



## Variation of Anglian Water's appointment to include Northstowe Phase 1

On 14 November 2014, Ofwat began a consultation on a proposal to vary Anglian Water's appointment to become the water provider for a development in South Staffordshire Water's water supply area called Northstowe Phase 1 ("**the site**"). When fully built, the site will consist of 1,500 household properties. The consultation ended on 12 December 2014. During the consultation period, we received one representation which we considered in making our decision. On 19 January 2015, 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 South Staffordshire 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. 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 proposes to serve the site by entering into a bulk supply agreement with South Staffordshire 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. South Staffordshire Water also confirmed that it agreed that the site was 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 having a significant negative impact on the financial position of Anglian Water.

## **Assessment of 'no worse off'**

Anglian Water will charge customers based on South Staffordshire Water's existing metered water domestic tariff. Anglian Water has Codes of Practice and a Charges Scheme in place, and we are satisfied that customers on the site 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 South Staffordshire Water.

## **Effect of appointment on South Staffordshire Water's customers**

In considering whether customers will be no worse off, we also looked at the potential effects of this variation on the price that South Staffordshire Water's existing customer base may face.

The calculation necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on customers of South Staffordshire Water's. It is therefore 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.

Broadly, we have assessed the potential magnitude of this impact by comparing how much South Staffordshire Water might have expected to receive in revenue from serving the site directly, with the revenue it might expect from serving the site indirectly via a bulk supply agreement with Anglian Water. The lower bound of the range takes into account the benefit to South Staffordshire Water as a result of Anglian Water serving the site, by estimating the costs that South Staffordshire Water is likely to avoid, such as retail costs and capital and operating costs associated with the local network used to serve the site. The upper bound of the range does not take these avoided costs into account. We look at these differences

in revenue and costs over a hundred year timeframe to reflect the long-lived assets that will be used to supply customers at the site.

In this case, we have calculated that if we grant the site to Anglian Water, there may be a potential impact on the bills of South Staffordshire Water's existing customers of between -£0.13 and -£0.55 per year. We are comfortable that this range accounts for the uncertainty in the costs that may be avoided by South Staffordshire Water.

It is important to note that we do not have information on the level of developer contribution that South Staffordshire Water would have received had it served the site. We have therefore used data on the level of developer contribution that Anglian Water will receive as a proxy.

This impact does not take into account the potential spillover benefits to customers arising from dynamic efficiencies achieved as a result of the competitive process to win new sites.

## **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.

## **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 Anglian Water's appointment. The main points raised in the response are set out below.

CCWater noted that Anglian Water proposes to match the charges of South Staffordshire Water for the foreseeable future. It asked Ofwat for assurance that it will monitor these charges with a view to challenging Anglian Water if they ever exceed those of South Staffordshire Water.

It also asked us to consider requiring Anglian Water to provide a longer term commitment to match South Staffordshire Water's charges for each price review until such time as competition in the household market is introduced.

When we grant a new appointment or variation, we get information on the charges that the new appointee for the relevant site will apply. However, this does not give us any guarantee of its charges in the future. So, for example, if a new appointee says it will offer a discount on the existing incumbent's charges, we have no means of

ensuring that that same discount will be offered in future years. In the case of a new appointee we can only check that its prices do not exceed that of the previous incumbent.

When there is a variation involving two established companies (as in this case) the checks are different and in particular we rely on the fact that the company taking over a site is subject to a full set of licence conditions, and will be subject to its own price review. This gives us an opportunity to challenge the charges that a company proposes making and the company must show that its charges are non-discriminatory.

We did not consider it to be appropriate to require Anglian Water to provide a longer term commitment to match South Staffordshire Water's charges for each price review until such time as competition in the household market is introduced. Doing so would not be enforceable without a licence amendment. Also, we are not aware of plans to introduce competition to household customers.

However, we are aware that we may need to review our policy in this area and we will involve CCWater in any discussions surrounding any proposed changes.

## **Conclusion**

Having assessed Anglian Water's application, and having taken account of the response 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 20 January 2015.