



Variation of Anglian Water's appointment to include Woods Meadow

On 19 November 2012, Ofwat began a consultation on a proposal to vary Anglian Water Services Limited's ("**Anglian Water**") appointment to become the water provider for a development in Northumbrian Water Limited's ("**Northumbrian Water**") area, called Woods Meadow, in Oulton ("**the site**").¹ When fully built, the site will serve 800 household properties and 52 non-household properties. The consultation ended on 17 December 2012. During the consultation period, we received representations from three organisations, which we considered in making our decision. We received the final signed bulk supply agreement on 24 July 2013 and on 30 July 2013, we granted Anglian Water a variation to its existing appointment to enable it to supply water to the site.

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, Anglian Water applied to replace Northumbrian Water as the appointed water 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.

¹ Please note that Northumbrian Water uses the trading name Essex and Suffolk in the South East, but the company that holds the appointment is Northumbrian Water.

- 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 mega litres per year (in England) or at least 250 mega litres 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

Anglian Water applied to be the water appointee for the site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). Anglian Water proposed to serve the site by entering into a bulk supply agreement with Northumbrian Water.

Unserved status of the site

To qualify under the unserved criterion, an applicant must show that at the time the appointment or variation 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 Anglian Water. Northumbrian 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.

We considered the impact of granting this variation on the financial position of the appointee as a whole. Having done this we are satisfied that granting this variation poses a low risk of a significant negative impact on the financial position of Anglian Water.

Assessment of ‘no worse off’

Anglian Water will match Northumbrian Water's existing water charges for the South East. This includes both volumetric and fixed charges. We have approved Anglian 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 Anglian Water instead of by Northumbrian Water.

Effect of appointment on Northumbrian Water's customers

We have looked at the potential impact of this appointment on Northumbrian Water's existing South East 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 Northumbrian Water will avoid by not serving the site.

We have calculated this upper bound by comparing how much Northumbrian 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 bulk supply agreement with Anglian 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 Northumbrian Water's area **might** have been if it had supplied the site. There are clearly difficulties involved in quantifying the effect on Northumbrian 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.²

When the site is fully built in 2021, we consider that the upper bound of the **potential** effect could amount to approximately a £0.08 increase per annual bill for each of Northumbrian Water's existing customers.

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 Northumbrian Water avoids as a result of it not serving the site, but dealing instead with Anglian 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 Northumbrian 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.

² Following an industry workshop, we now use a revised methodology for calculating the potential impact of a new appointment on the customer base of the incumbent. However, when we consulted on this application, the new methodology was not yet in place. When we granted the variation we therefore did so on the basis of our previous methodology but we tested the outcome using our new methodology.

Developer choice

We take into consideration the choices of the site developer. In this case, the developer said that it wanted Anglian Water to be the water 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 Northumbrian Water. We considered these responses before making the decision to vary Anglian Water's appointment. The main points raised in the responses are set out below.

Northumbrian Water

Northumbrian Water did not offer any objections to the proposal.

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's principal question was what Anglian Water's level of service would be if water use restrictions applied during a drought. Anglian Water has since clarified that it will match Northumbrian Water's level of service for its customers in the South East on this.

The Environment Agency also raised a question in relation to Anglian Water's draft water resource management plan and whether Anglian Water would be looking to promote higher levels of water efficiency. We have confirmed with Anglian Water that Woods Meadow will be incorporated within its water resource management plan and drought plan and it will not be imposing stricter water efficiency requirements on developers than those stipulated in the relevant regulations.³

Conclusion

Having assessed Anglian Water's application, and having taken account of the responses we have received to our consultation, we decided to grant a variation to Anglian Water's area of appointment to allow it to serve the site for water services. This variation became effective on 31 July 2013.

³ The Building Regulations 2010