



On 22 December 2011, Ofwat began a consultation on a proposal to vary SSE Water's appointment to become the water and sewerage services provider for a development in Wessex Water's area, called Brewery Square, in Dorchester ("the site"). When fully built, the site will serve 636 household properties. The consultation ended on 23 January 2012. During the consultation period, we received two representations which we considered in making our decision. On 22 March 2012, we granted SSE Water a variation to its existing appointment to enable it to serve the site for water and 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 Wessex Water as 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 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. 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**

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 initially by entering into a bulk supply and discharge agreement with Wessex Water, and then supplying the site through an onsite borehole once approval is gained from the Drinking Water Inspectorate (DWI).

## **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. Along with the facts of the case that SSE Water

made us aware of, Wessex Water also confirmed that it agreed 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 that the proposal was at low risk of being financially non-viable. While we considered that there was a risk to the viability of the proposal should the DWI not approve use of the borehole, we considered this risk to be low and this has been sufficiently mitigated by SSE Water agreeing to bear that risk. How we came to this assessment is dealt with below. 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 water and sewerage services of Wessex Water. 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 Wessex Water.

## Effect of appointment on Wessex 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 occur as it does not account for the costs that Wessex Water will avoid by not serving the site.

We have calculated this upper bound by comparing how much Wessex Water might have expected to receive in revenue from serving the site directly, with the revenues it might expect from serving the site indirectly through a supply 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 Wessex Water's area **might** have been if it had supplied the site. There are clearly difficulties involved in quantifying the effect on Wessex Water and it is necessary to

use a simplified set of figures. We have expressed the effect in 'per bill' terms to try to quantify the possible effect in an easily understandable way.

We consider that the upper bound of the **potential** effect could amount to approximately a £0.17<sup>1</sup> increase per annual bill for each of Wessex Water's existing customers when the site is fully built in 2018.

However, it should be noted that this upper bound effect is unlikely to occur. First, as this site has its own water supply, it is possible that the site would never have been served by Wessex Water for water services even if this variation had not been granted. Secondly, the calculation simply takes into account the revenues that an existing appointee forgoes. It does not take into account the costs that Wessex 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 Wessex 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

We take 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 Wessex Water. 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.

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<sup>1</sup> In our consultation document, we stated that this figure could amount to £0.11 based on 1.7 million customers. In its response to the consultation, Wessex Water informed us that the correct figure is 1.1 million customers. We have amended this figure as necessary, and concluded that this did not affect our decision to grant the variation.

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## CCWater

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

### Continuity of supply

CCWater's main concern is with the approach to viability of this application. One of our main principles is that an applicant should be able to finance the proper carrying out of its functions as an appointed water and sewerage company. In this case, SSE Water has stated to CCWater that, if the borehole is not brought into use, it will not be financially viable for SSE Water to continue to supply the site through bulk supply. CCWater is therefore concerned that we are considering granting a variation where SSE Water has not guaranteed what alternative arrangements will be in place should the borehole be unsuitable for use.

In particular, CCWater is concerned about the following statement that was included in the consultation:

“SSE Water will seek assurances from the developer and from Wessex Water that in the event that SSE Water's appointment to this site is terminated, either the developer or Wessex Water will take over responsibility for supplying the site.”

CCWater recognises that SSE Water is confident that the borehole will meet DWI requirements and provide a sustainable source of water for the long term. Nevertheless, CCWater states that Ofwat has no means of guaranteeing through any proposed licence amendments what will happen if SSE Water is not given approval to operate the borehole and withdraws from supplying the site.

Both CCWater and Wessex Water raise concerns regarding continuity of supply, from different perspectives. We address this issue below.

