

23 March 2018

Trust in water

Variation of Severn Trent Water Limited's (Severn Trent Water) appointment to include the Chester Site and variation of Dee Valley Water Limited's (Dee Valley Water) appointment to include the Powys site

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1. About this document

Variation of Severn Trent Water's appointment to include the Chester site and variation of Dee Valley Water's appointment to include the Powys site

On 8 December 2018 Ofwat published [a notice](#) pursuant to s8(3) of the Water Industry Act 1991 (WIA91) (the 8 December notice) proposing to vary Severn Trent Water's instrument of appointment ("**Appointment**") to become the water services provider for properties in Dee Valley Water's water supply area in and around Chester in England ("**the Chester site**"). The notice also proposed to grant a new appointment to Dee Valley and to vary Dee Valley Water's existing Appointment in order for it to replace Severn Trent Water as the water and waste water provider in Severn Trent Water's existing water and waste water supply area in Wales in and around Powys and Monmouthshire ("**the Powys site**"). Although the applications to which our notice related were separate as they were closely interlinked we considered them together.

The consultation period stated in the 8 December notice ended on 10 January 2018. During the consultation period, we received representations from five organisations, which we considered in making our decision. On 23 March 2018 we granted Severn Trent Water a variation to the water supply area in its existing Appointment to enable it to supply water services to the Chester site and also granted Dee Valley Water a new Appointment and a variation to its supply area in its existing Appointment to enable it to supply water and waste water services to the Powys site. This decision is conditional on Severn Trent Water and Dee Valley Water consenting to changes to the conditions of their Appointment which Ofwat considers to be necessary or desirable as a result of this decision.

This document is a notice pursuant to s8(5) WIA91 of Ofwat's decision to make the appointment and variations set out above. It also details the consultation responses and gives our reasons for making the appointment and variations. Like our 8 December notice, this notice relates to the appointment and relevant variations together.

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2. Summary

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 into areas where they are not the appointed company. In this case, Severn Trent Water applied to replace Dee Valley Water to become the appointed water company for the Chester site and Dee Valley Water applied to replace Severn Trent Water to become the appointed water and sewerage company for the Powys 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. When assessing NAV applications, we apply five principles – but as set out in our consultation, our application of the first two of these principles did not require detailed explanation because of the nature of the applications in this case. The three remaining policy principles we have considered in more detail 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.
3. The applicants are operationally viable as a water and/or sewerage company.

Although the applications from Severn Trent Water and Dee Valley Water were separate, as they were closely interlinked we considered both together and, consistent with this approach, we are concluding on both applications in this document. References in this document to the “applications” are to the applications from Severn Trent Water and Dee Valley Water collectively and references to an “application” is either one of the applications, as the context requires.

In our 8 December notice on which we [consulted](#) we proposed to:

- vary the Appointment of Severn Trent Water by adding the Chester Site to its water supply area;
- vary the Appointment of Dee Valley Water by excluding the Chester Site from its water supply area;
- grant Dee Valley Water a new Appointment in respect of wastewater services to the Powys site in order for it to become a water and wastewater company;
- vary the Appointment of Dee Valley Water by adding the Powys Site to its water supply area; and
- vary the Appointment of Severn Trent Water by excluding the Powys Site from its water supply and wastewater services areas.

Following consideration of the responses we have received we have decided to make these variations and the proposed appointment by means of which, Dee Valley Water will become a Water and Wastewater Services company based wholly in Wales and Severn Trent Water will become a Water and Wastewater Services company based wholly in England. The details of each area are in appendix 1.

We received 4 responses to our consultation (appendix 2) from the Environment Agency, Flintshire County Council, Welsh Assembly and CCWater.

The Environment Agency and Flintshire County Council did not raise any objections to either of these applications. The Welsh Assembly raised concerns regarding the loss of free supply pipe repairs in the Dee Valley Water application and had some more general areas where they requested clarification. CCWater had some significant concerns regarding the Dee Valley Water application, specifically bill increases for waste water only customers in Powys, access to retail competition for non-households using under 5Ml/day in Powys, and supply pipe repairs. CCWater's response did not support the applications.

Since our 8 December notice was published in December 2017 Severn Trent Water and Dee Valley Water have worked with CCWater to mitigate their concerns where possible. This has resulted in Dee Valley Water proposing to keep customers' waste water bills flat for the long term following the variation, rather than the 0.8% originally proposed in Dee Valley Water's application. Dee Valley Water submitted a new financial model, which we have considered in detail.

In our consultation, we said that overall, customers were no worse off as a result of the application when that application was underpinned by the original financial model. We remain satisfied that this is the case with the new proposal – as bills will be lower as a result. The new proposal is only slightly different from the original proposal and the changes made are specifically to address concerns regarding waste water bill impacts in Powys. The new proposal means minimal impact on bill impacts over the longer term without a material impact on financeability. Further, the new model addresses CCWater's objection to waste water bill increases in Powys, where they thought there was a detriment to customers. Further discussion of this new proposal and our analysis are available in sections 5.1.2 and 5.2 below.

We have discussed the concerns and areas of clarification raised in their respective consultation responses with the Welsh Assembly and CCWater and we detail our response further in this document.

In their original applications Severn Trent Water and Dee Valley Water requested the variations to their licences to take place from 1 April 2018. However, as the consultation process did not complete until 2018 due to the consultation responses and subsequent new proposal from the companies, Severn Trent Water and Dee Valley Water have asked for the requested variations to their licences to instead take effect from 1 July to allow both companies time to deal with the transition operationally, as well as to engage with their customers about the variations. Aside from the change of date, which we do not consider is a material difference to the content of our 8 December notice, we will still follow the same methodology described in that document to ensure commitments made to customers as part of the 2014 price review will still apply in 2018-19 and 2019-20, even though the companies serving those customers will have changed.

We have now approved both Severn Trent Water and Dee Valley Water's applications subject to Severn Trent Water and Dee Valley Water consenting to modifications to the conditions of their respective Appointments in the form of, or a form substantially similar to, the form consulted upon alongside this decision which Ofwat considers to be necessary or desirable as a result of this decision. Provided these conditions are satisfied, the Appointments and variations outlined above will take effect from 1 July 2018.

3. The applications

Severn Trent Water applied to be the water services appointee for the Chester site under the consent criterion set out in section 7(4)(a) of the Water Industry Act 1991 (“**WIA91**”). Subject to Severn Trent Water consenting to modifications to the conditions of their Appointment in the form of, or a form substantially similar to, the form consulted upon alongside this decision which Ofwat considers to be necessary or desirable as a result of this decision. Provided these conditions are satisfied, the Appointments and variations outlined above will take effect from 1 July 2018.

Dee Valley Water applied to be the water and waste water services appointee for the Powys site under the consent criterion set out in section 7(4)(a) of the Water Industry Act 1991 (“**WIA91**”). Subject to Dee Valley Trent Water consenting to modifications to the conditions of their Appointment in the form of, or a form substantially similar to, the form consulted upon alongside this decision which Ofwat considers to be necessary or desirable as a result of this decision. Provided these conditions are satisfied, the Appointments and variations outlined above will take effect from 1 July 2018.

3.1 The consent criterion

To qualify under the consent criterion, an applicant must provide a letter of consent from the existing appointee consenting to the application and consenting to the variation of its area of Appointment corresponding to the applicant's application.

We have seen letters of consent from Dee Valley Water to Severn Trent Water regarding the Chester site and from Severn Trent Water to Dee Valley Water regarding the Powys site. We are satisfied that the consent criterion has been met for both applications.

4. Responses received to the consultation

We received five responses to our consultation; from CCWater, Welsh Government, the Environment Agency, Natural Resources Wales and Flintshire County Council. Two of the responses were neutral, one response raised concerns and areas for clarification and one objected on several areas. We considered these responses before making the decision to vary Severn Trent Water and Dee Valley Water's appointments.

There were three main objections raised in the consultation responses:

- Increases of 0.8% per annum from 2020 in waste water bills for customers in the Powys site.
- Loss of ability to choose supplier for businesses, charities and public sector organisations (business customers) using under 50Ml/day in the Powys site.
- Loss of free supply pipe repairs for existing Dee Valley Water customers including the Chester site.

We have summarised the responses below but they are available in full in appendix 2.

4.1 CCWater

CCWater raised all three objections listed above although waste water bill increases for customers in Powys was their main concern.

