



Variation of SSE Water's appointment to include Hills Farm Lane

On 2 January 2013, 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 Southern Water's area, called Hills Farm Lane, in Horsham ("the site"). When fully built, the site will serve 945 household properties. The consultation ended on 30 January 2013. During the consultation period, we received three representations which we considered in making our decision. On 27 March 2013, 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 Southern 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 water and 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 bulk supply and discharge agreements 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. We concluded that the site was unserved based on information provided to us by SSE Water. Southern 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 an applicant will be able to finance the proper carrying out of its functions as a water and/or sewerage company. We clarified this policy principle in February 2011 when we published '[New appointments and variations – a statement on our policy](#)'. This states that we will assess financial viability on a site by site basis and we will look at the financial position of the company as a whole.

In November 2012, we published a further policy statement – '[Statement on our approach for assessing financial viability of applications for new appointments and variations](#)'. The purpose of this further policy was to:

1. allow applicants greater flexibility when satisfying us that they can finance their functions;
2. give applicants more responsibility and accountability for their business and business risks; and
3. adopt a company-based assessment of financial viability, rather than a detailed site-based assessment, where it is appropriate to do so.

In the policy we said that an applicant could either:

- demonstrate that a particular site is financially viable and that it will be able to finance its functions even if the risks it identifies happen; or
- provide additional financial safeguards so that we are satisfied the company will be able to finance its functions.

In circumstances where a company elects to provide additional financial safeguards, we do not conduct as rigorous an assessment of the site's financial viability on the basis that this is for the company's own risk.

In this case, SSE Water elected to provide additional financial safeguards and on the basis of this we adopted a company-based assessment of financial viability and considered the impact of granting this variation on the financial position of the appointee as a whole, taking into account the additional financial safeguard provided. 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 charges for water and sewerage services of Southern 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 Southern Water.

Effect of appointment on Southern Water's customers

We have looked at the potential impact of this appointment on Southern Water's existing customers, 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 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 through bulk supply and discharge agreements with SSE Water. The calculation necessarily depends on a range of assumptions about what revenues and costs **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 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 £0.034 increase per annual bill for each of Southern Water's existing customers when the site is fully built in 2024.

However, it should be noted that this upper bound effect is unlikely to occur. The calculation simply takes into account the revenues that an existing appointee forgoes. It does not take into account the costs that Southern Water avoids as a result of it not serving the site, but dealing instead with SSE Water as an individual customer at the boundary of the site. (Costs it avoids may include, for example, onsite 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

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

Southern Water

Although Southern Water acknowledged it had no objections to the proposal to grant this NAV, it noted that there could be a potential impact on Southern Water's existing customers' bills. Southern Water noted that the cumulative impact of such potential bill increases could be material to its existing customers, and asked Ofwat to clarify any work it has done to assess overall impact on customers' bills to determine that the generality of customers are no worse off.

In response to this representation and in response to similar representations from CCWater and other companies, we have revised the methodology we use for calculating the potential impact on the bills of the incumbent's customers. We held an industry workshop to consult on this methodology on 11 April 2013.

CCWater

CCWater noted that although the principle Ofwat applies when considering NAV applications is that customers should be made no worse off, customers of the existing appointee will pay marginally more every time a NAV is granted.

CCWater re-iterated its concern about the cumulative effect of Ofwat granting NAVs in the same existing appointee's area on the bills of these existing customers.

As noted above, we have revised our methodology for calculating the potential impact on bills, and we held a workshop to consult on changes to this.

The Environment Agency

The Environment Agency made no objections to us granting this variation, although it made the point that SSE Water should ensure the Hills Farm Lane development is included in its Water Resources Management Plan (WRMP). We have reminded SSE Water of its statutory duty to prepare and maintain a WRMP.

Conclusion

Having assessed SSE Water's application, and having taken account of the responses we have 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 28 March 2013.