

August 2018

Trust in water

Variation of Independent Water Networks Limited's appointment to include Europa Way

1. About this document

On 19 June 2018, Ofwat began a consultation on a proposal to vary Independent Water Networks Limited's ("**IWN**") appointment to become the water services provider for a development in Severn Trent Water Limited's ("**SVT**") water supply area called Europa Way in Warwick ("**the Site**").

The consultation ended on 18 July 2018. During the consultation period, we received one representation which we considered in making our decision. On 24 July 2018, we granted IWN a variation to its existing appointment to enable it to supply water 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 services for a specific area. This mechanism can be used by new companies to enter the market and by existing companies to expand into areas where they are not the appointed company. In this case, IWN applied to replace SVT to become the appointed water 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 new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our duty to protect consumers wherever appropriate, by promoting effective competition. In particular, in relation to unserved sites, we seek to ensure that the future customers on the Site – who do not have a choice of supplier – are adequately protected. When assessing applications for new appointments and variations, the two key policy principles we apply are:

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

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers (such as household and business customers and developers of new housing sites). Benefits can include price discounts, better

services, environmental improvements and innovation in the way services are delivered.

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

3. The application

IWN applied to be the water services provider for the Site under the unserved criterion set out in section 7(4) (b) of the Water Industry Act 1991 (“**WIA91**”). IWN will serve the Site by way of a bulk supply arrangement with SVT.

3.1 Unserved status of the Site

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

We have a letter from SVT, dated 21 December 2017, confirming its view that the Site is unserved and does not feature on its billing or asset records. Having reviewed the facts, we are satisfied that the Site is a greenfield site and is unserved for water.

3.2 Financial viability of the proposal

We will only make an appointment or variation 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.

IWN submitted this application on a package basis. The financial assessment of Europa Way was combined with Ings Lane, Cockering Road and Limebrook Park (together referred to as “**the Four Sites**”). The reason for this approach was that IWN was not able to demonstrate the financial viability of some applications (Europa Way, Ings Lane and Cockering Road) under our standard site-by-site assessment. IWN decided to submit the Four Sites as a combined package, which allows lower risk sites to support higher risk sites. Although not expressly set out in our published policy, this approach has been endorsed previously.

3.3 Assessment of ‘no worse off’

IWN will offer charges equivalent to those of SVT to customers on the Site.

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

3.4 Effect of variation on SVT's customers

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

The calculation necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on customers of SVT. 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 SVT might have expected to receive in revenue from serving the Site directly, were they to serve the Site, with the revenues they might expect from the proposed arrangement with IWN.

In this case, we have calculated that if we grant the Site to IWN, there will not be any impact on the bills of SVT's existing customers.

This impact does not take into account the potential spillover 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 (Catesby Property Group) said that it wanted IWN to be the water company for the Site.

4. Responses received to the consultation

We received one response to our consultation from the Consumer Council for Water (“**CCWater**”). We considered this response before making the decision to vary IWN's appointment. The points raised in the response are set out below.

4.1 CCWater

CCWater were disappointed that there was no direct financial benefit to customers on the Site from having IWN as their provider of water services, as it is IWN's intention to match SVT's charges to its customers. However it noted that in this case, IWN matches and generally exceeds most of the service standards offered by SVT and for this reason, it supports the application.

CCWater noted that SVT's levels of service have recently been revised in the light of the [Freeze/Thaw event](#) and may be revised again following the company's acquisition of Dee Valley Water. IWN has advised that it will mirror the recent changes and keep its Codes of Practice under review.

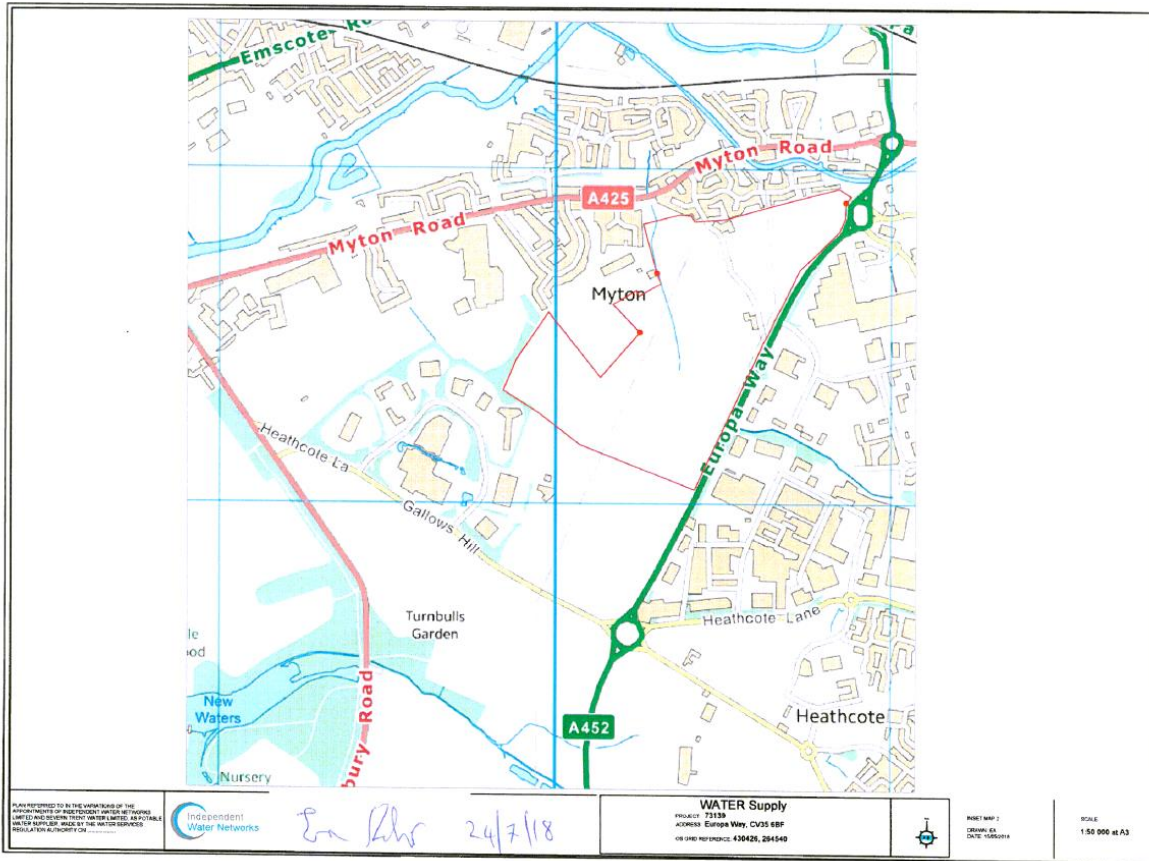
CCWater accepts that given IWN's relatively small size and disparate nature of its customer base, it may be appropriate for IWN to tailor some of the services it provides. Until it can provide a social tariff CCWater stated that it would expect IWN to offer appropriate, flexible support to any individual customers in financial difficulty that would otherwise benefit from a social tariff. CCWater expects that this should not be at the expense of IWN's other customers since the company is not currently in a position to research the views of its customers on the potential for cross-subsidy.

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 served by the previous incumbent. This requirement has been met by IWN in its proposal to improve the levels of service and match the pricing set by SVT. We do not require applicants to better the service and price of the previous incumbent.

5. Conclusion

Having assessed IWN's application, and having taken account of the response we received to our consultation, we decided to grant a variation to IWN's area of appointment to allow it to serve the Site for water services. This variation became effective on 25 July 2018.

Appendix 1: Site Map



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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