They stated that in their opinion some existing Severn Trent Water customers would be worse off as a direct result of the proposed licence variations and this detriment would not occur if the current licence arrangements remained in place. On this basis, CCWater opposed the proposed licence variations.

One of the two key areas where CCWater considered there would be detriment for certain customers arising directly from the NAV applications were waste water bill increases for existing Severn Trent Water customers in Wales, based in Powys and Monmouthshire, who if the applications were approved, would become customers of Dee Valley Water. CCWater were especially concerned about customers in Powys who would receive only waste water services from Dee Valley Water and therefore would notice increasing waste water bills of 0.8% per annum from 2020 with no reduction in their water bills.

The second key aspect was business customers in Powys using under 50Ml/annum losing access to the non-household retail water market. CCWater noted that before any licence changes these customers were able to use the market to choose their retail water supplier; negotiate or renegotiate price and service packages; and access other value-added services. CCWater noted that, if Ofwat approved the NAV applications, affected business customers in Wales would lose their right of access to the retail water market. CCWater added that many of these customers would also be affected by the upward wastewater bill impacts, meaning that they may experience detriment in two different areas. Although CCWater acknowledged that customers using under 50Ml/annum would be losing their access to the non-household retail market in 2020 under the Wales Act 2017 they stated that they believed there was, “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.”

CCWater went on to say it also considered the proposed removal of Dee Valley Water's free supply pipe repair scheme a detriment to customers. This is because existing Dee Valley Water customers currently benefit from a free supply pipe repair scheme which means that Dee Valley Water repairs leaks on customers' own supply pipes for free, subject to certain terms and conditions. However, CCWater also noted in their response that this detriment arises because of Severn Trent Water's merger with Dee Valley Water, rather than as a direct result of the proposed NAV applications and that Severn Trent Water can impose its policy on Dee Valley Water customers under the current licence arrangements without the NAV being approved.

CCWater also recognised that some customers may benefit from the NAV applications including business customers in the Chester area using under 50Ml/annum who would gain access to the retail water market; the Severn Trent Water reservoir income transferring to Dee Valley Water as a result of the NAV applications would mitigate upward bill impacts for Dee Valley Water water customers; and there would be downward wastewater bill impacts for Severn Trent Water customers in England, although these would be small.

However, in conclusion CCWater stated that in its opinion these benefits did not offset the detriment that other customers may experience as a result of these NAV applications.

CCWater stated that, although it understood the driver behind the NAV applications was the Wales Act 2017, it believed the changes could be accommodated within Severn Trent Water's and Dee Valley Water's existing licence arrangements. CCWater also considered an alternative option in their response where Severn Trent Water and Dee Valley Water could have applied for a single licence to cover the whole of Severn Trent Water and Dee Valley Water's area. CCWater believed that this would allow all business customers using under 50Ml/annum in both areas to gain access to retail competition until the Wales Act comes into effect in 2020 and they also stated it would allow the reservoir income which is currently within Severn Trent Water to mitigate upward bill impacts for Dee Valley Water water customers. CCWater did not believe Severn Trent Water or Dee Valley Water had sufficiently considered alternatives to applying for NAV's.

4.2 Welsh Assembly

The Welsh Assembly noted that they were disappointed that Dee Valley Water would be reducing the level of service that was previously available to their customers prior to the merger by removing free supply pipe repairs. They noted that their Water Strategy for Wales highlighted leakage as an area of importance stating that "we expect water companies to continue to innovate and develop expertise in preventing, identifying and repairing leakage more effectively. We expect Ofwat to continue to drive improvements in respect of leakage, building on improvements already achieved since targets were introduced".

The Welsh Assembly did not believe Dee Valley Water removing free supply pipe repairs aligned with Welsh Government's policy on leakage and believed the removal of this scheme was detrimental to customers in Wales.

The Welsh Assembly also required clarification on whether the higher GSS payments currently offered by Dee Valley Water would also be applied to customers in Powys as well as the rest of Dee Valley Water and Severn Trent Water's customers.

Finally the Welsh Assembly noted that the consultation said that Dee Valley Water accepted that the wastewater control will not be financeable. Furthermore, Dee Valley Water also said it will not seek to use the financial levers (PAYG and RCV run-off) to address any wastewater financeability issues, provided the company remains financeable. It noted that it expected Ofwat to ensure the Dee Valley Water business plan for PR19 reflects this commitment.

4.3 Environment Agency

The Environment Agency confirmed that the information provided by Severn Trent Water in the pre-consultation phase and the information in our consultation meant that they did not have any reason to not support the application.

However they did note if the applications were granted there would need to be some subsequent work between the Environment Agency, Severn Trent Water and Dee Valley Water to address any practical issues.

4.4 Natural Resources Wales

Natural Resources Wales had no specific concerns. However, they stated they would like to understand how Severn Trent Water's current leakage ODI in the Powys resource zone would be addressed by Dee Valley Water following the licence variations.

Natural Resources Wales also noted that they would have to consider how they would report on the metrics regarding their monitoring of water company performance which forms part of their Environmental Performance Assessment (EPA) during the remainder of AMP5 and AMP6.

Finally, they added that if the applications were approved Natural Resources Wales would have to work closely with the water companies to ensure all permits and legal documents involving them reflected the new arrangements, however they did not foresee any significant implications of approving the licence variations on either security of supply or the environment.

4.5 Flintshire County Council

Flintshire County Council confirmed that they were content for the proposals to proceed and raised no objections.

5. Our analysis and response to issues raised in the consultation responses

As set out in our 8 December notice, when assessing applications for new appointments and variations we consider 5 principles:

- Principle 1: New appointees should be regarded as wholesale customers of and competitors to existing appointees.
- Principle 2: We will consider applications on a site-by-site and company wide basis as appropriate.
- Principle 3: Customers, or future customers, should be no worse off than if the site had continued to be supplied by the existing company.
- Principle 4: Ofwat must be satisfied that an applicant is financially viable and will be able to finance the proper carrying out of its functions as a water and/or wastewater services company.
- Principle 5: Ofwat must be satisfied that an applicant is operationally viable and can demonstrate the competencies required to technically and operationally be able to fulfil the functions of an appointed water and/or wastewater services company.

Our notice outlined why we were satisfied that these principles were satisfied by the applications. All responses to our notice related to our assessment of Principle 3. However, as a result of changes made to Dee Valley's financial model to deal with these responses, we have considered further whether our assessment under Principles 3, 4 and 5 has changed. We remain satisfied that Principles 1 and 2 have been met for the reasons set out in our previous notice. This section of the notice sets out our initial position as stated in the consultation, any issues that have been raised in the consultation responses and our final conclusion.

5.1 Principle 3: Customers, or future customers, should be no worse off than if the site had continued to be supplied by the existing company

Our statement of policy sets out that we will consider both price and service when considering impact on customers. In line with our statement of policy, we considered the overall effect on customers of granting the applications compared to no changes taking place. We discussed this principle and our approach in more detail in our consultation.

5.1.1 Service

a) Codes of practice for domestic customers, debt and leakage

Severn Trent Water's codes of practice on customer service, debt and leakage would apply to the Chester Site, and Dee Valley Water's codes of practice on customer service, debt and leakage would apply to the Powys Site immediately after the licence changes take effect.

Following their applications, Severn Trent Water and Dee Valley Water have said that overall, customers will be no worse off and will receive (as far as possible) the same or better level of service. In appendix 2 of our consultation document there is a table showing a side-by-side comparison between Severn Trent Water and Dee Valley Water's current codes of practice, and Severn Trent Water's and Dee Valley Water's proposals to address these differences. In most cases, this is a commitment to match the highest level of service across the two companies.

The main areas of difference between the two codes of practice are:

- Longer contact hours and more communication channels are available for Severn Trent Water customers than for Dee Valley Water customers. Dee Valley Water has agreed to offer these benefits to all of its customers, not just those in the Powys area;
- Severn Trent Water offers a Charitable Trust Fund for its customers in debt, and this will be extended to customers in Chester. Dee Valley Water will continue to offer a Charitable Trust Fund to customers in the Powys area, and will consider how this can be extended across the remainder of the Dee Valley Water area. Dee Valley Water has committed to working with its customers and stakeholders in Wales to better understand the affordability challenges and develop more

effective measures to help vulnerable customers and those struggling to pay as part of its PR19 plans;

- Dee Valley Water has higher GSS (Guaranteed Service Standards) payments than Severn Trent Water. Severn Trent Water has committed to adopting the higher level of payments for customers in the Chester site;
- Dee Valley Water currently offers free service pipe repairs for its customers. Severn Trent Water stopped offering this in 2015. Dee Valley Water intends to stop offering this service whether its application is approved or not. However, Dee Valley Water has confirmed that if private supply pipes are adopted as a result of Welsh or UK Government legislation, it would support this.

