



Variation of SSE Water's appointment to include Abbotswood

On 30 August 2011, Ofwat began a consultation on a proposal to vary SSE Water's appointment to become the sewerage services provider for a development in Southern Water Services Ltd's (Southern Water) sewerage services area called Abbotswood in Romsey (the Site). When fully built, the Site will serve 800 household properties. The consultation ended on 27 September 2011. During the consultation period Ofwat received two representations which we considered in making our decision. On 16 December 2011, we granted SSE Water a variation to its existing appointment to enable it to serve the Site for sewerage services.

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, SSE Water applied to replace Southern Water as the appointed 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 megalitres per year (in England) or at least 250 megalitres 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. 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.

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 raise its game. We believe the wider benefits of competition via 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

SSE Water applied to be the sewerage appointee for the Site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (WIA91). SSE Water proposed to serve the Site by entering into a bulk discharge agreement with Southern Water.

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 will be served by the existing appointee. SSE Water submitted a report (from an independent professional advisor appointed by it) which verified the Site as unserved and Southern Water did not dispute the findings of that report. Having considered this report, we concluded that the Site was unserved for sewerage.

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 that the proposal was of low risk of being financially non-viable. We considered the impact of granting this variation on the financial position of the appointee as a whole. Having done this we were satisfied that granting this variation posed a low risk of a significant negative impact on the financial position of SSE Water.

Assessment of 'no worse off'

SSE Water will match the household volumetric charges for sewerage services of Southern Water, but will provide a 3% discount on the standing charge for that service. We have approved SSE Water's Codes of Practice and Charges Scheme and are satisfied that customers will be offered an appropriate level of service. As such, we consider that customers will be 'no worse off' being served by SSE Water instead of by Southern Water.

Effect of appointment on Southern Water's customers

We have looked at this potential impact by calculating the upper bound effect that could occur, while noting that in practice this figure is unlikely to eventuate as it does not account for the costs that Southern Water will avoid by not serving the site.

We have calculated this upper bound by comparing how much Southern 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 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 Southern Water's area **might** have been if it had supplied the Site. There are clearly difficulties involved in quantifying the effect on Southern Water and it is 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.

We consider that the upper bound of the **potential** effect could amount to approximately a £0.02 increase per annual bill for each of Southern Water's existing sewerage customers when the site is fully built in 2018.

However, it should be noted that this upper bound effect is unlikely to eventuate. This is because it simply takes into account the revenues that an existing appointee forgoes and does not take into account the costs that Southern Water avoids as a result of them not serving the site but dealing instead with SSE Water as an individual customer at the boundary of the site (costs they avoid may include, for example, on-site capital expenditure, operational expenditure, capital maintenance costs and retail costs).

Furthermore, this approach does not take account of the additional benefits to customers that may arise from the new appointments mechanism.

Given this, it is not evident that Southern Water's customers will automatically see their bills increase by this amount. In this case, we consider this potential effect is outweighed by the benefits of granting this variation.

Developer choice

Ofwat takes into consideration the choices of the site developer. In this case, the developer said that it wanted SSE Water to be the water and sewerage company for the Site.

Responses received to the consultation

We received two responses to our consultation, from the Consumer Council for Water (CCWater) and the Environment Agency. We considered the responses before making the decision to vary SSE Water's appointment. The main points raised in the responses are set out below.

CCWater

CCWater does not object to the granting of this variation, but it makes the following points:

It would expect new appointees to provide consumers with prices, services and service guarantees that match, and ideally better those of the existing company.

We are satisfied that customers on the Abbotswood site will be no worse off being served by SSE Water than they would have been had they been served by Southern Water. Requiring applicants to show a demonstrable (and certain) benefit to customers, rather than our 'no worse off' test, would be an unnecessarily high hurdle

for new entrants to clear. Our 'no worse off' policy approach was endorsed by the High Court in the recent **Llanilid** judgment. The Court accepted that our approach of using the new appointments mechanism to further competition is reasonable and accepted our evidence that it has resulted in demonstrable benefits to customers.¹

It has some concerns generally about the cumulative impact that the growth of new appointments could have on water and sewerage companies' remaining customers.

Taking into account the scale of the possible disbenefits that may result for Southern Water's existing customer base and the wider benefits we consider the new appointments regime brings for customers, we consider it likely that the disbenefits will be outweighed by the benefits of granting this variation. As part of our assessment of this application we considered the impact of this variation on Southern Water's existing customers. We have explained the potential impact under 'Effect of appointment on Southern Water's customers' above.

Environment Agency

The Environment Agency does not object to the granting of this variation. In its response it pointed out that SSE Water must consult with Southern Water to ensure there is sufficient capacity for the connection to Southern Water's sewer network and at its receiving sewerage treatment works. The connection must not increase the risk of pollution incidents occurring.

SSE Water has confirmed that it has agreed a programme of works that Southern Water will need to undertake to enable the connection to be made and ensure that its network can handle the likely flows of waste water.

Conclusion

Having assessed SSE Water's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to SSE Water's area of appointment to allow it to serve the Site for sewerage services. This variation became effective on 16 December 2011.

¹ R (oao Welsh Water Ltd) v Water Services Regulation Authority [2009] EWHC 3493 (Admin), Mitting J, in particular, paragraphs 19 – 21.