



**Proposal to vary the appointments of Severn Trent
Water and Dee Valley Water -
CCWater's response to Ofwat's consultation**

1 Introduction

1. The Consumer Council for Water (CCWater) is the statutory consumer organisation that represents the interests of the customers of water and sewerage companies in England and Wales. CCWater has four regional committees in England and a committee for Wales.
2. We welcome the opportunity to reply to Ofwat's consultation in relation to its proposal to modify the existing Instruments of Appointment (or licences) of Severn Trent Water (SVT) and Dee Valley Water (DVW) under its New Appointments and Variations (NAV) process.
3. We note that two NAV applications have been made under the 'consent criterion'¹, because the existing monopoly suppliers, SVT and DVW, are each proposing to transfer part of their existing customer base to the other, on the basis of geographical location.
4. We also note that these NAV applications are unusual in several respects, notably that the applications are from two incumbent appointees; that the applicants are in the same ownership; and that it is usual for a single enlarged area of appointment to be sought in the case of a water company takeover or merger.
5. We understand that Ofwat must consider all NAV applications against five stated policy principles and that all of these principles must be met for any NAV application to be approved². Whilst we recognise the importance of all five, the focus of our response to this consultation is on Principle 3: that customers, or future customers, should be no worse off than if the site had continued to be supplied by the existing company.
6. In the months leading up to this consultation we have engaged directly with SVT (which also owns DVW), Ofwat, Welsh Government and some of the customers who would be affected by the proposed licence changes. We have done this to inform our own position; to share out thoughts and concerns with other interested parties; and ultimately to try to ensure that all affected customers (bill-payers) and consumers (service users) who might suffer detriment as a result of the proposed licence changes, are protected.

2 Our response

7. All NAV applicants must demonstrate that their proposals meet Ofwat's five policy principles in order for their applications to be approved. This includes that customers, or future customers, should be no worse off than if the site had continued to be supplied by the existing company. In the case of the SVT and DVW applications, that means that customers should be no worse off than under the current licence arrangements.
8. SVT and DVW have not ensured that customers will be no worse off if these proposals to vary their licences are approved; in fact it is clear that some existing SVT customers will be worse off as a direct result of the proposed licence variations and this detriment would not occur if the current licence arrangements remain in place. On this basis, **we oppose the proposed licence variations.**

¹ Page 6 of the consultation document

² Page 9 of the consultation document

9. This is because there are two key aspects of detriment for customers which arise directly from the proposals to vary the existing SVT and DVW licences, namely:

i) Wastewater bill impacts

- This relates to existing SVT customers in Wales, based in Powys and Monmouthshire, who currently receive wastewater services from SVT and under the proposed changes would be moved to the DVW licence. These customers would face upward wastewater bill impacts into the future as a direct result of these proposals. Whilst SVT and DVW are proposing some mitigation, meaning that these upward bill impacts would be kept very low for an initial period, wastewater charges would need to rise more significantly in subsequent years. This would be especially impactful on those customers who currently receive only a wastewater service from SVT, for example those who receive their water service from Dŵr Cymru, because they would not receive any benefit from proposals to use reservoir income to offset future water bill increases for DVW's customers in Wales.

ii) Access to the non-household retail water market

- This also relates to existing SVT customers in Wales, based in Powys and Monmouthshire, who are classified as being 'non-household' (NHH) and are currently eligible for the retail water market. At present these NHH customers are able to use the market to choose their retail water supplier; negotiate or renegotiate price and service packages; and access other value-added services. If Ofwat approves these NAV applications, affected NHH customers in Wales would lose their right of access to the retail water market. Many of these customers would also be affected by the upward wastewater bill impacts described above, meaning that they might well experience detriment on two counts.

10. Both of the above aspects of detriment are direct consequences of the proposals to vary the existing SVT and DVW licences. Neither would occur as a direct consequence of the licences remaining as they are; nor for that matter would they occur as a direct consequence of a single licence if SVT were to apply successfully for a variation on that basis, as is usual following a water company takeover or merger. For this reason, **it is our view that SVT and DVW have failed to ensure that customers would be no worse off under the proposed licence variations and in view of Ofwat's third policy principle, the NAV applications should be refused.**

11. We recognise that there are two matters relevant to the second aspect of detriment, which relates to the NHH retail water market:

- i) This detriment would depend upon each individual customer's view of having or losing the right of access to the market. We know, however, both from SVT's qualitative research³ and from our own engagement exercise⁴ with NHH customers in Powys and Monmouthshire that there are some who are unhappy about the potential loss of this right, and as such the proposed licence variations would cause either actual or perceived detriment to those customers.