In our 8 December notice, we confirmed that we were satisfied that Severn Trent Water and Dee Valley Water had made commitments that they would match the highest level of current customer service levels of either company with the exception of free supply pipe repairs, based on the current customer codes of practice. Severn Trent Water and Dee Valley Water stated that they would implement these benefits for all customers in both regions, and Severn Trent Water and Dee Valley Water both committed to making these changes from 1 when the licence variation takes effect, allowing them time to engage with their stakeholders, including CCWater.

The exception to these commitments to match the highest level of service is free supply pipe repairs. The decision for Dee Valley Water to remove its free supply pipe repairs regardless of whether their application is approved or not has been made at a group level following the merger.

We would encourage Severn Trent Water and Dee Valley Water to continue to reduce their leakage and we will continue to set challenging leakage targets through the Price Review process. However, it is up to individual companies to determine how best this might be achieved.

Companies are under no legal obligation to offer free supply pipe repairs although the majority of them do offer some service in order to keep their leakage low.

We agree with the Welsh Assembly and CCWater that it is disappointing that Dee Valley Water will be proposing to remove its free supply pipe repairs service but as it will be seeking to do this regardless of the outcome of this application, we do not consider this grounds for not approving the application. We will consider requests for our approval to consequential changes to Dee Valley Water's leakage code of practice to remove free supply pipe repairs when they are brought forward.

Based on this, we remain satisfied that customers will be offered an appropriate level of service by Severn Trent Water and Dee Valley Water and that overall customers will be 'no worse off' in terms of service levels as a result of these applications.

b) Levels of service including minimum service standards (GSS), customer service levels (SIM) and voluntary standards

When we review NAV applications, we normally consider the service standards which a new appointee is proposing compared to the incumbent appointee. As the applications concerned two existing water companies which must already meet standards on levels of service, this comparison was more complex.

As set out in our 8 December notice, both water companies are currently required to comply with a set of minimum service standards for water services known as the Guaranteed Standards Scheme, or GSS.

Further, Severn Trent Water and Dee Valley Water committed to ensuring that customers would continue to be served by the same customer service teams which means that customers in the Chester Site area would continue to be served by the same customer service teams, based in the same location as they are now. These teams would be recharged by Dee Valley Water to Severn Trent Water. As set out above, these customers will also benefit from an increased out of hours service and greater communications channels. Customers in the Powys Site area would continue to be served by the current Severn Trent Water customer service teams and these teams will be recharged to Dee Valley Water.

Secondly, both companies are subject to the Service Incentive Mechanism (SIM). The SIM is an annual incentive included in price determinations which is designed to encourage water companies in England and Wales to provide better customer service. The SIM provides incentives to the best performing companies for good customer service and penalises the worst performing at the end of the price control period. Our 8 December notice set out how the incentives would be allocated between Severn Trent Water and Dee Valley to ensure that customers were no worse off, essentially by ensuring that any poor performance penalties and high performance payments for the first three years and three months followed the customers.

We received no comments in the consultation responses regarding our proposed approach and therefore we remain satisfied that customers will be no worse off in terms of Levels of Service including minimum service standards (GSS), customer service levels (SIM) and voluntary standards if these applications are approved.

c) Performance commitments and ODIs

All large companies, including Severn Trent Water and Dee Valley Water, have performance commitments and outcome delivery incentives (ODIs) as part of their price review – and they must report on their progress against these performance commitments each year. For many performance commitments, there is also a financial incentive as well as this reputational incentive. Some of these financial ODIs are 'in-period', with annual adjustments for outperformance or underperformance. The rest are 'end-period', with adjustments made at PR19.

When considering if customers would be no worse off under these applications, we considered Severn Trent Water's and Dee Valley Water's approach to their performance commitments and ODIs for the first three years and three months and the remaining one year and 9 months of this AMP period. We noted in our 8 December notice that both companies would propose new performance commitments and ODIs from April 2020 onwards as part of the PR19 process in respect of their new areas but commitments made to customers as part of the 2014 price review would still apply in 2018-19 and 2019-20, even though the companies serving those customers would have changed.

We noted that as customers in the Chester Site area are currently only receiving water services from Dee Valley Water (United Utilities Water provides the wastewater services in these areas) and would continue to receive only water services from Severn Trent Water, there would be no impact on wastewater ODIs for customers in the Chester Site area as a result of the application.

For wastewater customers in the Powys area, the existing Severn Trent Water performance commitments and ODIs would need to be split so that customers at the Powys Site would be in the same position if Dee Valley Water supplies them.

For water ODIs we noted that the situation was more complex, albeit that as Severn Trent Water and Dee Valley Water were average performers on wholesale water price control performance commitments, ODI outperformance and underperformance adjustments were likely to be small. To consider the adjustments in more detail in our assessment, we split these into before, and after, the proposed boundary changes. We set out full details of our analysis in our 8 December notice.

Severn Trent Water and Dee Valley Water both committed to continue to uphold their outcome commitments set at PR14 in the relevant areas for the rest of the 5 year period for 2018-19 and 2019-20, transferring these (or parts of these) along with customers where this is applicable. We have published the new outcome commitments alongside this final decision on the applications and we will expect

each company to report against these commitments in 2018-19 and 2019-20, as well as in any information provided as part of the business plans.

We have not received any comments in the consultation responses regarding our proposed approach which we discussed in more detail in the [consultation](#) paper. We remain satisfied that our approach will mean customers will be no worse off in terms of performance commitments and ODIs as a result of these applications. As noted in our 8 December notice, the adoption by Dee Valley Water of the ODIs that apply to Powys customers requires us to determine the payment "in-period". As Dee Valley Water's currently licence does not have a mechanism to enable such a determination, one of the licence modifications required as a result of our decision (and on which we are consulting alongside this notice) is the introduction of in-period ODIs.

5.1.2 Price

a) Charges scheme - statements of assurance

Under the Water Industry Act, companies must publish charges schemes to apply charges in their area – and under our charging rules, they must also publish statements of assurance that they have followed the relevant charging rules and obligations. Both Severn Trent Water and Dee Valley Water currently have published charges schemes and statements of assurance covering their current areas. We do not need the companies to provide new charges schemes or statements of assurance before 1 July 2018 as they have already published these and they do not propose to change any charges in 2018-19 as a consequence of the changes in areas of appointment.

b) Customer charges

As set out in our 8 December notice, we assessed the bill impacts resulting from the applications under the current control and beyond. In our consideration of bill impacts beyond 2020 we said that the outcome of future business plans and Price Reviews is unknown, and we would need to consider the impact of the applications in this context. To assist our assessment over the long term, Severn Trent Water and Dee Valley Water modelled bills beyond 2020 by assuming that current costs and price controls would continue to apply after 2020. An example of areas which were not included in the modelling, were the effects of any future decisions by the relevant

companies to change their tariffs in response to higher levels of metering – where we might expect to see higher bills in the Powys region in future.

For 2017/18 – 2019/20

Severn Trent Water committed to match Dee Valley Water's existing water charges for the Chester Site until 2020. Dee Valley Water committed to match Severn Trent Water's charges for the Powys site until 2020. This included both volumetric and fixed charges.

For 2018-19 and 2019-20, Severn Trent Water proposed to charge customers who moved from Dee Valley Water to Severn Trent Water (that is, customers in the Chester Site area) a bill determined on the same basis as ongoing Dee Valley Water charges – that is, based on our Final Determination for Dee Valley Water at PR14.

Bills for Chester and the surrounding area have never been merged with those of Wrexham, and remain set at a different level. It was proposed that this would continue once the NAV took effect. All types of charge, whether measured, unmeasured or fixed, will be the same as those that would have applied if no changes were made to boundaries. This includes the small number of Wrexham customers that fall into England, who will continue to be charged at a different rate from the rest of Severn Trent Water.

Severn Trent Water and Dee Valley Water confirmed that customers in the Chester Site and Powys Site areas would not see an impact on their bills as a result of the applications until at least 2020.

We concluded that customers would be no worse off under either application for this period. We received no consultation objections to bill impacts over this period.

