

Variation of Independent Water Network's appointment to supply water and sewerage services to Castle Hill

On 3 August 2016 we granted Independent Water Networks a variation to its existing appointments to enable it to provide water and sewerage services to an area called Castle Hill in Ebbsfleet, Kent (“**the site**”). The water application and the sewerage services application were submitted separately and will be covered separately in this paper.

This notice gives our reasons for making the variations for water and sewerage services.

Water

On 20 October 2015, Ofwat began a consultation on a proposal to vary the appointment of Independent Water Networks (IWN) to become the water provider for the Castle Hill development in Thames Water's (TMS) water supply area.

The consultation ended on 17 November 2015. During the consultation period, we received representations from two organisations, which we considered in making our decision.

Sewerage

On 20 January 2015, Ofwat began a consultation on a proposal to vary the appointment of IWN to become the sewerage services provider for the Castle Hill development in Southern Water's (SRN) sewerage services area.

The consultation ended on 17 February 2015. During the consultation period, we received a representation from one organisation, which we considered in making our decision.

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, IWN applied to replace TMS to become the appointed water company for the site and applied to replace SRN to become the appointed sewerage company.

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

IWN applied to be the appointed water and sewerage company for the site under the unserved criterion set out in section 7(4)(a) of the Water Industry Act 1991 (“**WIA91**”).

IWN provided an independent report from Halcrow confirming that the site is unserved for water and sewerage services. We shared the report with SRN and TMS, who agreed 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 the site demonstrates sufficient financial viability, and IWN has satisfied us that it can finance its functions and that it is able to properly carry them out.

Assessment of ‘no worse off’

When we assess applications for new appointments and variations (NAVVs), we seek to ensure all customers are made no worse off. This includes customers on the site as well as customers of the incumbent.

Water

IWN will charge all customers based on existing TMS' tariffs. IWN will offer the WaterSure tariff to qualifying customers, ensuring such customers are no worse off from being supplied by IWN rather than by TMS.

With regard to service levels, we have reviewed all aspects relating to customer service and service levels that will be provided to customers by IWN. Based on this review we consider that the customers on this site will be ‘no worse off’ in respect of the service being provided by IWN than they would have been had they been served by TMS.

Sewerage

IWN will offer customers a 5% discount on the volumetric charge for sewerage services compared to that of SRN, while matching SRN's fixed sewerage services charge.

With regard to service levels, we reviewed all aspects relating to customer service and service levels that will be provided to customers by IWN. Based on this review we consider that the customers on this site will be 'no worse off' in respect of the service being provided by IWN than they would have been had they been served by SRN.

Developer choice

We take into consideration the choices of the site developer. In this case, the developer said that it wanted IWN to be the water and sewerage services provider for the site.

Responses received to the consultation- water

We received two responses to our consultation relating to the supply of water for the site; from the Environment Agency and the Consumer Council for Water ("**CCWater**"). We considered these responses before making the decision to vary IWN's appointment. The points raised in the responses are set out below.

Environment Agency

The Environment Agency did not object to us granting this variation, although it noted that TMS has not specifically mentioned this appointment in its latest Water Resources Management Plan (WRMP). Nevertheless, it also noted that the company's forecasts for demand were based on Local Authority plans and therefore, if this development has been included in the Local Authority growth plans then there should not be any concerns in terms of water supply.

The Environment Agency also suggested that IWN should treat their current and future NAVs as resource zones within their water resources management plan and drought plan. We have reminded IWN of its statutory duty to prepare and maintain a WRMP.

CCWater

CCWater welcomed IWN's approach to offering guaranteed standards and improved voluntary service standards which typically match and in some places exceed those set by TMS. CCWater was pleased that IWN proposes to match TMS' charges. However, CCWater raised a concern in both consultations (water and sewerage) about the impact that the growth of new appointments could have on water and sewerage companies' existing customers. It does not consider that the overall benefit of new appointments and variations to existing customers of the water or sewerage companies is clear, particularly in areas where there have been a high number of new appointments, such as in TMS' area.

One of Ofwat's key NAV policies is that an applicant must ensure its new customers are no worse off in terms of price and service than they would have been had they been served by the incumbent company. Like CCWater, we are satisfied that IWN will match

or exceed the levels of service set by TMS and SRN. New appointments and variations provide challenge to existing appointees. This drives efficiencies, stimulates innovation and reveals information. We are satisfied that they have the potential to benefit all customers, including through:

- lower prices;
- improved service;
- a better range of products and services;
- environmental benefits; and
- greater choice of supplier for developers and large user customers.

Examples of benefits delivered to date include the following:

- There have been cases in which new appointees provided solutions which meant that significant new capital investment was not necessary. This provided benefits for both the environment and to customers through reduced bills.
- New appointees have provided services using more environmentally sustainable, on-site methods of treatment and discharge.
- In some cases, customers are paying volumetric charges that are between 5% and 13% lower than they would have paid had they been served by the existing appointee, while receiving comparable levels of service.

Responses received to the consultation- sewerage

We received one response to our consultation relating to sewerage services for the site; from CCWater. We considered the response before making the decision to vary IWN's appointment. The points raised in the response are set out below.

CCWater

CCWater expressed concerns that household customers may move on to the site before the sewage treatment works were completed. When we raised this issue with IWN, it became apparent that some customers had already moved onto the site and were receiving a tankered sewerage service. We decided to consult again to raise this issue. During the second consultation CCWater spoke to IWN and subsequently told us that they were satisfied that IWN's tankering arrangements were appropriate.

Conclusion

Having assessed IWN's applications to become the water and sewerage services provider for the site, and having taken account of the responses we received to our consultations, we decided to grant variations to IWN's area of appointment to allow it to serve the site for water and sewerage services.