
Variation of SSE Water’s appointment to include Kingsbrook

On 8 June 2016, 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 Thames Water’s water supply area and sewerage services area called Kingsbrook in Aylesbury (“**the site**”). When fully built, the site will consist of 2,446 household properties. The consultation ended on 6 July 2016. During the consultation period, we received representations from two organisations, which we considered in making our decision. On 9 August 2016, we granted SSE Water a variation to its existing appointment to enable it to supply water and sewerage services 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, SSE Water applied to replace Thames 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 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:

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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 services appointee for the site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). SSE Water proposes to serve the site by entering into a bulk supply agreement and a bulk discharge agreement with Thames Water.

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 SSE Water.

Assessment of ‘no worse off’

SSE Water will charge customers based on Thames Water’s existing metered water and sewerage domestic tariffs. SSE Water has Codes of Practice and a Charges Scheme in place, and we 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 Thames Water.

Effect of appointment on Thames Water’s customers

In considering whether customers will be no worse off, we also looked at the potential effect of this variation on the price that Thames 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 Thames Water. 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 Thames Water might have expected to receive in revenue from serving the site directly, with the revenues they might expect from serving the site indirectly via bulk supply and bulk discharge agreements with SSE Water. The lower bound of the range takes into account the benefit to Thames Water as a result of SSE Water serving the site, by estimating the costs that Thames Water are 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 SSE Water, there may be a potential impact on the bills of Thames Water’s existing customers of between £0.00 and £0.04 per year. We are comfortable that these ranges account for the uncertainty in the costs that may be avoided by Thames Water.

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 SSE Water to be the water and sewerage company for the site.

Responses received to the consultation

We received two responses to our consultation, from the Consumer Council for Water and the Environment Agency. 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.

The Consumer Council for Water

The Consumer Council for Water (“**CCWater**”) welcomed SSE Water’s approach to offering guaranteed standards and voluntary service standards which generally match or improve on the standards offered by Thames Water.

CCWater was pleased that SSE Water proposes to offer £30 if it fails to read a customer's meter once per year. However, it also noted that SSE Water does not currently have a customer assistance fund, as Thames Water does.

CCWater reiterated a concern it has raised previously about the impact that the growth of new appointments could have on water and sewerage companies' existing customers. Ideally, in its view, existing customers should receive some benefit from the new arrangements. However, under the current regime, existing customers of water and sewerage companies often pay marginally more for each new appointment. CCWater argues that over time, as more new appointments are granted, this could amount to a significant sum without any clear offsetting benefit. CCWater feel that this issue could be addressed by carrying out an assessment of the actual costs and benefits arising from new appointments that have been granted.

While there may potentially be an impact in the short run, due to low capital maintenance associated with a new development, capital maintenance will rise as the assets on these new developments age. On average, an incumbent will have a mix of old and new assets and this would not materially change if the incumbent served new sites rather than a new appointee. We are therefore of the view that the potential cumulative impacts that concern CCWater will not arise or will not be material.

The Environment Agency

The Environment Agency was supportive of the application but wanted assurance that the Kingsbrook development has been incorporated within local plans and water cycle studies. SSE Water were able to provide this assurance. The Kingsbrook Development is included within Aylesbury Vale Local Plan.

Conclusion

Having assessed SSE Water's application, and having taken account of the responses we 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 10 August 2016.