

24 November 2017

Trust in water

# **Proposal to grant a variation of appointment to Independent Water Networks Limited as a water and sewerage company to enable it to serve Chilmington Green**

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## 1. About this document

This notice is a consultation (under section 8(3) of the Water Industry Act 1991 (“**WIA91**”)) on our proposal to vary the appointment of Independent Water Networks Limited (“**IWN**”) as a water and sewerage company and to make consequential variations to the appointment of South East Water (“**SEW**”) as a water company and the appointment of Southern Water (“**SRN**”) as a sewerage company.

We will consult for 28 days from the date of publication of this notice. Having considered any representations submitted during the consultation period in response to the consultation, Ofwat will decide whether or not to grant a variation of appointment to IWN as a water and sewerage company.

## 2. The Site

IWN has applied for a variation to its appointment to enable it to provide water and sewerage services to a site called Chilmington Green (“**the Site**”) which is in **SEW’s** water supply area and in **SRN’s** sewerage services area.

The Site is in Ashford, Kent. When fully built, the Site will comprise of up to 5,750 residential units in a mix of sizes, types and tenures, a secondary school and up to four primary schools and other premises for community and leisure uses. Housebuilding will start in December 2017.

### **3. The applicant**

In October 2007, IWN was appointed as a water and sewerage undertaker for a housing development at the Long Croft Road site in Anglian Water Services' area. Since then, Ofwat has agreed to vary IWN's area of appointment so it can serve a further 15 sites for water and/or sewerage.

## **4. The proposal**

Ofwat proposes to:

- grant a variation of appointment to IWN as a water and sewerage company to include the Site in its water supply area and its sewerage services area;
- vary the appointment of SEW as a water company by excluding the Site from its water supply area; and
- vary the appointment of SRN as a sewerage company by excluding the Site from its sewerage services area

By means of the above, IWN will become the water and sewerage services supplier for the Site.

## 5. Our approach to the assessment of this application

The new appointment and variation mechanism, set out in primary legislation<sup>1</sup>, provides an opportunity for entry and expansion into the water and sewerage sectors by allowing one company to replace the existing appointee 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 appointees to expand their businesses.

When considering applications for new appointments and variations (NAVs), Ofwat operates within the statutory framework set out by Parliament, including our statutory duty to protect consumers, wherever appropriate by promoting effective competition. In particular, in relation to unserved sites, we consider that we must ensure that the future customers on a site – who do not have a choice of supplier – are adequately protected. When assessing applications for NAVs, the two key policy principles we apply are that:

- customers, or future customers, should be no worse off than if the site had been supplied by the existing appointee; and
- Ofwat 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.

We clarified these two policy principles in February 2011 when we published our New appointments and variations – [policy](#) and [process](#) documents. In November 2012, we published our '[Statement on our approach for assessing financial viability of applications for new appointments and variations](#)'. This states that we will adopt a company-based assessment of financial viability, rather than a detailed site-based assessment, where it is appropriate to do so.

When we assess whether customers will be no worse off as a result of the appointment or variation, we not only consider the customers on the site but also the generality of customers. These include not only the customers of the existing provider but also customers more generally across England and Wales, who in our view benefit from the effective operation of the new appointment and variation mechanism.

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<sup>1</sup> The legal framework for new appointments is set out in the Water Industry Act 1991 (WIA). Section 7 of the WIA sets out the criteria by which an appointment or variation may be made. Section 8 sets out the procedure for making that appointment or variation.

## **6. The application**

IWN has applied to be the water and sewerage company for the Site under the unserved criterion, set out in section 7(4) (b) of the WIA91.

### **6.1 Unserved status of the Site**

To qualify under the unserved criterion, an applicant must show that at the time the appointment is made, none of the premises in the proposed area of appointment is served by the existing appointee.

The Site has a road that runs through it, on which there are premises served for water by SEW. The site map for the Site has an unbroken perimeter line that encircles the site, but that includes a corridor which omits the part of the road on which the served premises are located. There are other served premises within the site boundary which are of a temporary nature, and will be demolished before the NAV is granted.

A site status report has been obtained for the proposed site. It confirms that the Site, as drawn showing the premises in the corridor as being outside the boundary of the Site, is unserved for both water and sewerage.

SEW has confirmed that it has infrastructure running through the Site serving customers in the corridor and on either side of the site. SEW and IWN are engaged in ongoing discussions related to the operational issues that may arise through the close proximity of pipework in order to ensure that they are comprehensively managed.

SEW confirmed that the Site, as set out, is unserved. SRN has confirmed that the Site is unserved for sewerage services.

Given the information provided by the applicant and the incumbent companies, we are satisfied that the Site may be considered unserved.