³ SVT research April / May 2017 - Dee Valley Customer Research with customers in Powys and Dee Valley

⁴ 61 customers replied to CCWater's email to NHH customers in the Chester area and in the Powys/Monmouthshire area, October 2017.

ii) This detriment may occur at a later date as a result of changes being implemented by Welsh Government under the Wales Act 2017:

- These legislative changes, expected to take effect from 1 April 2020, would mean that all water and sewerage customers whose premises are in Wales would be governed in accordance with legislation and regulations applicable to Wales. A consequence of this would be that existing SVT customers in Wales would lose their right of access to the NHH water retail market, unless the Welsh Government were to adopt measures to protect the current rights of the affected customers.
- We recognise that there is a fundamental difference between an impact arising as a result of a change in legislation or government policy and an impact arising because of the actions of a privatised water company and a decision by the regulator.
- Additionally, the Welsh Government making these changes under the Wales Act 2017 does not necessitate SVT and DVW having to apply for the same licence variations as they are now. On the contrary, the impact of these changes being made by Welsh Government could be accommodated within SVT's and DVW's existing licence arrangements. As such, no upward wastewater bill impacts would arise, and that aspect of detriment to customers would be avoided. Similarly, if SVT were to apply successfully for a single licence, as is usual following a water company takeover or merger, the changes being made by the Welsh Government could be accommodated within that licence. Again, no upward wastewater bill impacts would then arise, and that aspect of detriment to customers would be avoided.

12. There is a third aspect of customer detriment which is relevant to these NAV applications, and this relates to the proposed removal of DVW's free supply pipe repair scheme:

- Existing DVW customers currently benefit from a free supply pipe repair scheme whereby DVW repairs leaks on customers' own supply pipes for free, subject to certain terms and conditions.
- Water companies estimate that around 25% of total leakage may be on customers' pipework. The majority of water companies in England and Wales provide free supply pipe repair schemes, albeit with varying terms and conditions, because it enhances their customer service offering and because it is an important part of their leakage management strategy.
- In common with SVT which no longer provides a free supply pipe repair scheme to its existing customers, DVW plans to stop offering this free service.
- We consider this to be poor practice, in the context of both leakage management and customer service; and we would much prefer to see SVT adopt DVW's policy, rather than the reverse.
- We recognise, however, that this detriment arises because of SVT's takeover of DVW, rather than directly as a result of the proposed licence variations; and SVT can impose its policy on DVW customers under the current licence arrangements.

13. We recognise that some customers may benefit from these NAV applications. Eligible NHH customers in the Chester area would gain access to the retail water market; SVT reservoir income transferring to DVW would mitigate upward bill impacts for DVW water customers; and there would be downward wastewater bill impacts for SVT customers in England, although these would be negligible.

14. These benefits do not, however, offset the detriment that other customers may experience as a result of these NAV applications. Additionally, the first two benefits could be realised without the detriment being caused, if SVT were to apply successfully for a single licence, as is usual following a water company takeover or merger.
15. **In conclusion, we do not agree with Ofwat's assertion that "on balance, the applications are not likely to create a detriment to customers"⁵ as there is clear detriment (both actual and potential) arising directly as a result of the proposals to vary the licences of SVT and DVW. This would not be the case if the existing licence arrangements remain in place or if SVT were to apply successfully for a single licence as is usual following a water company takeover or merger. As such, we do not consider that the proposals meet all five of Ofwat's policy principles for considering NAV applications, and they should therefore be refused.**

3 Further commentary relevant to our response

16. We have made our concerns known to Ofwat and to SVT and DVW over recent months, and our objection to the proposals to vary the licences of SVT and DVW will therefore not come as a surprise to them.
17. We have provided additional information and commentary below, which explains or provides further context to our response.

Water bill impacts arising from the proposals

18. We recognise that directly arising from the proposals to vary the licences of SVT and DVW, there would be a benefit to existing DVW customers in Wales in relation to their water charges.
19. We note that income from two SVT reservoirs, which are located in Powys and are rented out to other users, would move from SVT to DVW and be used to reduce upward pressure on customers' water bills from 2020/21. This would mean that water charges for DVW customers would fall and then remain below the level projected for 2019/20 up until 2026/27⁶, excluding other factors such as inflation and Outcome Delivery Incentive (ODI) rewards.
20. We also note the assumption made in the consultation document that water charges for DVW customers would be subject to upward pressures after 2026/27 but the overall effect on DVW's water-only customers and SVT existing combined water and wastewater customers in Wales would be "neutral" to 2034/35 because of other offsetting factors which may arise⁷. We are not, however, in a position to validate this assumption. It is not clear whether other possible causes of upward pressure on these customers' bills have been considered, or if only potentially mitigating factors have been taken into account.

