

July 2019

Trust in water

Conclusions on NAV policy statement

About this document

New Appointments and Variations (NAVs) are new entrant water and wastewater companies which serve end customers by becoming the local licensed supplier and replacing the existing incumbent water and / or wastewater company (incumbent) for a specific area.

In [November 2018 we consulted](#) on an [update to our policy statement for NAVs](#) which took account of changes in the sector since our previous policy was issued. In preparation of that revision to our policy we held a number of discussions with NAVs and other relevant parties.

This document confirms our NAV statement of policy, summaries the responses from stakeholders to our consultation and notes the actions we have taken to reduce barriers to NAVs.

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1. Overview

- 1.1 Our policy for NAVs was previously updated in January 2014.¹ Following that update, we commissioned Frontier Economics to undertake a study of NAV activity.² That study, published in October 2017, identified a number of barriers to entry that were preventing NAVs from competing effectively. When we published the report, we committed to a number of actions to help NAVs compete on a level playing field.³
- 1.2 We consulted on a revised policy statement in November 2018.
- 1.3 This document confirms our NAV statement of policy, summaries the responses from stakeholders to our consultation and notes the actions we have taken to reduce barriers to NAVs. Our statement of policy on NAVs can be [found here](#).

¹ New appointments and variations – a statement of our policy <https://www.ofwat.gov.uk/wp-content/uploads/2017/09/Statement-of-NAV-policy.pdf>

² <https://www.ofwat.gov.uk/publication/study-nav-market-report-frontier-economics/>

³ <https://www.ofwat.gov.uk/publication/study-market-new-appointments-variations-summary-findings-next-steps/>

2. Background

Regulatory framework for NAVs

- 2.1 NAVs can compete with incumbents to supply infrastructure and retail services to new build development sites not served by, or with the consent of, the current incumbent. They can also compete to supply large users (customer taking more than 50MI/d in England, or more than 250MI/d in Wales).
- 2.2 NAVs can take on two broad forms:
- **Full-NAV** – A NAV can provide a complete end-to-end service. On the water side this incorporates obtaining a water source, treatment, distribution and retailing. On the wastewater side this incorporates collection, treatment and sludge treatment including disposal.
 - **Bulk-supply NAV** – A NAV can provide its own onsite infrastructure, but rely on a bulk supply of water, or bulk discharge of waste water, from or to the local incumbent's network. The NAV still serves end-customers, but the NAV pays the incumbent for bulk services.
- 2.3 Some NAVs may use a bulk-supply for one service (e.g. water) but have their own resources for the other.
- 2.4 NAVs have the same duties and responsibilities as the statutory water company. When companies apply for a licence, we check that the applicant has the ability and resources to meet its legal duties and responsibilities. The Drinking Water Inspectorate and Environment Agency also separately check the suitability of the applicant.
- 2.5 When we grant a licence, we check that the customers of the company will be no worse off overall than they would have been had they been served by the incumbent. We also include a “relative price control” in the company's licence so that the prices it can charge are linked to those of the local incumbent.

Addressing barriers to NAVs

2.6 We commissioned Frontier Economics to undertake a study of the NAV market.⁴ That study, published in October 2017, identified a number of barriers to entry that were preventing NAVs from competing effectively. These barriers are summarised in the table below, together with the actions we have taken, which we have updated since our November consultation.

Regulatory and administrative barriers

Issue: Several respondents to the Frontier Economics report noted that the process for applying for a NAV limited the scope for competing for new development sites. In particular, there was uncertainty over whether a licence would be granted, and the time it takes precludes NAVs from competing for smaller sites.

Actions:

- We have provided [further guidance on “unserved” criterion](#) for applicants.
- We have clarified our approach to financial viability assessments in the [accompanying policy document](#) and the [application guidance](#).
- We have streamlined our [NAV application processes](#) to reduce the timeframe for applications from a target of 110 working days down to 85 days.
- Our [application guidance](#) also provides clearer information on our policies and processes to applicants.
- We have assigned a dedicated relationship manager to each NAV. These are there to help guide NAVs through the application process and to be a point of contact with Ofwat to raise issues. Their role is not to amend applications or collate information from across different applications.

Access to information, service standards

Issue: Access to information that is essential to be able to provide a commercial offering to developers was noted by many NAVs as being inadequate.