### **6.2 Protecting customers**

Ofwat acts to protect consumers, especially those who are unable to choose their supplier. In assessing applications to supply new development sites, Ofwat acts on behalf of both existing customers as well as potential new customers who are not yet

on site, to protect their interests. The fact that future customers on a site have not directly chosen their supplier is not a position unique to NAVs – only business, charity and public sector customers (“Business Customers”) in England and Wales are able to choose their supplier<sup>2</sup>.

Recognising this, our assessment of an applicant’s proposals includes analysis of its plans to ensure customers will be at least no worse off in terms of their annual bills and levels of service than if they had been supplied by the existing appointee in whose geographical area the relevant site sits. We will continue to protect customers on a site by regulating the new appointee's prices and service levels.

### **6.3 Price**

IWN proposes to charge customers on the Site charges that are equivalent to the charges of SEW and SRN.

### **6.4 Levels of service**

Every appointee is required under its conditions of appointment to publish Codes of Practice on debt and leakage and to have a Customer Code for its household customers. We have assessed IWN’s proposed Codes of Practice and Customer Code, and our view is that these are of an appropriate standard. Our view is that customers on the Site would be no worse off in relation to the points covered by the above Codes of Practice and the Customer Code than they would be if SEW were to be the customers’ water supplier, and SRN were to be the customers’ sewerage services provider.

### **6.5 Site owner choice**

IWN has the consent of the Site developer, Hodson Developments (Ashford) Limited, to become the water and sewerage services provider for the Site.

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<sup>2</sup> The majority of Business Customers where the area of the relevant appointed company is not wholly or mainly in Wales (and whose premises are, or are likely to be, supplied with at least 50 MI where the relevant area is wholly or mainly in Wales) can effectively switch suppliers of water and/or sewerage from 1 April 2017.

## **6.6 Environment Agency (EA) and Drinking Water Inspectorate (DWI)**

We take the views of these organisations into account before progressing to formal consultation on an application for a new appointment. Both the EA and DWI informed us that they are content for us to consult on this application<sup>3</sup>.

## **6.7 Incumbent's existing customers**

In considering whether customers will be no worse off, we also considered the potential effects of this new appointment on the prices that SEW's and SRN'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. 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.

In assessing the impact that granting the Site may have on the incumbent's customers, we compare the revenue the incumbent might have been expected to receive and the maintenance costs it would expect to incur if it were to serve the Site directly, as opposed to the revenues it would receive and costs it would incur from the proposed variation arrangement.

We recently updated the approach we take to this calculation to reflect the current price setting regime and the latest financial data.

Using this updated approach, we estimate a potential £0.10 annual increase on the water bills of existing SEW customers, and a potential £0.03 annual increase on the sewerage bills of existing SRN customers if we grant this variation to IWN. This is once the Site is fully built out.

This estimate does not take into account the potential spill-over benefits to customers arising from dynamic efficiencies achieved as a result of the competitive process to win sites.

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<sup>3</sup> The EA and the DWI will also be formally consulted on the proposals, as they are on the list of organisations which must be formally consulted as set out in section 8(4)(b) of WIA91.

Therefore we consider that granting this variation to IWN would have a very small financial impact on customers' bills and could have potential benefits for customers.

## **6.8 Ability to finance and properly carry out its functions**

We have a statutory duty to ensure that efficient appointees can finance the proper carrying out of their functions. When a company applies for a new appointment or variation, it must satisfy us that it is able to carry out all of the duties and obligations associated with being an appointed sewerage company.

We have considered the revenues and costs of the entire Site relating to sewerage services should the relevant variation be granted. Following our review, which considered our standard analysis and the specific risks associated with the Site, we have concluded the Site demonstrates sufficient financial viability.

IWN has a financial security agreement with its owner Brookfield Utilitied UK No2 Limited ("BUUK"), which meets our requirements, in that it covers one year's annual operating costs required to supply the number of connections the business is projected to have in two years' time.

On this basis, our view is that the risk of this Site not being financially viable is small and as a result we are currently satisfied that applicant would be able to finance its functions if the variation is granted.

## 7. Conclusion and next steps

In assessing IWN's application, we have considered the general benefits of NAVs. Our view is that our two key policy principles would be met in this case, as customers would be no worse off, and a NAV would be able to finance, and carry out, its functions. We have also considered the effects of granting the proposed variation on the existing customers of SEW and SRN.

We are currently minded to vary the appointment of IWN as a water and sewerage company under the unserved criterion. We are consulting on our proposal to do so.