For 2020 and beyond:

As stated in our 8 December notice, Severn Trent Water customers in the Chester site will initially have a reduction in their water bills in 2020-21 before bills slowly start to increase year on year reaching 2020 levels again by 2027-28. Throughout this period, customers will have lower bills, on average, as a result of these changes in areas of appointment. The modelling underpinning the application anticipated that bills would continue to increase slowly to 2035. For the period from 2020-2035, although bill increases were anticipated, we considered that the initial reduction in bills meant that, overall, customers will be no worse off.

From 2020, there will be some minor impacts from the variations on Severn Trent Water's existing customers' bills outside the Chester and Powys sites. Severn Trent Water will no longer benefit from the income from reservoirs in Powys, and will have a slightly higher average RCV per customer. Since these impacts will be spread over so many customers, the individual bill impacts related to this will be extremely small. But there are also factors that will tend to put downward pressure on bills in the long term, because Severn Trent Water will no longer be providing a cross subsidy to customers in Powys (who have relatively high costs to serve but relatively low bills).

We have had no objections to the potential bill impacts of the NAV application on Severn Trent Customers based in England and the Chester Site.

Originally Dee Valley Water proposed an initial drop in bills from 2020-21 before a steady year on year increase, reaching the 2019-20 level by about 2026-27. From 2026-27, there was proposed to be continued upward pressure until 2034-35 and beyond. The overall effect on water-only and combined water and wastewater customers' bill from 2020 – 2035 as a result of the application was anticipated to be neutral. These estimates were subject to the impact of price reviews, and both companies said that they expected bills to fall at the next price review (PR19) due to a lower cost of capital and the impact of efficiency savings that they would deliver.

We had no objections to the potential bill impacts of the NAV application on Dee Valley Water water only or water and waste water customers based in Wales and the Powys site.

Dee Valley Water also originally proposed using some of the potential reduction in water bills due to reservoir income to offset the increases in the wastewater bills in its area – using the PAYG rates, rather than as a direct cross subsidy between controls. As the income is from reservoirs that do not serve customers, this could potentially be considered as income that is not specific to water or waste water customers, but which could instead be used for the benefit of either or both. However, Dee Valley Water's original modelling still predicted increases of around 0.8% per annum in real terms (approximately 80p/year for a wastewater only customer in Powys) from 2020.

CCWater strongly objected to this increase in their consultation response and did not support the application as a result.

Following further discussions with CCWater, Dee Valley Water submitted a revised model to us which maintained the initial proposed bill profiles for water only and combined water and waste water customers for Dee Valley Water customers in Wales, including those in the Powys site, and also kept waste water bills in Powys

flat with no increase as a result of the NAV application for the foreseeable future. It will achieve this by proposing regulatory levers (including PAYG ratios) in future price reviews to keep the waste water revenue requirement in Powys below the level which might otherwise be expected. Dee Valley Water published a letter dated 23rd January explaining this process (appendix 3).

We were already satisfied that, overall, customers were no worse off as a result of the application made with the original financial model. The revisions are not so materially different from the original application we consulted on as to prejudice our previous notice. There will be no material effect on customers, other than Powys Waste Water customers, between the original model and this revised version.

In practice this means that customers in the new Dee Valley Water Welsh company should benefit from reduced or neutral bill impacts as a result of the application until 2035.

Our view of these proposals

We have considered the consultation responses and the revised proposal to vary Severn Trent Water and Dee Valley's appointments.

As before, for 2018-19 and 2019-20, our analysis of the evidence presented to us suggests that there will be no change in bills for customers in the Powys or Chester sites (compared to their bills if the applications were not approved). This is unaffected by the variation to Severn Trent Water's and Dee Valley Water's areas taking place from 1 July 2018 rather than 1 April 2018.

From 2020, our analysis suggests there will be some very minor impacts from these applications on Severn Trent Water customers' bills (as set out in our 8 December notice). Severn Trent Water will no longer benefit from the income from reservoirs in Powys, and will have a slightly higher average RCV per customer. However, since these impacts will be spread over so many customers, the individual bill impacts related to this will be extremely small. Our analysis also suggests that there are other factors that will tend to put downward pressure on bills in the long term, because Severn Trent Water will no longer be providing a cross subsidy to customers in Powys (who have relatively high costs to serve but relatively low bills). Therefore we still conclude that these customers will be no worse off as a result of our approval of the applications.

As a result of the further refinements made to financial models sent to us to support Dee Valley's application and assurances provided by Dee Valley Water, wastewater only customers in Powys will not see their bills increase under this application. Water only and water and waste water customers in Dee Valley Water's water and waste

water supply areas will also still see an initial bill reduction as a result of the licence changes, followed by a steady increase, but overall they will be no worse off as a result of this application over the period 2020-2035. We understand that this addresses CCWater's concerns and we remain satisfied that customers will be no worse off as a result of the applications.

We consider that, overall, when we consider the period 2018-2035, there is minimal effect on the level of customer bills as a result of these applications and so customers will not be worse off.

5.1.2 Other relevant factors

a) Application of Welsh legislation and policy to Powys Site customers and English legislation and policy to Chester Site customers before the Wales Act

The applicable law in relation to customers' water and wastewater services is determined by where the area of the appointee that serves them is "wholly or mainly" based (that is, either in England or Wales). When relevant provisions of the Wales Act 2017 come into effect, customers will be subject to the law of the country in which they are based – that is, the law will be applied along the national border between England and Wales. As our approval of the applications could bring about this change sooner than customers may have anticipated, we considered some areas where the position under English and Welsh legislation currently differs, how customers may be affected earlier than anticipated and the companies' proposals for managing this.

In their consultation response CCWater made the point that there was a "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."

We understand CCWater's point and their concern that as a result of these applications Welsh legislation would apply to customers in the Powys site earlier than when the Wales Act comes into effect. However, we considered whether there was any detriment to customers irrespective of this fact. We did not consider any of the changes would leave customers any worse off as a consequence of moving under different legislation. We detail the difference in English and Welsh legislation and the impact on customers in more detail below.

b) Ability to choose retail supplier for business customers

As set out in our 8 December notice, all business customers served by appointed companies whose areas are wholly or mainly in England (including Severn Trent Water) can choose their water and wastewater retailer. Customers of appointed companies whose areas are wholly or mainly in Wales (including Dee Valley Water) can only switch their water service retailer if they use more than 50MI per year.

We noted that if Severn Trent Water's application was granted, customers in the Chester site would become customers of Severn Trent Water – and so all business customers in this area would be able to switch their water and wastewater service retailer from when the licence changes come into effect. Severn Trent Water proposes to notify all business customers in the Chester Site area if they become eligible to change supplier.

By contrast, Severn Trent Water's business customers who are currently based in Wales and use less than 50MI per year have been able to switch their water service retailer since April 2017 when the new business retail market opened. Of all the businesses in the Powys Site area, 3,157 were able to switch supplier but only a very small number of eligible business customers in the Powys Site area have changed supplier since the market opened.

We noted in our 8 December notice that, if Dee Valley's application was successful, business customers using less than 50MI per year in the Powys Site would transfer to Dee Valley Water when the variations take effect and would no longer have the ability to choose their water and wastewater service retailer, although business customers using over 50MI per year would still be able to. If a business customer in the Powys Site area moved from Severn Trent Water to a different water service retailer before the variations took effect, they would be moved again to Dee Valley Water when the variations took effect.

In our 8 December notice, we considered that, as this impact reflects the different government policies in England and Wales to which Ofwat has regard when carrying out its functions, we did not consider either change to leave customers any worse off as a consequence of different legislation. We considered that customer views on their ability to switch suppliers were also relevant to our assessment, and both Severn Trent Water and CCWater conducted research with the affected customers.

In their response to the consultation CCWater stated that they considered that business customers in Powys using under 50MI per year losing access to the retail market was a detriment and therefore the NAV applications should be refused. CCWater stated "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 research and from our own engagement exercise 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."

CCWater stated that there were potential alternatives that had not been considered by both companies such as Severn Trent Water and Dee Valley Water choosing to operate under a single licence. CCWater considered that such a model would have resulted, in all non-household customers across both companies gaining access to retail competition. We recognise that there are other options that Severn Trent Water and Dee Valley Water could have considered but we only assess the applications against our principles compared to the current situation, not other possible configurations. . Therefore we have not considered any other options other than the NAV applications throughout this process.