⁵ Page 25 of the consultation document

⁶ Page 23 of the consultation document

⁷ Page 24 of the consultation document

21. Whilst this benefit for DVW water customers would not arise under the existing SVT and DVW licence arrangements, we recognise that a benefit for these customers would be likely to arise if SVT were to apply successfully for a single licence, as is usual following a water company takeover or merger.
22. We also note that any detriment caused by upward water bill impacts for existing SVT customers in England which would result from moving reservoir income from SVT to DVW would be minimal⁸. We recognise that this would logically be the case because the impact on water bills will be spread across a relatively large number of customers.

Wastewater bill impacts arising from the proposals

23. Our primary objection to these NAV applications relates to the upward wastewater bill impacts which existing SVT customers in Powys and Monmouthshire would face over time, if the proposals are approved; this detriment would not occur if the current SVT and DVW licence arrangements were to continue, or if SVT were to apply successfully for a single licence, as is usually the case following a water company takeover or merger.
24. We recognise the relevance to this issue of regional average pricing and the unwinding of existing cross-subsidies:
- All water companies are required to raise charges that are cost-reflective but regional average pricing underpins this principle.
 - Within each water company region, there are some customers who are less expensive to serve and some who are more expensive to serve. The latter group typically includes customers in very rural areas.
 - Regional average pricing means that all customers in a water company region are charged the same tariffs; and those who are more expensive to serve are subsidised to some extent by those who are less expensive to serve.
 - Moving customers from one water company to another will therefore unwind these existing cross-subsidies, and this may have an undesirable effect on some customers.
 - To our knowledge, there are no plans to change this charging model.
25. We are aware that existing SVT customers in Powys and Monmouthshire benefit from cross-subsidies from other SVT customers, especially in relation to wastewater charges. We note that currently these equate to around £15 per annum⁹.
26. Under the proposals to vary the licences of SVT and DVW, SVT customers in Wales would move to DVW and the existing SVT cross-subsidies benefiting them would be unwound. They would be worse off as a result, partly because DVW would still have substantially fewer customers than SVT and partly because most DVW customers would still not receive wastewater services from DVW - and therefore the current SVT cross-subsidies benefiting SVT wastewater customers in Powys and Monmouthshire could not be replicated by DVW.

⁸ Page 24 of the consultation document

⁹ Page 22 of the consultation document

27. We note that without any mitigation the upward impact on the bills of these existing SVT wastewater customers would equate to increases of 2.7% but mitigation is proposed which would artificially limit these increases to 0.8% per annum¹⁰ for an initial period.
28. It is unclear from the consultation document for what period this mitigation would be applied. It references "2018-2020 and for a period of time afterwards" and also 2030¹¹; but it also implies that the mitigation might be applied to 2034/35. Information which Ofwat and SVT have shared with us previously, suggested that the period might only be to 2024/25 or to 2026/27, whereas SVT has recently informed us that it will be to 2029/2030.
29. We support (and have encouraged) mitigation of these upward wastewater bill impacts, for example by SVT and DVW using efficiency savings arising from the takeover; however we expect this mitigation to be provided over the long term, in order to protect affected customers and ensure that they are not worse off under the proposed licence variations. As such, we consider proposals for short-term mitigation to be unacceptable.
30. We recognise that any proposals which SVT and DVW make to mitigate these upward wastewater bill impacts must be achievable within the regulatory framework of the water sector, and they must be binding and ultimately enforceable by Ofwat, for example by being incorporated within the DVW licence or by being subject to some other form of regulatory undertaking.
31. The unravelling of the existing SVT cross-subsidies which currently benefit its wastewater customers in Powys and Monmouthshire, and the resulting detriment in the form of future upward bill impacts, arise directly because of the proposals to vary the licences of SVT and DVW. This situation would not arise if the licence arrangements remain as now; and it would not arise if SVT were to apply successfully for a single licence, as is usual following a water company takeover or merger.
32. We recognise that the wastewater charges of these existing SVT customers in Powys and Monmouthshire will be impacted over time by a number of factors, and that these may either place upward or downward pressure on bills. These factors would include inflation, ODI rewards and penalties, and future price settlements.
33. We also recognise that the unravelling of the aforementioned wastewater cross-subsidies would benefit SVT customers in England; however the downward impact on their wastewater bills would be negligible due to the large number of customers concerned.

Access to the NHH retail water market

34. We understand the differences between government policy in England and government policy in Wales in relation to market reform and competition in the water sector:
- Eligible NHH customers of water companies whose areas are wholly or mainly in England, including SVT, have had access to a NHH retail water market since 1 April 2017 and are able to use this market to choose their retail water supplier, negotiate or renegotiate price and service packages and access other value-added services.

