

May 2018

Trust in water

## **Variation of SSE Water Limited's appointment to include Prince of Wales Drive, Wandsworth**

## 1. About this document

### Variation of SSE Water Limited's appointment to include Prince of Wales Drive

On 29 November 2017, Ofwat began a consultation on a proposal to vary SSE Water Limited's ("**SSE**") appointment to become the water and sewerage services provider for a development in Thames Water Utilities Limited's ("**TMS**") water supply area and sewerage services area called Prince of Wales Drive in Wandsworth ("**the Site**").

The consultation ended on 27 December 2017. During the consultation period, we received representations from two organisations, which we considered in making our decision. On 15 May 2018, we granted SSE a variation to its existing appointment to enable it to supply water and sewerage services to the Site.

This notice gives our reasons for making this variation.

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## 2. Introduction

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 sewerage services for a specific area. This mechanism can be used by new companies to enter the market and by existing companies to expand into areas where they are not the appointed company. In this case, SSE applied to replace TMS to become the appointed water and sewerage company for the Site.

A company may apply for a new appointment (or a variation of its existing appointment to serve an additional site) if any of the following three criteria are met:

- None of the premises in the proposed area of appointment is served by the existing appointed company at the time the appointment is made (the “**unserved criterion**”);
- Each premises is likely to be supplied with at least 50 mega litres per year (in England) or at least 250 mega litres per year (in Wales) and the customer in relation to each premises consents (“**the large user criterion**”);
- The existing water and sewerage supplier in the area consents to the appointment (“**the consent criterion**”).

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

1. Customers, or future customers, should be no worse off than if they had been supplied by the existing appointee; and
2. We must be satisfied that an applicant will be able to finance the proper carrying out of its functions as a water and/or sewerage company.

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers (such as household and non-household customers and developers of new housing sites). Benefits can include price discounts, better services, environmental improvements and innovation in the way services are delivered.

Benefits can also accrue to customers who remain with the existing appointee, because when the existing appointee faces a challenge to its business, that challenge can act as a spur for it to improve its services. We believe the wider benefits of competition through the NAV mechanism can offset any potential disbenefits for existing customers that might arise. We consider these potential disbenefits in more detail below.

### **3. The application**

SSE applied to be the water and sewerage services appointee for the Site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). SSE will serve the Site by way of bulk supply and bulk discharge agreements with TMS.

#### **3.1 Unserved status of the site**

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

SSE have prepared and provided a Site report which indicates that the Site is unserved. The Site has previously been used for commercial activities, but has been cleared of all permanent connections. All existing buildings have been demolished. The Site is currently occupied by the Site developer.

In addition, we have been provided with a letter from TMS confirming that it considers the Site to be unserved for both water and sewerage services. Having reviewed the facts, we are satisfied that the Site is unserved for water and sewerage.

#### **3.2 Financial viability of the proposal**

We will only make an appointment if we are satisfied that the proposal poses a low risk of being financially non-viable. We assess the risk of financial viability on a site-by-site basis and also consider the financial position of the company as a whole.

Based on the information available to us, we concluded that SSE has satisfied us that it can finance its functions and that it is able to properly carry them out.

#### **3.3 Assessment of ‘no worse off’**

SSE proposes to match the charges of TMS – i.e. it will not offer a discount.

With regard to service levels, we have reviewed SSE's Codes of Practice and its proposed service levels and compared these to the Codes of Practice and the performance commitments of TMS. Based on this review, we are satisfied that customers will be offered an appropriate level of service by SSE and that overall customers will be ‘no worse off’ being served by SSE instead of by TMS.

### **3.4 Effect of appointment on TMS' customers**

In considering whether customers will be no worse off, we also looked at the potential effects of this variation on the price that TMS' existing customer base may face.

The calculation necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on customers of TMS. It is therefore necessary to use a simplified set of figures. We have expressed the effect in 'per bill' terms to try and quantify the possible effect in an easily understandable way. Broadly, we have assessed the potential magnitude of this impact by comparing how much TMS might expect to receive in revenue from serving the Site directly, were they to serve the Site, with the revenues they might expect from the proposed bulk supply and discharge agreements with SSE.

In this case, we have calculated that if we grant the Site to SSE, there may be no increase in the water bills of TMS' customers and a potential impact on the sewerage bills of £0.004 annually.

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

### **3.5 Developer choice**

Where relevant, we take into consideration the choices of the site developer. In this case, the developer of the Site, St William Homes LLP, said that it wanted SSE to be the water and sewerage company for the Site.

## 4. Responses received to the consultation

We received two responses to our consultation; from the Consumer Council for Water (“**CCWater**”) and the Environment Agency (“**EA**”). We considered these responses before making the decision to vary SSE's appointment. The points raised in their responses are set out below.

### 4.1 CCWater

In its response to our consultation CCWater stated that it agrees with Ofwat's conclusion that customers will be no worse off under SSE than they would have been had they been served by TMS.

CCWater indicated that it was disappointed that customers will not receive any financial benefit from having SSE as its service provider as opposed to TMS. However, CCWater supports the application as SSE improves on most of the service standards offered by TMS.

CCWater also highlighted that a small cost will be passed on to TMS' customers. Whilst it notes that this is a very low cost, there has been no material evidence of a significant benefit for those customers arising from a NAV.

One of Ofwat's key NAV policies is that customers should be 'no worse off' if a NAV is granted. In other words, an applicant must ensure its new customers are made no worse off in terms of price and service than if they had been supplied by the previous incumbent. This requirement has been met by SSE in its proposal to improve the levels of service and match the pricing set by TMS. We do not require applicants to better the service and price of the previous incumbents.

### 4.2 EA

The EA responded to our consultation by email dated 27 December 2017, it stated that it has no comments in relation to the application.



## **5. Conclusion**

Having assessed SSE's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to SSE's areas of appointment to allow it to serve the Site for water and sewerage services. This variation became effective on 16 May 2018.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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