CCWater carried out research into customers' opinions regarding the loss of the ability to choose their retail supplier in the Powys site or gaining the ability to choose their retail supplier in the Chester site. Their research was targeted at affected business customers in Powys and Chester but, due to a very small number of responses, was inconclusive. In our 8 December notice we interpreted both this and Severn Trent Water's research along with the very small number of business customers using under 50Ml/per annum in Powys who have currently switched as an indication that the majority of the affected customers would consider it to be no or very small detriment as a result of these applications.

We believe this detriment, whether perceived or actual, to be very small given the number of business customers using under 50Ml/annum who have chosen to switch their retail supplier in Powys. We also note that our approval of the applications will result in a similar number of businesses in Chester becoming eligible to choose they retail supplier. The NAV applications will also lead to improvements to GSS payments and levels of service across Severn Trent Water and Dee Valley Water customers and lower water and combined water and waste water bills for Dee Valley Water customers as a result of these applications.

Having considered CCWater's response, we consider that there is no additional new evidence to suggest that a significant number of customers have raised concerns in either the Powys or Chester site regarding these changes. We therefore do not think that, overall, customers will be any worse off in terms of the different eligibility thresholds for retail competition as a result of this application. We have discussed our views with CCWater and Welsh Government.

Severn Trent Water and Dee Valley Water have committed to working with CCWater to ensure that communications about and support for these changes are adequate for business customers.

c) Limits on the right to make new connections to public sewers

Since 1 October 2012, there have been differences between English and Welsh legislation regarding the right of developers to make connections to a public sewer for companies wholly or mainly based in Wales (that is, Dee Valley Water and Dŵr Cymru/Welsh Water). This has implications for developments currently underway in the Powys Site where developers may think they need to comply with English legislation and will be able to connect to the public sewer after 1 July 2018, but who may need to check that the standards of their drains comply with Welsh Government Standards. We discuss what this means in practice in more detail in our consultation document.

Severn Trent Water and Dee Valley Water consider that the main difference between the positions under English and Welsh legislation in this regard is that developers will need to build the connection to Welsh standards but, as these are similar to SFA75, the standards should be broadly the same as today. Severn Trent Water and Dee Valley Water have confirmed that their staff will need to be both aware of the changes and trained appropriately.

Severn Trent and Dee Valley have committed to working with CCWater to ensure any communications and support are adequate for developers.

We have not received any responses to our consultation addressing this area. Therefore we maintain our position that, as there are likely to be a relatively small number of developments affected, the standards are similar between England and Wales, and for those developers who are affected, Severn Trent Water and Dee Valley Water have committed to providing support, we do not believe there will be any significant detriment to developers relating to this difference in English and Welsh legislation in either the Powys Site or the Chester Site as a result of these applications.

d) Obligations on residential landlords

Since 1 January there have been additional obligations on residential landlords based in the Dee Valley Water area and the Dŵr Cymru/Welsh Water area. In practice, this means that:

- Non-resident owners of rented residential premises are required to give information about the occupiers to water companies – or else become jointly liable for the bill with the occupiers – if their premises are supplied with water, or receive wastewater services from, Dŵr Cymru/Welsh Water or Dee Valley Water; and
- Non-resident landlords of residential premises in the Powys Site could therefore become jointly liable for their tenants' bills from the date of any licence changes as a result of this application if they did not provide information about the occupiers to Dee Valley Water.

These additional obligations do not apply to Severn Trent Water and other companies whose areas are wholly or mainly based in England.

In our 8 December notice, we considered that the impact of this difference in legislation on landlords should be minimal and require little expense as landlords in the Powys region would only be required to inform Dee Valley Water of their tenants' details in order to avoid joint and several liability. Dee Valley Water and Severn Trent Water committed to carrying out appropriate engagement with affected customers and stakeholders and communicate any new landlord's responsibilities effectively to any affected customers.

We do not believe there would be any significant detriment to customers relating to this difference in English and Welsh Legislation in either the Powys Site or the Chester Site as a result of these applications. We have not received any objections to our view in the consultation responses.

5.2 Principle 4: Ability of Severn Trent Water and Dee Valley Water to finance and properly carry out their functions

Where we make an appointment under the NAV regime, we need to be satisfied that the appointees will be able to finance and properly carry out their functions.

Both companies must be separately able to raise finance and have sufficient funds to operate as standalone businesses, even though they are both in the Severn Trent Plc group. In carrying out our assessment we considered the financial viability of each Appointee and in doing so, we have adopted a proportionate approach. Both Severn Trent Water and Dee Valley Water are currently able to finance their functions and raise capital under their existing appointments, and the changes resulting from the licence variations would be unlikely to change that.

A consequence of the licence variation is a reallocation of assets, RCV and financial liabilities between Severn Trent Water and Dee Valley Water. We explained Severn Trent Water's proposals with respect to the allocation of RCV in our consultation.

The approach proposed by Severn Trent Water is to allocate RCV between the new appointees in a way that allows Dee Valley Water to maintain consistent bill profiles now and in the future such that there is no bill increase to customers as a direct consequence of the appointment variations. The approach aims to secure that the level of debt in the new Dee Valley Water can be supported given the revenues collected from customers and the costs of running the services in the Dee Valley Water area. It is proposed that the balance of the RCV is allocated to Severn Trent Water and going forward, RCV for each area will reflect the ongoing investment profile in each of the companies.

We considered other methods of allocation, based on average RCV per customer and asset values. These would have allocated significantly higher RCV to Dee Valley Water. However, we rejected these methods because, while it was possible to maintain consistent customer bills in the short term using PAYG and run-off levers, maintaining bills for a longer term would not be financially viable for the company. Following analysis provided by Severn Trent Water and discussions with the company, we consider the approach to be reasonable.

The RCV for Dee Valley Water and Severn Trent Water arising as a consequence of the change in areas of appointment is stated in Table 1.

Table 1 - Projected RCV allocation of RCV values as at 31 March 2020 based on the PR14 Final Determinations

	RCV (31 March 2020 2012/13 Prices)	
	Before licence variation £m	Post licence variation £m
Severn Trent Water	7,947.9	7,970.0
Water	3,834.3	3,858.0

Waste	4,113.6	4,112.0
Dee Valley Water	87.3	65.2
Water	87.3	63.6
Waste	-	1.6

Overall, at the Appointee level, the reallocation is projected to result in a 25.3% decrease in the RCV of Dee Valley and 0.3% increase in the Severn Trent region. Given the small impact on the RCV for Severn Trent, the changes in areas of appointment will not impact the financial viability of Severn Trent Water. Our assessment therefore focussed on the impacts for Dee Valley Water.

Dee Valley Water provided us with a revised financial model to show the impacts of the licence variation on the financial viability of Dee Valley Water and the impact on customer bills. We have assessed this submission as part of the application process. The model is based on a notional financial structure, underpinned by data from the PR14 final determinations and the cost of capital stated in Ofwat's PR19 methodology. Where possible allocations are made with reference to actual costs and revenue in the impacted areas.

Dee Valley Water has set out that it will be financeable at the level of the Appointee. However, given the rural nature of the Powys area and the relatively high costs of providing the wastewater service, coupled with the objective to maintain the wastewater bill profile for its customers, Dee Valley Water has said that the wastewater business will not appear financeable on a standalone basis for the foreseeable future. However, Dee Valley Water has confirmed¹ it considers this approach is appropriate given that it does not want bills to change for wastewater customers as a consequence of these changes of area of appointment. It proposes to set this out in its PR19 business plan and to apply the same principles in business

¹ Full details of assurance in Appendix 3.

plans for future price reviews in order to maintain the bill differential for wastewater customers.

We have considered the financial modelling carried out by Dee Valley Water. This is likely to mean the price controls for wastewater will not look financeable on a standalone basis at PR19 and beyond. However, our financeability assessment focusses on the financeability of the Appointee and we consider Dee Valley Water's approach is appropriate given the objective that customers should not receive a bill impact as a direct consequence of the merger.

Severn Trent Water have publically stated in the acquisition documents that one of the benefits of the acquisition of Dee Valley Water was to improve the financial resilience of the company. It has already taken steps to deliver this by novating long-dated and expensive external debt to Severn Trent Water and replacing expensive credit facilities with lower cost group facilities. As a consequence of these actions, long term credit ratings for Dee Valley Water have increased by 1 notch for both Moody's and Standard & Poor's to A3 and BBB+ respectively, and gearing has reduced from 76% at 31 March 2016 to 70% at 31 March 2017 and is expected to continue to reduce.

Severn Trent Water has stated its intention to maintain a sensible and sustainable balance sheet structure for Dee Valley Water.

