

September 2018

Trust in water

# Variation of SSE Water Limited's appointment to include Chestnut Avenue, Eastleigh, Hants

## 1. About this document

### Variation of SSE Water Limited's appointment to include Chestnut Avenue, Eastleigh, Hants

On 17 July 2018, Ofwat began a consultation on a proposal to vary SSE Water Limited's ("**SSE Water**") appointment to become the sewerage services provider for a development in Southern Water Services Limited's ("**Southern Water**") sewerage services area called Chestnut Avenue in Eastleigh, Hants ("**the Site**").

The consultation ended on 14 August 2018. During the consultation period, we received a representation from one organisation, which we considered in making our decision. On 20 September 2018, we granted SSE Water a variation to its existing appointment to enable it to supply 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 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 Water applied to replace Southern Water to become the appointed 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 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**

SSE Water applied to be the sewerage services provider for the Site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). SSE Water will serve the Site by way of a bulk discharge agreement with Southern Water.

#### **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.

SSE Water has submitted a report to us confirming that the Site is unserved and Southern Water has confirmed in an email, dated 23 May 2018, that it agrees with this report.

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

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

We will only make a variation of appointment if we are satisfied that the proposal poses a low risk of being financially non-viable. In November 2012, we published the '[Statement on our approach for assessing financial viability of applications for new appointments and variations](#)' which revised our policy with regards to financial viability to facilitate a more flexible approach. This policy says that we will:

- adopt a company-based assessment of financial viability, rather than a detailed site-based assessment where it is appropriate to do so;
- allow applicants greater flexibility when satisfying us that they can finance their functions; and
- give applicants more responsibility and accountability for their business and business risks.

Based on the information available to us, we concluded that SSE Water has demonstrated sufficient financial viability and SSE Water 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 Water will match Southern Water's charges to customers i.e. it will not offer a discount.

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

### **3.4 Effect of variation on Southern Water'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 Southern Water'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 Southern Water. 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 Southern Water might have expected to receive in revenue from serving the Site directly, were it to serve the Site, with the revenues it might expect from the proposed arrangement with SSE Water.

In this case, we have calculated that if we grant the Site to SSE Water, there may be a potential impact on the bills of Southern Water's existing customers of £0.006 annual increase on sewerage bills.

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, Highwood Construction said that it wanted SSE Water to be the sewerage 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 SSE Water's appointment. The points raised in the response are set out below.

### **CCWater**

In its response CCWater stated it was disappointed that there are no direct financial benefits to customers from being served by SSE Water rather than by Southern Water for sewerage services, as SSE Water proposes to charge its customers the same rate as Southern Water. It noted however, that SSE Water proposes to match or exceed many of the service standards currently provided by Southern Water, notably more generous compensation in the event of service failures. For this reason, it supports our proposal and agrees with our assessment that customers will be no worse off.

### **Our response**

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 Water in its proposal to improve the levels of service and match the pricing set by Southern Water. We do not require applicants to better the service and price of the previous incumbent.

## **5. Conclusion**

Having assessed SSE Water's application, and having taken account of the response we received to our consultation, we decided to grant a variation to SSE Water's area of appointment to allow it to serve the Site for sewerage services. This variation became effective on 21 September 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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