provided us with an independent report that verifies the Site as being unserved. Having reviewed the facts, we are satisfied that the Site is unserved. This is consistent with our policy and process statements on new appointments and variations, published in February 2011.

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.

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. This will change in April 2017 in England, in that the 5MI threshold will no longer apply and any non-household customer will be able to choose their supplier.

Customers on the Site - price

IWN proposes to purchase a bulk supply of water from Severn Trent to supply the Site. IWN is proposing to charge customers based on existing Severn Trent tariffs but will offer a 5 per cent discount on the volumetric charge.

Having considered IWN'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 served by Severn Trent.

Customers on the Site - levels of service

IWN is subject to the same customer service level requirements as other water and sewerage appointees.

Guaranteed Standards of Service (GSS) compliance and base service levels

IWN 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 Severn Trent 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 IWN's Codes of Practice, and are content that these are of an approvable standard so customers on the Site would be no worse off.

IWN's voluntary standards

We have also made a detailed check of IWN's voluntary service standards, including where it enhances the statutory GSS provisions. We require that IWN matches or exceeds Severn Trent's own standards (except where there is reasonable justification for not doing so).

Examples of where IWN will offer improved customer service compared with Severn Trent include:

- enhanced GSS standards in a number of areas, for example responding to complaints and billing enquiries within 5 working days compared with Severn Trent's 10 working days and offering £35 if it fails to read a customer's meter once a year compared to Severn Trent's £20;
- some additional standards, for example, IWN will: process a request for a payment plan within 5 working days of receipt or pay £35; provide copies of receipts or any requested customer literature in 5 days or pay £35; and IWN will pay £150 if they issue a Court Claim in error.

However, IWN does not propose to match Severn Trent in some ways, for example:

- IWN currently has no charitable trust fund. Charitable trusts are set up on a voluntary basis by companies to assist those in financial difficulty. Severn Trent does have a charitable trust fund.

While the areas in which IWN does not propose to match Severn Trent are not statutory or appointment requirements, we have explained to IWN that these areas must be kept under review as its customer base expands. IWN has committed to do so. As IWN extends into different incumbent company areas and as IWN's customer base grows, all Codes will be assessed against other incumbents' policies, at which point we might request any improvements we consider necessary.

Having considered IWN's overall proposed service levels, and compared them with those of Severn Trent, we are satisfied that customers on the Site will receive a level of service that is comparable with the level of service that they would have received had they been served by Severn Trent.

Developer choice

Ofwat takes into consideration the choices of the site developer. In this case, the Site developer has said that it wants IWN to be the water company for the Site.

Environment Agency 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. The Environment Agency has informed us that it is content for us to consult on this application. The DWI has been consulted and has raised no concerns.

Severn Trent'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 Severn Trent'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. 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 Severn Trent might have expected to receive in revenue from serving the Site directly, with the revenues they might expect from serving the Site indirectly via a bulk supply agreement with IWN. The lower bound of the range takes into account the benefit to Severn Trent as a result of IWN serving the Site, by estimating the costs that Severn Trent 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 IWN, there may be a potential impact on the bills of Severn Trent's existing customers of -£0.01 and £0.02.

We are comfortable that these ranges account for the uncertainty in the costs that may be avoided by Severn Trent.

Further, this impact does not take into account the potential spill-over 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 with this Site being served by IWN than they would have been had the Site been served by Severn Trent. We consider that the potential effect on Severn Trent's existing customers is negligible or positive 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.

Because of the unique position of the Site (adjacent to a previously granted site, which Severn Trent will treat as one site for bulk supply purposes), our usual application of a site by site analysis is not appropriate. As the site will be operated as a single site, we have considered the revenues and costs of the entire site should this variation be granted.

On this basis, we have concluded that the risk of this Site not being financially viable is small and as a result we are satisfied that IWN will be able to finance its functions if this variation is granted.

Conclusion and next steps

In assessing IWN'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, and IWN 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 Severn Trent.

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 the Case Management Office, Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA so as to be received no later than Friday 15 April 2016.