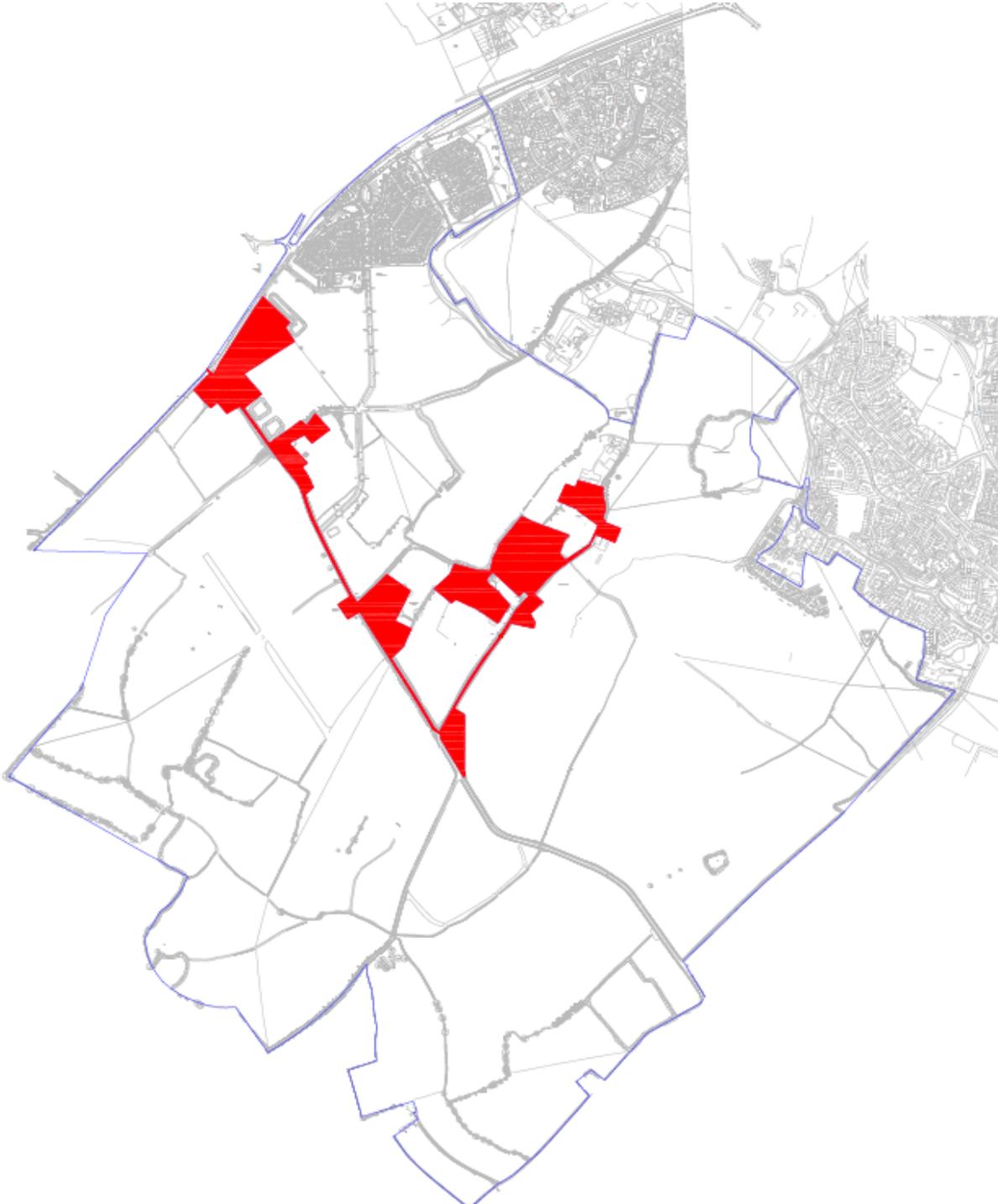
### Where to send submissions

Any person who wishes to make representations or objections with respect to the application should do so in writing (which includes by email) to Chris Daly at Centre City Tower, 7 Hill Street, Birmingham, B5 4UA or by email at [Chris.Daly@ofwat.gsi.gov.uk](mailto:Chris.Daly@ofwat.gsi.gov.uk)

Representations must be received by Ofwat no later than 17.00 hours on 22 December 2017. Further information about how to make representations or objections, including information on the treatment of confidential information, can be obtained from Ofwat at the above address or at <http://www.ofwat.gov.uk/foi/>

Ofwat will only use the information you have provided for the purpose of this consultation. We will retain your information in accordance with Ofwat's retention schedule and will not share with third parties unless we have a legal obligation to do so. For further information please see Ofwat's Privacy Policy in our [Publication Scheme](#).

## 8. Site map



- *The perimeter boundary of the Site is edged in blue. The part of the map coloured in red is excluded from the Site, and is served for water by SEW.*