We received no comments in the consultation responses regarding our assessment of the financial viability of Severn Trent Water and Dee Valley Water and, we do not consider that the revised financial models provided by Dee Valley since our 8 December notice materially affect this assessment. We are satisfied that both applications are financially viable at an appointee level. We have received assurance from Dee Valley Water that their future business plans will reflect these commitments, and we are satisfied that we would be able to apply this in future price reviews.

5.3 Principle 5: Operational viability

In their NAV applications Severn Trent Water and Dee Valley Water were required to demonstrate to us that they each have the competencies required to technically and operationally be able to fulfil the functions of an appointed water and wastewater company.

As the first application is for Severn Trent Water - a longstanding existing water and wastewater services supplier - to add the Chester Site area to its current licence, we

are satisfied that it has the competencies required to technically and operationally be able to fulfil the functions of an appointed water and wastewater company across all of its proposed new area.

For the same reason, we are also satisfied that Dee Valley Water has the competencies required to technically and operationally be able to provide water services in the Powys Site area and also to continue to provide these services to the rest of its customers based in Wales.

However, as Dee Valley Water is currently a water only supplier we carefully considered whether it would be able to technically and operationally provide wastewater services to customers in Wales for customers currently supplied by Severn Trent Water.

5.3.1 Asset transfer

In our 8 December notice, all relevant property, assets, rights and liabilities in Wales currently held by Severn Trent Water in Wales would be transferred from Severn Trent Water to Dee Valley Water using a Statutory Transfer Scheme.

The same would also apply to all relevant property, assets, rights and liabilities currently held in England by Dee Valley Water, which would also be transferred from Dee Valley Water to Severn Trent Water through a Statutory Transfer Scheme.

Severn Trent Water and Dee Valley Water's NAV applications were supported by draft transfer schemes and we have now received the final versions. These were supported by assurance from Severn Trent Water's and Dee Valley Water's boards that all assets which are required by each company to properly carry out their functions as water and wastewater companies would be transferred pursuant to those schemes. We have now approved the transfer schemes subject to the same conditions set out in this notice and, subject to the satisfaction of these conditions, they will take effect from 1 July 2018 in accordance with their terms.

As a result, from 1 July 2018, Dee Valley Water and Severn Trent Water will be the legal owners of the assets they require to carry out their functions (subject to their acceptance of licence modifications).

In our 8 December notice, we noted that Dee Valley Water would initially outsource the operation and maintenance of the transferred assets in Wales through an arm's length agreement with Severn Trent Water. Severn Trent Water would also initially

outsource the operation and maintenance of the transferred assets in England to Dee Valley Water, also through an arm's length agreement.

Severn Trent Water submitted to us in January 2018 a final draft of the proposed arm's length agreement within the "operating manual".

Severn Trent Water and Dee Valley Water have also provided us with their assurance that they consider the final version of the Operating Manual to be fully compliant with respective licence conditions and Regulatory Accounting Guideline 5 (Guideline for transfer pricing in the water and sewerage sectors).

Having checked the final operating manual document as part of our normal regulatory duties we are satisfied that it is in line with the commitments that the companies have made throughout the process of their applications.

The statutory transfer schemes, operating manual and assurances all satisfy us that Severn Trent Water and Dee Valley Water will have all the necessary assets and expertise to operate those assets in order to remain operationally viable when their areas of appointment are varied.

5.3.2 Governance

Following the acquisition of Dee Valley Water by Severn Trent Water in February 2017, Severn Trent Water and Dee Valley Water are each separate companies within the Severn Trent Plc group.

As noted in our 8 December notice, Severn Trent Plc has informed us it intends to operate the two separate companies, Dee Valley Water and Severn Trent Water, on an integrated basis - for example, in eventually using a shared customer service department. Severn Trent Water believes that this will maximise the synergy potential and therefore increase benefits to customers. Both Severn Trent Water and Dee Valley Water would, however, retain different brand identities and Dee Valley Water would aim to establish a strong Welsh identity which may involve rebranding.

Our 8 December notice also noted that Dee Valley Water had agreed that their board would have three independent non-executive directors who are independent of Severn Trent Water and the wider Severn Trent plc group. Dee Valley Water has confirmed that these directors will be the single largest group on the board in accordance with our board leadership, transparency and governance principles in this area.

6. Conclusion

Following our consultation we have looked all the relevant information – including the applications, our previous analysis and the responses received to our consultation. As part of this, we have received and reviewed revised financial models submitted by Dee Valley Water in support of its application and showing no bill increases to Powys waste water customers as a result of the applications. We are satisfied that these models address one of the main objections we received to the applications.

We have considered the second objection to the NAV applications regarding the loss of free supply pipe repairs for Dee Valley Water customers. We understand that this is proposed to take place regardless of whether the applications are approved or not. Therefore we consider this is outside the scope of our consideration of the NAV applications and not grounds for rejecting the applications.

Finally, while we note CCWater's concerns regarding the loss of competition for business customers using under 50ML/day in Powys we consider that this impact results from the different policy positions of the Welsh Government and the UK Government in relation to competition, each of which considers its position to be of most benefit to people in its jurisdiction and to which people they are accountable.. Further, we have not seen new evidence that a significant number of customers in Powys consider the loss of competition to be a detriment.

We are satisfied that both companies are financially viable at an appointee level and operationally viable with the appropriate assets and operational support to enable Severn Trent Water to provide water services in Powys and Dee Valley Water to provide water and waste water services in Chester.

This means that we are satisfied that both of the NAV applications, as revised by the adjustments on bills, meets our principles.

We are satisfied that the request from Severn Trent Water and Dee Valley Water for the variations to their licences to take effect from 1 July rather than 1 April will allow both companies time to notify their customers about the variations. We do not consider the change of date from the original applications is a material difference to the content of our 8 December notice.

Throughout our considerations, we noted consequential licence modifications that would be required in order to give effect to the commitments made in and alongside the applications. Alongside this notice we have published a consultation on the form of these licence modifications. As we consider these modifications to be necessary

and/or desirable in order for us to be satisfied that the appointment and variations to Severn Trent Water and Dee Valley Water's areas of appointment can take effect as we anticipate, we decided to make our decision on the application and variations conditional on the companies acceptance of these licence modifications in the form or a form substantially similar to the form on which we are consulting.

Therefore, having assessed Severn Trent Water's application, additional information and assurances, and having taken account of the responses we received to our consultation, we decided to grant a variation to Severn Trent Water's area of appointment to allow it to serve the Chester site for water services. This appointment will become effective on 1 July 2018 subject to the outcome if the licence modification consultation.

Having assessed Dee Valley Water's application, additional information and assurances (as amended by revised proposals on wastewater bills), and having taken account of the responses we received to our consultation, we decided to grant a variation to Dee Valley Water's area of appointment to allow it to serve the Powys site for water and waste water services. This appointment will become effective on 1 July 2018 subject to the outcome of the licence modification consultation.

Appendix 1: Definition of the new areas of Severn Trent Water and Dee Valley Water following the NAV application

This appendix details the new areas of Appointment for Severn Trent Water and Dee Valley Water following their licence variations which will take effect from 1 July 2018 conditional on Severn Trent Water and Dee Valley Water consenting to changes to the conditions of their Appointment which Ofwat considers to be necessary or desirable as a result of this decision. .

1. Before the licence variations Dee Valley Water plc (“Dee Valley Water”) and Severn Trent Water Limited (“Severn Trent Water”) currently hold Appointments as water undertakers under the Water Industry Act 1991 for areas that include part of England and part of Wales. Severn Trent Water currently holds an Appointment as a sewerage undertaker under the Water Industry Act 1991 for an area that includes part of England and part of Wales.
2. We intend to vary the current areas to which the Appointments of Dee Valley Water and Severn Trent Water as water undertakers relate subject to the licence changes being accepted by Dee Valley Water and Severn Trent Water so that:
 - (a) the area for which Dee Valley Water holds an Appointment as a water undertaker is wholly in Wales; and
 - (b) the area for which Severn Trent Water holds an Appointment as a water undertaker is wholly in England.
3. We intend to appoint Dee Valley Water to be a sewerage undertaker for the part of the area for which Severn Trent Water currently holds an Appointment as a sewerage undertaker that is in Wales subject to the conditions described above. As a consequence of that new Appointment:
 - (a) Dee Valley Water will be a sewerage undertaker whose area is wholly in Wales; and
 - (b) Severn Trent Water will become a sewerage undertaker whose area is wholly in England.

