



Variation of SSE Water's appointment to include Kennet Island Phases 5 and 6

On 27 July 2009, Ofwat began a consultation on a proposal to vary Scottish and Southern Energy Water's (SSE Water) appointment to become the water and sewerage services provider for a development in Thames Water's area called Kennet Island Phases 5 and 6, in Reading. The consultation ended on 24 August 2009. During the consultation period Ofwat received three representations which we considered fully and carefully in making our decision.

We granted SSE Water a variation to its existing appointment to serve the Kennet Island development on 23 September 2009. We published an information bulletin about the variation to SSE Water's appointment on 8 October 2009.

This notice expands on the reasons given in that bulletin for our decision.

Introduction

The new appointment and variation (NAV) 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 their businesses. In this case, SSE Water applied to replace Thames Water as the appointed water and sewerage company for the Kennet Island 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 is 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) (the 'large user criterion');
- the existing water 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 believe that we must 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 that:

1. customers whose supplier is changed should be no worse off than if they had remained with the incumbent; and
2. Ofwat must be satisfied that a potential new appointee will be able to finance the proper carrying out of its functions as a water and/or sewerage undertaker.

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers (such as developers of new housing sites and household and non-household customers). Benefits can include price discounts, better services, environmental improvements and innovation in the way services are delivered. Benefits can also accrue to the incumbent's existing customers, because when the incumbent faces a challenge to its business, that challenge can act as a spur for it to raise its game. We believe the wider benefits of competition via the NAV mechanism can offset any potential disbenefits for existing customers that might arise. We consider these potential disbenefits in more detail below.

Unserved status of the site

The Kennet Island application was made via the 'unserved criterion'. Premises are served if water is supplied by a connection to a distribution main of the existing incumbent provider or if they are drained by means of a lateral drain or public sewer of the existing incumbent provider. In this case, SSE Water submitted a report (from an independent professional appointed by it) which verified the site was unserved, and this report was accepted by Thames Water.

Financial viability of the proposal

We will only make an appointment if we are satisfied that the proposal is financially viable. We assess financial viability on a site by site basis and also consider the financial position of the company as a whole. We have concluded that, based on the information available to us, the proposal is viable. We do not have any concerns about the financial position of the company as a whole. SSE Water is supported by a Parent Company Guarantee from Scottish and Southern Energy that is sufficient to support the total operating costs of this site and SSE Water's three other sites. SSE Water and Thames Water have agreed and signed bulk supply and bulk discharge agreements and we are satisfied with the content of those agreements.

Assessment of 'no worse off'

SSE Water will charge customers the same tariffs those customers would have paid had Thames Water served the site.. 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 a result, we consider that customers will be 'no worse off' being served by SSE Water instead of by Thames Water.

Effect of appointment on Thames Water's customers

We also considered the potential effects of this variation on Thames Water's existing customers. We have looked at this potential impact, by comparing how much Thames Water might have expected to receive in revenue had it supplied the site directly, with the revenue expected by supplying the site indirectly via supplies to SSE Water. The calculation necessarily depends on a range of assumptions about what revenues might have been received and what the customer base in Thames Water's area might have been if it had supplied the site. There are difficulties involved in quantifying the effect on Thames Water and it is necessary to use a simplified set of figures. When Kennet Island is fully developed in 2013, the 269 properties on this site would have made up 0.005% of Thames Water's customer base. We believe that the potential effect amounts to approximately £0.002 increase per annual bill for each of Thames Water's existing customers by 2013.

Views of the developer

Ofwat takes into consideration the site developer's preference with regard to which undertaker should supply the site. In this case, the site developer said that it wanted SSE Water to be the water and sewerage undertaker for the site.

Responses received to the consultation

We received three responses to our consultation, from CCWater and two water companies. We carefully considered each response before making the decision to vary SSE Water's appointment. The main points raised in these responses are set out below.

- CCWater was broadly supportive of our proposal, but sought assurance that SSE Water would have a responsibility to promote water efficiency. We were satisfied that we could give this assurance in that although we do not currently set water efficiency targets for SSE Water, we have the option to do so when SSE Water's customer base increases. SSE Water also has the same rights and responsibilities as other appointees to promote the efficient use of water by its customers.
- One water company objected to our proposal. It thought that the fact we were prepared to grant a variation for a site at which customers would not get a price discount was a major change of policy. The respondent also thought that Thames Water's existing customers would be disadvantaged if we granted this variation. We were satisfied that this is not a change in policy in that we have

granted variations in the past that have not included a price discount for the customers on the site. Our policy remains that the customers should be at least no worse off. With regard to Thames Water's existing customers, we were satisfied that any potential effects on their bills will be negligible. That negligible effect would also be outweighed by the wider benefits brought by the variation in terms of providing competitive pressure to incumbents.

- Another water company raised several concerns about new appointments in general, rather than this specific proposal. Its concerns included -
 1. the need to involve the incumbent in verifying the site status;
 2. the fact that the assessment of the site status is carried out by a person paid for by the applicant;
 3. how surface water drainage (SWD) is dealt with in relation to determining the unserved status of a site;
 4. the contingency options for the developer if a new appointment or variation cannot be granted in time.

The assessment of whether a site is served is carried out by an independent professional who acts in terms of guidelines issued by us. We have recently changed our process so that we share this independent report with the relevant incumbent early in the application process. This allows us to carry out further investigations into the unserved status of a site if any aspect of the report is disputed. In determining if a site is served, the legislation does not distinguish between surface water drainage and other forms of drainage.

With regard to contingency options, applicants must construct infrastructure that is of an adoptable standard, so that if the variation cannot be granted, the incumbent could adopt the infrastructure and supply water and sewerage services to customers.

The policy objectives of new appointments

In our view, new appointments and variations are useful tools in helping us to achieve our strategic goals. One of our strategic goals is the introduction of competition progressively where it benefits consumers. As noted above, the new appointees themselves may offer lower prices and/or better levels of service and more innovative infrastructure solutions. These benefit consumers directly if they are supplied by the new appointee, and indirectly, by acting as a spur for incumbents to raise their game. New appointments may also benefit consumers by revealing information to aid transparency and to aid regulatory awareness.

We are currently reviewing our policy and process on new appointments and variations and will consult on draft policy and process statements later this year.