**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 Brewery Square site will be no worse off being served by SSE Water than they would have been had they been served by Wessex 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.<sup>2</sup>

**It has queried what the cost savings experienced by Wessex Water may be by it dealing with one customer (SSE Water) as opposed to many customers individually. It is not clear to CCWater how much of these cost savings will be passed on to Wessex Water's customers because they are billed by a separate company, Bristol Wessex Billing Services Limited (BWBSL). CCWater understands that Wessex Water has an 80% holding in BWBSL and has asked Ofwat to clarify what level of savings will be passed on to Wessex Water's customers.**

We considered the effect on Wessex Water's customers generally when considering the potential impact of granting this variation. In this case, we are unable to comment on the arrangements between Wessex Water and BWBSL – how Wessex Water allocates any cost savings to its customers is a matter for Wessex Water and BWBSL to decide between themselves.

## **Wessex Water**

### **Continuity of supply**

Wessex Water also raised a concern regarding continuity of supply, but from an onsite water supply network perspective. The developer will design and lay the onsite network, which SSE Water will adopt. SSE Water will therefore be responsible for approving and inspecting the design and fittings of internal and external plumbing of the premises to be served. If SSE Water's licence were terminated, we would look to either the developer, Wessex Water or another appointee to take over responsibility for supplying the premises. Wessex Water's concern is that the onsite supply network and plumbing of the premises may not meet its standards or those deemed appropriate by other companies.

For this reason, it suggests that we make it a condition of any appointment that SSE Water must submit its plans for the proposed supply network to Wessex Water so that it can comment on the adequacy of the plans. Wessex Water also proposes that it be given an opportunity to inspect and comment on the construction.

**It is concerned about the cumulative impact that granting new appointments or variations has on its own customer base.**

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<sup>2</sup> *R (oao Welsh Water Ltd) v Water Services Regulation Authority* [2009] EWHC 3493 (Admin), Mitting J, in particular, paragraphs 19 – 21.

Taking into account the scale of the possible disbenefits that may result for Wessex 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 Wessex Water's existing customers. We have explained the potential impact above.

## **Response to continuity of supply issue**

In considering the issues raised in responses to the consultation, we sought the views of SSE Water. SSE Water is of the view that the risk of the DWI not approving the use of the borehole is minimal. It substantiates this by saying that the aquifer that provides the water to the borehole is the same aquifer from which Wessex Water draws its water. It is of the view that the DWI process is to ensure that its treatment of the water will be appropriate rather than to refuse consent altogether.

We also sought assurances from SSE Water that it is willing to bear the risk of the borehole not getting the necessary approvals, and SSE Water has indicated that it is happy to take this risk. In practice this will mean that if DWI does not approve the use of the borehole, SSE Water will continue to improve the quality of the water to obtain the necessary consent; or will continue to supply the site through a bulk supply from Wessex Water. Alternatively it will make arrangements for Wessex Water at that stage to inspect the infrastructure and take over the site by consent.

Our view is that the nature of the risk is such that it should appropriately sit with SSE Water and that it is not appropriate at this stage to put in place a water-tight contingency plan. We understand and agree with Wessex Water's unwillingness to give an undertaking now that it will take over the site. However, it seems likely that the risk of the DWI not giving consent is small, and more appropriately dealt with when it arises rather than at this stage.

We are of the view that this is not inconsistent with our current policy of only granting new appointments or variations if each individual site runs a low risk of being financially unviable. If SSE Water is correct that the risk of the DWI not consenting to the use of the borehole is low, then the overall risk of the site being unviable financially is also low.

## **Conditions of appointment**

In parallel with the consultation into a proposal to grant this variation, we also consulted on a proposal to amend Condition O of SSE Water's licence. We proposed

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to insert an additional clause into SSE Water's Condition O to say that we could terminate the Brewery Square variation at 12 months' notice if the DWI does not give consent for SSE Water to utilise the borehole.

We received one response to this consultation, from CCWater. CCWater queried whether 12 months would be sufficient for us to find a replacement company to serve Brewery Square.

We are no longer proposing to amend SSE Water's Condition O, as SSE Water has agreed to carry the risk of the DWI not providing consent to use of the borehole. If consent is not granted, it will be SSE Water's responsibility to make alternative arrangements at Brewery Square.

## **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 water and sewerage services. This variation became effective on 23 March 2012.