This will be achieved by “the Powys Site” referred to in our [consultation](#) becoming part of Dee Valley Water’s Appointed water and sewerage area and “the Chester Site” referred to in our consultation becoming part of Severn Trent Water’s Appointed water area. This is further illustrated below.

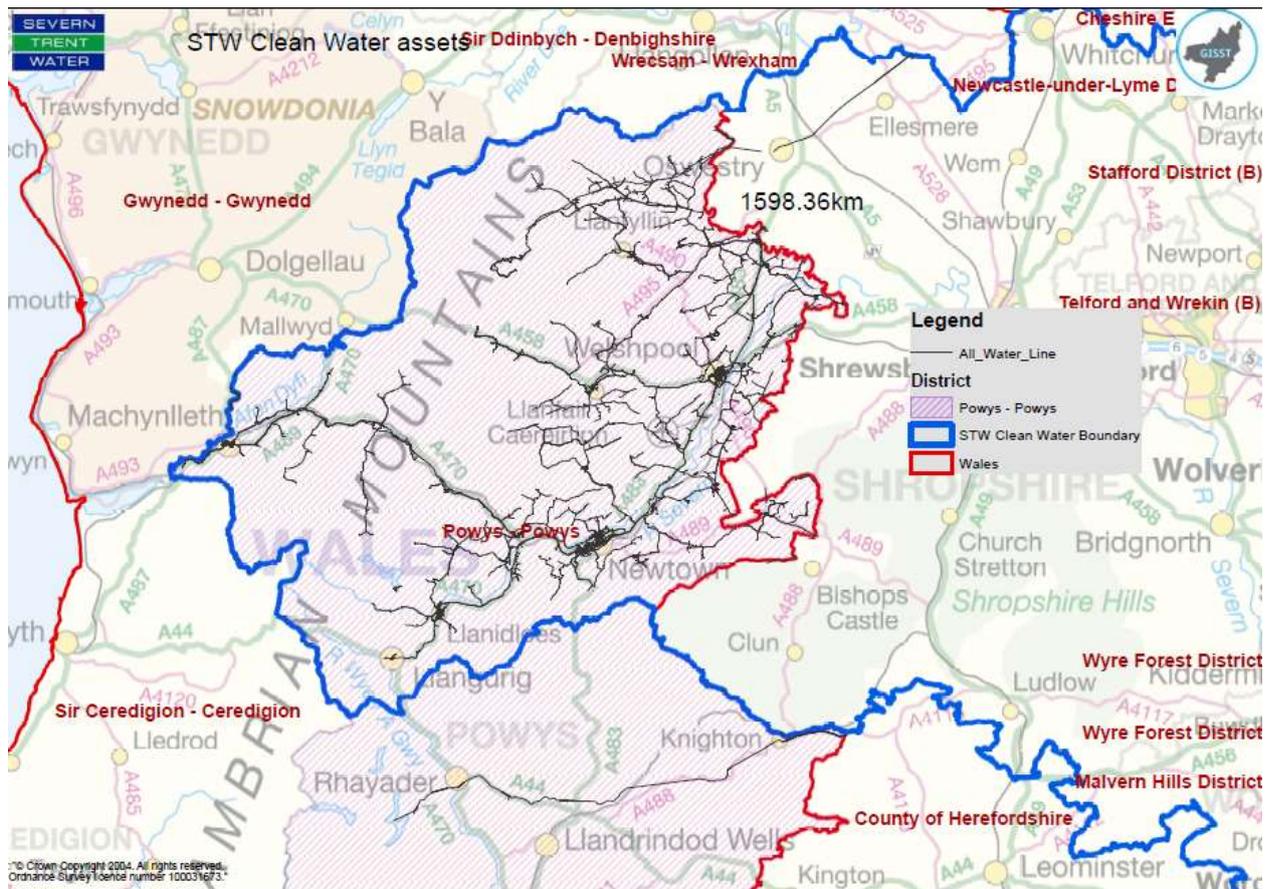
The Chester Site

The map below shows the area for which Dee Valley Water hold an Appointment as a water undertaker before the licence variations. Everything in Dee Valley Water's area on the English side of the English/Welsh border is the Chester Site and will become part of the area for which Severn Trent Water will hold an Appointment as a water undertaker.



The Powys Site

The map below shows part of the area for which Severn Trent Water holds an Appointment as a water and sewerage undertaker before the licence variations. Everything in Severn Trent Water's area on the Welsh side of the English/Welsh border is the Powys Site and will become part of the area for which Dee Valley Water will hold an Appointment as a water and sewerage undertaker.



Appendix 2: Consultation responses

CCWater Consultation Response

Welsh Assembly Consultation Response:

Thank you for your letter of 18 December 2017 in respect of the proposed variations to Severn Trent Water and Dee Valley Water.

There are a few areas where we would like further information or might merit further discussion. These are set out below:

We are disappointed that STW will be reducing the level of service that was previously available to DVW customers prior to the acquisition. Our Water Strategy for Wales highlights leakage as an area of importance stating that “we expect water companies to continue to innovate and develop expertise in preventing, identifying and repairing leakage more effectively. We expect Ofwat to continue to drive improvements in respect of leakage, building on improvements already achieved since targets were introduced”. We would like to understand how the removal of DVW's old leakage repair scheme can be seen to align with Welsh Government's policy on leakage and how the removal of this scheme is not detrimental to customers in Wales prior to the merger.

Dee Valley Water pay higher GSS payments than Severn Trent Water. The consultation says that Severn Trent Water will retain the higher level of payments currently applied to Dee Valley Water customers and will also extend this to former customers; since Chester will become part of the English company, this includes the 4 million existing Severn Trent Water customers in England as well as Wales. It is unclear from the consultation what the intention is in respect of the customers of the Powys site.

The consultation says that Dee Valley Water have stated that they accept that the wastewater control will not be financeable. They have also said they will not seek to use the financial levers (PAYG and RCV run-off) to address any wastewater financeability issues, provided the company remains financeable. We expect Ofwat to ensure the Dee Valley business plan for PR19 reflects this commitment.

The consultation refers to all assets in Wales falling under the Dee Valley licence – does this include assets outside of that geographical area but are in Wales (e.g. the laboratory in Bridgend)?

Please confirm that you have seen and are content with the asset operating manual referred to on page 33.

I look forward to hearing from you.

Kind regards,
Eifiona

Eifiona Williams

Natural Resources Wales Consultation Response

Flintshire County Council Consultation Response:

Dear Cheryl

Sorry to be late with our response

Flintshire County Council is content for the proposals to proceed

Gareth

Gareth Owens

Environment Agency Consultation Response:

Assessment of application: Ofwat consultations

Applicant details		
1	Name of applicant:	Severn Trent Water
2	Application type:	New Appointment and Variations: Variation to Appointments (Dee Valley/Severn Trent)
3	Reference:	Severn Trent & Dee Valley Water NAV Application
4	Date received from Ofwat:	11/12/17

5a	Response deadline:	10/01/18
5b	Revised deadline (if stop clock in WSSL process):	N/A
6	Organisation:	Environment Agency
Application Assessment		
Technical proficiency demonstrated?	Responding organisation are supportive of New Appointment and Variation (NAV only)	<p>Reasons / points to consider:</p> <ul style="list-style-type: none"> • Pre-consultation covered majority of Environment Agency concerns • Response from Pat Spain (Severn Trent) during pre-consultation detailed thinking and how each company will relate to the respective English and Welsh regulatory regimes • Responses to pre-consultation and detail within the proposal to vary document from Ofwat give assurance that the necessary steps will be taken by the company to ensure responses to the issues raised during pre-consultation. • We do however recognise that certain issues e.g. operation of Section 20 agreements, will require further work. However, it is accepted that the commitment to resolve those regulatory or permitting issues identified within our initial response exists and this should not be a barrier to the application.
	Supportive of NAV in principle but further information required before approval recommended:	<p>Details of further information required:</p> <ul style="list-style-type: none"> • N/A
	Not supportive of New Appointment and Variation:	<p>Reasons:</p> <p>N/A</p>
OFWAT Notification		

Variation of Severn Trent Water's appointment to include the Chester Site and variation of Dee Valley Water's appointment to include the Powys site

7	Date OFWAT notified:	10 January 2018
8	Supporting evidence/files (<i>Optional</i>)	N/A
9	Sign-off by:	Simon Ross

Appendix 3: Proposal to allocate performance commitment levels and ODIs between the two companies

The tables below detail how Severn Trent Water are proposing to split the PR14 performance commitment levels and outcome delivery incentives (ODIs) for Severn Trent Water and Dee Valley Water between the two new companies.