¹⁰ Pages 23 & 24 in the consultation document

¹¹ Pages 22 and 31 of the consultation document

- NHH customers of water companies whose areas are wholly or mainly in Wales, including DVW, can only switch retailer if their water usage is greater than 50 megalitres per annum.
35. We also understand that under the proposed variations to the licences of SVT and DVW, eligible NHH customers in the Chester area would gain the right of access to the retail water market and eligible NHH customers in Powys and Monmouthshire would lose their right of access to the market. This is because Chester-based customers would move from DVW to SVT and Powys and Monmouthshire customers would move from SVT to DVW.
36. We recognise that whilst the impact of the proposed changes would represent a benefit (actual or perceived) to some NHH customers in the Chester area, it would also represent a detriment (actual or perceived) to some NHH customers in the Powys and Monmouthshire area.
37. We also recognise that this benefit or detriment would depend upon each individual NHH customer's view of (gaining or losing) the right of access to the retail water market. We know, however, from SVT's qualitative research¹² and from our own engagement exercise with NHH customers¹³ that there are some customers in the Chester area who would welcome the right of access to the retail water market and there are some customers in Powys and Monmouthshire who are unhappy about the potential loss of this right. Other NHH customers (in both areas) appear indifferent to the proposed changes.
38. The detriment to NHH customers in Powys and Monmouthshire would arise as a direct result of the proposals to vary the existing SVT and DVW licences, but would not occur as a direct consequence of the licences remaining as they are or as a direct consequence of a single licence if SVT were to apply successfully for a variation on that basis, as is usual following a water company takeover or merger. The benefit to NHH customers in the Chester area would still arise, if SVT were to apply successfully for a single licence.
39. Under Ofwat's five policy principles which NAV applications must meet, customers should be no worse off than under the current licence arrangements. Even though the proposals to vary the licences of SVT and DVW would mean benefit for some NHH customers (namely those in the Chester area), there would be detriment to others (namely those in Powys and Monmouthshire), and the one does not offset the other. It is clear therefore that some NHH customers in Powys and Monmouthshire would be worse off, if the proposed licence variations are approved.
40. We are especially concerned that many of the NHH customers in Powys and Monmouthshire who would lose their right of access to the retail water market under the proposals to vary the licences of SVT and DVW would also be affected by the wastewater bill impacts we have previously described, meaning that they might well experience detriment on two counts.

¹² SVT research April / May 2017 - Dee Valley Customer Research with customers in Powys and Dee Valley

¹³ CCWater provided information to NHH customers in the Chester area and in the Powys/Monmouthshire area by email in October 2017 and invited customers to share their views on the proposed changes. 61 responses were received.

41. We acknowledge that the impacts which would affect NHH customers in the Chester area and in Powys and Monmouthshire as a result of the proposals to vary the licences of SVT and DVW may occur at a later date as a result of changes being implemented by the Welsh Government under the Wales Act 2017. These changes reflect recommendations made by The Commission on Devolution in Wales - also known as The Silk Commission - which was established by UK Government in 2011 to look at the future of the devolution settlement in Wales. These legislative changes are expected to take effect from 1 April 2020.
42. We recognise, however, that there is a fundamental difference between an impact arising as a result of a change in legislation or government policy and an impact arising because of the actions of a privatised water company and a decision by the economic regulator.
43. Moreover, the Welsh Government could choose to protect the rights of NHH customers in Powys and Monmouthshire who currently have access to the retail water market, whereas neither Ofwat nor a water company has powers to do this. Even if the Welsh Government chooses not to act in this way, eligible NHH customers in Powys and Monmouthshire would not be constrained in the intervening period from accessing the benefits (whether actual or perceived) that they might gain from having access to the market.
44. We also recognise that if Welsh Government implements the aforementioned changes under the Wales Act 2017, SVT and DVW would not then be required to submit NAV applications to vary their existing licences. On the contrary, the effects of these legislative changes could be accommodated within SVT's and DVW's existing licence arrangements, and as a result the wastewater bill increases arising from the current proposals to vary the licences of SVT and DVW would be avoided. Similarly, if SVT were to apply successfully for a single licence, as is usual following a water company takeover or merger, the effects of these legislative changes could be accommodated within that licence and the aforementioned upward wastewater bill impacts would again be avoided.

Other benefits arising from the proposals

45. We acknowledge the service benefits to existing customers and consumers of DVW and SVT which are outlined in the consultation document¹⁴, including:
- Longer 'opening hours' and additional communication channels for existing DVW customers; and
 - Higher Guaranteed Standards Scheme (GSS) payments when service failures occur for existing SVT customers where the current DVW payment level exceeds the current SVT payment level.
46. We do not believe, however, that these service benefits arise directly as a result of the proposals to vary the licences of SVT and DVW. They are changes which could be made under the existing licence arrangements (as a result of SVT's takeover of DVW).

¹⁴ Page 13 & Appendix 2 of the consultation document

4 Enquiries

47. If you have any questions about CCWater's response to this consultation, please contact:

Phil Marshall
Deputy Chief Executive
Consumer Council for Water
Email: philip.marshall@ccwater.org.uk
Tel: 0121 345 1041 / 07778 160808