Actions:

- We have an ongoing programme working with a Water UK led working group comprising incumbents and NAVs examining the information made available to NAVs and suitable KPIs. The working group will recommend what information incumbents should publish to support self-service (eg identifying network connection points), how incumbents can share best practice in improving services

⁴ <https://www.ofwat.gov.uk/publication/study-nav-market-report-frontier-economics/>

to NAVs and review how incumbents report on the level of service provided to NAVs.

- This includes challenging the industry to develop a Code of Practice for bulk supply/discharge agreements. If one is not reached by agreement we will consider imposing one.
- We have included the “D-MeX” outcome delivery incentive as part the PR19 methodology to incentivise incumbent companies to deliver a better service to NAVs, as well as developers and SLPs.
- We have introduced a licence modification⁵ requiring companies not to discriminate between their own offerings and those of alternative providers (including in the provision of developer services).
- Our CEO, Rachel Fletcher, [wrote to the CEOs of all incumbent water companies](#)⁶ reminding them of the special role they have in ensuring markets function effectively. She set out how, in our view, their action, or inaction, can be detrimental to effective competition. In some instances we observe companies obstructing competition by opposing or delaying initiatives aimed at improving markets. Conversely we also observe some companies proactively engaging with alternative providers to support functioning markets.

⁵ See consultation and outcome at <https://www.ofwat.gov.uk/consultation/consultation-under-section-13-of-the-water-industry-act-1991-on-proposed-modifications-to-the-licence-conditions-of-17-water-companies/>

⁶ Operating wholly or mainly in England

Pricing issues

Issue: NAVs suggested that the way incumbents price bulk services and services to developers can prevent them from competing for some sites.

Action: We have issued new bulk supply charging guidance which changes the way bulk supply charges are to be determined to facilitate greater competition⁷. We also consider that incumbents should change the treatment of the income offset⁸ so that bulk-supply NAVs will benefit from it.⁹

Awareness

Issue: Several NAVs suggested that awareness of the option to use a NAV was low amongst developers. Some NAVs also noted that other agencies, specifically the Environment Agency and the Drinking Water Inspectorate, have less awareness of NAVs than they have of incumbents and this can make agreeing plans to serve sites more difficult.

Action: We have a programme of providing information to raise awareness with developers and other agencies. Additional information has been provided on our website on the role NAVs play in serving developers. Ofwat representatives have attended developer events and highlighted the role of NAVs. And we have visited NAV sites with other agencies so that they can learn directly about the benefits that NAVs can provide.

⁸ The income offset refers to the discount incumbents apply to site development costs intended to reflect future income from the site that reduces the charges developers pay for connections. Until April 2018, the income offset was regulated by section 43 of the WIA (which has now been repealed). It provided that the income offset calculation was made taking the infrastructure costs of a development less an amount to reflect the income the incumbent would receive from the site over a twelve year period. Since the repeal of section 43 WIA, the income offset is regulated by charging rules issued by Ofwat. In developing charging rules, we must have regard to guidance issued by Defra. Defra's most recent charging guidance specifies that the balance of contributions between developers and bill pays should be broadly maintained.

⁹ We expect our charging rules to bring this into effect from April 2020

3. Consultation on our statement of policy on NAVs

Our consultation

3.1 In our consultation we proposed changes to our statement of policy. All our proposed changes were minor and reflected how our approach to NAVs has adapted as their activity has grown. These changes are:

- We have updated the links to documents we have updated to reflect changes to our process guidance (July 2018) and bulk charging guidance (May 2018);
- We have amended links to reflect the changes to the DWI's policies towards NAVs;
- We explain that NAVs no longer need to submit their charging schemes to us each year for approval, but must publish these on line in accordance with our charging rules;
- We provide greater clarification on the application of the no worse off rule;
- We have updated the text to reflect our revised approach to assessing financial viability of NAVs; and
- We set out the alternative ways in which we may assess the financial viability of a NAV by examining the company as a whole and/or packages of sites in addition to examining each site.

Responses to our consultation

3.2 We received six responses to our consultation: two from NAVs, two from incumbent water companies, one from the Consumer Council for Water (CCWater – the watchdog which represents water consumers in England and Wales) and one from the Home Builders Federation (HBF – one of the organisations whose membership comprises of developers).