The references in this table relate to the outcome performance commitments set out at PR14 for each company, and set out on our website as part of our final determinations. Further detail on each commitment and ODI is available there.

Table A1: Severn Trent Water's PR14 ODIs

Please note: outperformance payments / underperformance penalties are referred to here as out / under for simplicity.

We note that when average of historical performance to split the target for leakage. This maintains the same % reduction in both areas since the initial PR14 target was based on a % reduction from a historic baseline over the AMP.

	Measure of success	England			Wales		Unit	England / Wales Split
		Yr 4 Q1	Yr 4 Q2-4	Yr 5	Yr 4 Q2-4	Yr 5		
Same target applicable to England and Wales								
RA1	Customer satisfaction with their service (based on a customer survey)	UQ	UQ	UQ	UQ	UQ	Index	Customer postcode
RA2	Customers' experience of dealing with us (based on Ofwat's SIM)	UQ	UQ	UQ	UQ	UQ	index	Customer postcode
RB2	% of customers who do not pay	2.7	2.7	2.7	2.7	2.7	%	Customer postcode
WA2	Compliance with drinking water quality standards	100	100	100	100	100	%	Customer postcode
WB1	Resource efficiency (amount of water we take out of the environment)	216	216	213	216	213	l/p/d	Population by property split by WIS
WB3	Speed of responses in repairing leaks (% fixed within 24 hours)	95	95	95	100	100	%	Asset location

Variation of Severn Trent Water's appointment to include the Chester Site and variation of Dee Valley Water's appointment to include the Powys site

	Measure of success	England			Wales		Unit	England / Wales Split
		Yr 4 Q1	Yr 4 Q2-4	Yr 5	Yr 4 Q2-4	Yr 5		
WB4	Number of minutes customers go without supply each year	2.4	7.1	8.0	7.1	8.0	Mins/pro p/yr	Customer postcode
WB8	Restrictions on use	0	0	0	0	0	No.	Customer postcode
WD2 SC3	Asset stewardship : environmental compliance	100	100	100	100	100	%	Asset location
SC5	Number of sustainable sewage treatment solutions	0	0	0	0	0	No.	Asset location
Target not applicable to Wales (FD allocated to England)								
WC1 SB1	Customer value for money – Customers rating our services as good value for money	53	53%	53%	N/A	N/A	%	N/A
WB9 -14	Birmingham Resilience	N/A	Completion	Completion	N/A	N/A	N/A	England (not transferred to DVW)
SC7	Overall environmental performance	N/A	N/A	3	N/A	N/A	index	N/A
Targets allocated, based on normalization or historic performance								
RB1	Number of customers helped by a review of their tariff and water usage and/or supported by our social fund	N/A	49,750	49,750	250	250	No.	Based on current uptake of social tariff
WF1 SE1	Improved understanding of our services through education	33,600	85,795	124,125	605	875	No	Proportion of population
WA1	Number of complaints about drinking water quality	4596	5,358	9,922	38	70	No.	Proportion of population
WA3	Asset stewardship : number of sites with coliform failures	N/A	<6	<6	0	0	No.	Proportion of WTWs
WB2	Leakage levels	429	423.5	418.6	5.5	5.4	ML/d	Average proportion of historic leakage in the two regions
WB5	% of customers with resilient supplies (those who benefit from a second source of supply)	N/A	N/A	78.00	N/A	29.4	%	Target split based on start of AMP performance.
WB6	Asset stewardship: mains bursts	1312	<5444	<6726	<149	<179	No.	Proportion of mains length

Variation of Severn Trent Water's appointment to include the Chester Site and variation of Dee Valley Water's appointment to include the Powys site

	Measure of success	England			Wales		Unit	England / Wales Split
		Yr 4 Q1	Yr 4 Q2-4	Yr 5	Yr 4 Q2-4	Yr 5		
WB7	Customers at risk of low pressure	n/a	229	229	21	21	No.	Average of previous two years performance in the two regions
WE1	Size of our carbon footprint	55	164	214	1	2	ktCO2e	Proportion of electricity usage in each region
SD1	Size of our carbon footprint	50	157	210	1	2	ktCO2e	Proportion of electricity usage in each region
SA1	No. of internal sewer flooding incidents	269	653	885	5	7	No.	Sewer connections
SA2	No. of external sewer flooding incidents	1981	5311	7161	44	59	No.	Sewer connections
SA4	Asset stewardship – blockages	13,802	<35,278	<48,607	<213	<293	No.	Proportion of gravity sewer length
SC2	The number of category 3 pollution incidents	198	171	364	5	10	No.	Proportion of historic pollutions in the two regions
SC6	Number of serious pollution incidents	1	1	0	0	0	No.	Proportion of historic pollutions in the two regions
SC8	The number of category 4 pollution incidents	96	80	174	6	8	No.	Proportion of historic pollutions in the two regions
Targets split by geographical location, based on current activity								
WA4	Successful catchment management schemes	0	12	12	0	0	No.	Location of scheme NGR Linked to asset location that has benefitted

Variation of Severn Trent Water's appointment to include the Chester Site and variation of Dee Valley Water's appointment to include the Powys site

	Measure of success	England			Wales		Unit	England / Wales Split
		Yr 4 Q1	Yr 4 Q2-4	Yr 5	Yr 4 Q2-4	Yr 5		
WD1	Improvements in river water quality	N/A	N/A	31	N/A	0	Points	Asset location – linked to improvement location of River
SC1	Improvements in river water quality	N/A	N/A	202	N/A	0	Points	Asset location – linked to improvement location of River
WD3 SC4	Biodiversity improvements (hectares)	N/A	N/A	409	N/A	0	hectares	Location of scheme NGR
WD4	Sites with eel protection at intakes		Progress milestone	-		-	No.	Asset location
SA3	Partnership working (measure of joint initiatives on flooding)	N/A	N/A	21	N/A	0	No.	Location of scheme NGR
SA5	Statutory obligations (section 101a schemes connectable properties)	N/A	N/A	312	N/A	0	No.	Location of scheme NGR

Table 2: Dee Valley Water's PR14 ODIs

	Measure of success	England			Wales		Unit	England / Wales Split
		Yr 4 Q1	Yr 4 Q2-4	Yr 5	Yr 4 Q2-4	Yr 5		
Same target applicable for England and Wales								
A1	Number of discoloured water contacts	1.01	1.01	1.01	1.01	1.01	Per 1,000	Customer postcode
A2	Mean Zonal Compliance	100	100	100	100	100	%	Customer postcode
B1	Average duration of interruptions	0.2	0.2	0.2	0.2	0.2	Hrs/prop	Customer postcode
B2	Sustainable economic level of leakage	90.8	90.8	90.8	90.8	90.8	l/prop/day	Customer postcode
B3	Security of supply index	100	100	100	100	100	%	Customer postcode
D1	Survey of customers' perception of value for money and affordability		Improved	Improved	Improved	Improved	comparative	Customer postcode

Variation of Severn Trent Water's appointment to include the Chester Site and variation of Dee Valley Water's appointment to include the Powys site

	Measure of success	England			Wales		Unit	England / Wales Split
		Yr 4 Q1	Yr 4 Q2-4	Yr 5	Yr 4 Q2-4	Yr 5		
E1	Per capita consumption and water efficiency target	128.37	128.37	127.28	128.37	127.28	l/p/d	Population by property split
E2	Service Incentive Mechanism (SIM)	80	80	80	80	80	index	Customer postcode
F1	Non-household Service Incentive Mechanism (SIM)	80	80	80	80	80	indemarch	Customer postcode
Target not applicable for England (thus entire FD assigned to Wales)								
A3	Delivery of the outcomes of the Legacy Treatment Works major scheme	N/A	N/A	N/A	N/A	N/A	Completion	Wales only
A4	Delivery of the outcomes of the Service reservoir water quality risk management schemes	N/A	N/A	N/A	Progress milestone	Completion of 4 schemes	Completion	Asset location
Targets allocated, based on normalization or historic performance								
B4	Number of mains bursts	42	54	67	126	155	No.	Proportion of mains length
C1	Greenhouse Gas emissions	2438	1646	2192	8049	7535	tCO ₂ e	Proportion of electricity usage in each region

Appendix 4: Assurances from Severn Trent Water and Dee Valley Water

[Letter from Severn Trent Water](#)

[Letter from Dee Valley Water](#)