



Variation of South Staffordshire Water's appointment to include Cadley Hill

On 4 February 2014, Ofwat began a consultation on a proposal to vary South Staffordshire Water's appointment to become the water provider for a development straddling the water supply areas of South Staffordshire Water and Severn Trent Water, called Cadley Hill ('**the site**'). When fully built, the site will consist of 215 new household properties. The consultation ended on 4 March 2014. During the consultation period, we received representations from one organisation, which we considered in making our decision. On 24 March 2014, we granted South Staffordshire 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, South Staffordshire Water applied to replace Severn Trent 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:

- 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.

The application

South Staffordshire Water applied to be the water and sewerage services appointee for the site under the consent criterion set out in section 7(4)(a) of the Water Industry Act 1991 (**'WIA91'**) as Severn Trent Water consented to the appointment.

Financial viability of the proposal

We will only make a new appointment or variation if we are satisfied that the applicant can finance its functions. In this case, South Staffordshire Water is a large, established undertaker. We collect regulatory information and accounts from South Staffordshire Water, which gives us no reason to be concerned about its ability to finance its functions. It has access to many sources of finance and this site would represent only a very small proportion of its total appointed business.

Assessment of 'no worse off'

We have taken a different approach to the assessment of this application, because it involves two established appointees and one consents to the other's application.

South Staffordshire Water will charge customers at Cadley Hill based on its charges to its existing customers. These are currently lower than those of Severn Trent Water.

As an appointed undertaker, South Staffordshire Water is required to publish Codes of Practice on debt, leakage and a Customer Code for its household customers under Conditions G, H and I of its licence conditions. It has a set of Codes for its existing appointment that satisfies the relevant licence conditions.

As an appointed undertaker, South Staffordshire Water is required to publish a set of key performance indicators ('KPIs'). South Staffordshire Water's 2012-13 KPIs raised no concerns, with the company meeting leakage and security of supply targets and delivering a low level of supply interruptions. Additionally, South Staffordshire Water's overall Service Incentive Mechanism (SIM) score of 88 was the highest in England and Wales, reflecting a high level of customer service.

Therefore, we are satisfied that customers will be adequately protected.

Developer choice

We take into consideration the choice of the site developer. In this case, the developer said that it wanted South Staffordshire Water to be the water company for the site.

Response received to the consultation

We received one response to our consultation, from the Consumer Council for Water ('CCWater'). We considered this response before making the decision to vary South Staffordshire Water's appointment. The main point raised in the response is set out below.

CCWater asked for reassurance that we will consider how to protect customers from any future increase in price above that of Severn Trent Water.

In general, when we grant a new appointment, we ensure that customers will be no worse off by requiring the new appointee to either match the charges of the incumbent or offer a discount on those charges. This 'relative price control' is in place because most of Condition B of new appointees' licences is suspended, and therefore they are not subject to the normal price review process. We therefore do not scrutinise the future prices of a new appointee but it is a licence condition for a new appointee not to charge customers more than the charges of the previous incumbent for each of its sites. When a new appointee reaches a certain size, Condition B will be triggered and the new appointee will become subject to a normal price review.

This case is different, however, because South Staffordshire Water is an established undertaker that is already subject to Condition B. It will not therefore have a licence requirement to match or better the charges of Severn Trent Water as it is subject to its own price review. We consider that the price review process both:

- scrutinises South Staffordshire Water's future prices; and
- provides adequate protection to all of South Staffordshire Water's customers.

Additionally, CCWater asks that we apply the same level of rigour in assessing the levels of service of established undertakers applying for variations to their appointments as we would for new appointees. Given South Staffordshire Water's existing customer service record we did not carry out as detailed an assessment in this application as we normally do in the case of a new appointee. However, we have told CCWater that we will not again depart from our usual process without first consulting on our intention to do so.

Conclusion

Having assessed South Staffordshire Water's application, and having taken account of the response we received to our consultation, we decided to grant a variation to South Staffordshire Water's area of appointment to allow it to serve the site. This variation became effective on 25 March 2014.