3.3 Two NAVs, Independent Water Networks Limited (IWNL) and Albion Water Limited, responded. The issues they highlighted in responses had previously been communicated through prior engagement. The issues differ in part because of the differences between the companies' business models. IWNL predominately uses bulk-supply from the local incumbent. While Albion Water typically self-supplies wastewater services which includes the function for providing non-potable water to supplement a bulk supply of potable water from the local incumbent.

3.4 IWNL identified a range of issues it considered remained as barriers to NAVs. Amongst those it prioritised three.

- Obtaining a point of connection – IWNL considered that incumbents all too often provide a poor level of service in providing points of connection and that there should be industry standard terms and conditions to simplify reaching agreements.
- Bulk charges – IWNL lamented the lack of revised NAV bulk supply and discharge charges following our May 2018 guidance on charges to NAVs; and
- Time taken to grant a licence variation - which IWNL considered should be no more than 28 days.

3.5 Albion Water set out three areas it considered remain the most significant barriers to full-service NAVs.

- Income offset - It considered there should be a mechanism for full-service NAVs to be paid the income-offset by incumbents
- Incumbent charges to developers - It considered incumbents should set regional developer charges that reflected costs of serving new developments in that vicinity, and that any discounts to reflect actions taken by developers to reduce future customer demand (eg fitting reduced water consumption fittings) should be no greater than the cost savings incumbents expect to gain.
- Clarification on extent of requisition charges – specifically it thought we should clarify that requisition charges should be based on the practical point of connection, not the point at which the requisitioned pipe crosses one of equal or larger size.

3.6 In addition Albion Water thought that consideration should be given to amending the Water Industry Act 1991 (WIA) to enable NAVs to charge developers for treatment capacity if they develop a site near to an existing NAV site.

3.7 Two incumbents responded. South West Water supported the policy. Welsh Water supported the overall principles on the NAV policy and the revised guidance with the exception of the application of the income offset to the infrastructure charge, or instances where there is no future charge to a NAV. Welsh Water's point relates to new connection charges, and in particular a policy decision that we have taken for companies based wholly or mainly in England. The old rules continue to apply to companies based wholly or mainly in Wales, including Welsh Water.

- 3.8 CCWater was broadly sportive of our policy. However, it thought that we should consider undertaking work to better understand quantitatively the benefits of existing and future NAVs.
- 3.9 The HBF raised two concerns. The first was how the move of the income offset to the infrastructure charge would apply. It was concerned that the shift of the income offset (a discount to new connection charges funded by the generality of customers) may lead to charges to its members increasing. The second was that it considers 85 days to grant a licence to be too long and that it should be a maximum of 28 days.

Our decision

- 3.10 We welcome responses to our consultation. All of these issues have been raised with us in discussions prior to consulting on our draft policy. The work we have undertaken since the Frontier Economics study sought to address many of the issues raised. A number of issues related to new connection charging rules and were not within scope of this consultation. We confirm our statement of policy on New Appointments and Variations, which can be [found here](#).
- 3.11 The 2014 statement of policy included a chapter on key issues¹⁰, ranging from information about relevant legislation and regulations to policy positions. We have decided that there is merit in including an updated version of this material in our statement of policy or as a separate document. There are parts of it that need updating, for example the sections on infrastructure charges and on bulk charges need to reflect our relevant charging rules and charging guidance respectively. We may include additional sections, for example on the business retail market, and potentially remove others. It is our intention to publish the updated material later this year.
- 3.12 We recognise there is more we, and the sector more widely, can do to support the NAV market and improve the complementary regulatory regime. The letter

¹⁰ The 2014 statement sets out the following key issues: regulation of new appointees (appointment conditions, suspensions and future regulation requirements); bulk services and bulk agreements; infrastructure charges; surface water and highway drainage charges; applications by associated companies; applications by existing appointees; infrastructure standards; competition for new appointments; If an appointee's business fails; abortive and non-abortive costs associated with new appointments; and Security and Emergency Measures Direction.

from our CEO to water incumbent CEOs set out our expectations of their conduct towards alternative providers and markets in general. It also set out that we expect all incumbents to explain how they interact with markets effectively, and that we will be monitoring markets, including that for developer services going forward.

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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July 2019

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