

July 2019

Trust in water

Minded-to decision to vary South West Water's area of appointment to include the Isles of Scilly

About this document

In February 2019, we [consulted](#) on our proposal to vary the area of appointment of South West Water Limited (**SWW**) so that it becomes the appointed water and wastewater company for the Isles of Scilly (**IoS**).

We are minded to vary SWW's licence when the legislation is in place. This document sets out issues raised in the consultation responses, our views on these issues and hence the basis for our decision, providing more information where relevant.

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1. Our minded-to decision

This is a minded-to decision on our proposal to vary the area of appointment of South West Water Limited (**SWW**) so that it becomes the appointed water and wastewater company for the Isles of Scilly (**IoS**). We [consulted](#) on our proposal in February 2019.

This takes the form of a “minded to” decision because the decision can only be made once the Water Industry Act 1991 has been extended to include the IoS.

We are minded to vary SWW's licence when the legislation is in place.

If there are material changes to the information on which we have relied in order to make this minded-to decision, those changes will be taken into account in making the final decision on whether to vary SWW's area of appointment. The information on which we have relied is principally as set out in SWW's application to vary its licence, our consultation and in this decision document.

This document summarises the [responses](#) received to our consultation and sets out how we have taken those responses into account in making this minded-to decision. It also provides more information on certain arrangements, specifically giving more details on SWW's plans for billing unmetered customers, and arrangements with respect to the business retail market.

2. Outline of the arrangements

Substantial investment is required for the IoS to bring its water and wastewater infrastructure up to the standards of mainland England. Addressing this has required a major collective effort over a number of years and requires legislative change.

In 2016, the Department for Environment, Food and Rural Affairs (**Defra**) invited expressions of interest in operating the public water and wastewater networks on the IoS. SWW was the only company that responded. SWW has since conducted due diligence and prepared a proposed plan for extending its area of operation to the IoS. It explains its proposals for the IoS [here](#).

SWW provides water and wastewater services to Devon, Cornwall and parts of Dorset. Ofwat regulate it by licence. We consulted in February 2019 on our proposal to vary SWW's licence to include the IoS within its area from April 2020 onwards. Our ability to do this is subject to the UK Government's plan to extend the relevant legislation so that it applies to the IoS.

SWW would take on responsibility for existing water and wastewater infrastructure on the IoS, currently owned by the Council of the Isles of Scilly (**the Council**), the Duchy of Cornwall (**the Duchy**) and the Tresco Estate (**Tresco**). It has prepared its business plan on the basis that it would be under equivalent mainland regulations from April 2020, with agreed work being carried out to achieve full water quality and environmental protection from April 2025 onwards for four of the five inhabited islands. For the fifth, Tresco, the equivalent date SWW has planned for is April 2030 onwards. The investment on Tresco would come later because SWW's assessment is that the infrastructure on Tresco is already relatively well maintained and effective.

Although dependent on the Order that extends relevant legislation to the IoS, we anticipate that residents on private supplies will be entitled to a connection to SWW's infrastructure from April 2025, and potentially earlier where SWW has sufficient water resource, treatment and network capacity available to enable this. We also anticipate that new connections would be subject to the same statutory and regulatory arrangements and charges that apply on the mainland from April 2025. Prior to this new connections will be evaluated on case by case basis and if sufficient water resource, treatment and network capacity is available the new connections will be made under the same charging rules that apply to other customers of SWW.

Although the proposed IoS investment costs are high per head of the IoS population, as with any other large investment by a water company SWW is proposing to spread the costs over all its customers. IoS customers would be treated equivalently to customers on the mainland and pay equivalent charges. We expect most customers' metered bills to be broadly stable in real terms or to decrease at the point of switching to SWW. However households with larger than average water consumption currently on the Council's water and wastewater tariffs may experience bill increases. For customers who struggle to pay their bills, SWW's range of affordability support will be available, including water efficiency advice, benefit entitlement checks and flexible payment plans.

It is intended that arrangements for business customers will be on an equivalent basis to the rest of England. In particular, they will be served directly by a licensed retailer, who is responsible for customer services including billing and meter reading. Business customers will be subject to the same price and non-price protections as the rest of England and they will also be able to switch retailer.

The investment that SWW proposes for the IoS would be funded primarily by SWW's customers through our 2019 price control (PR19), with a significant contribution from the Duchy of Cornwall. SWW developed its PR19 business plan in consultation with its customers, of whom 82% supported extending the SWW area to include the IoS.

The impact on SWW customers' bills due to the inclusion of the IoS within SWW's area will be more than offset by expected bill reductions due to increased efficiency, also secured through PR19.

In common with the IoS, Cornwall and Devon have required substantial investment by SWW to improve the coastal environment since privatisation. In recognition of these costs, the UK Government has funded an annual reduction in each household bill of SWW's customers of £50 a year from April 2013. This runs until 31 March 2020. This funding agreement is not a matter for Ofwat or this consultation. Government is considering the position for April 2020.

In our consultation we explained that we considered that SWW's proposed investment is needed to meet the challenges of protecting public health and safeguarding the environment on the IoS, now and in the future. We considered that its proposed package of measures protects customer interests on the mainland and delivers substantial benefits for residents of, and visitors to, the IoS.

3. Responses to our consultation and subsequent developments

In this chapter we set out the responses that we received and our views on points made. It provides more information on certain arrangements, specifically giving more details on SWW's plans for billing unmetered customers, and arrangements with respect to the business retail market.

3.1 Responses received

Our consultation lasted from 26 February 2019 to 9 April 2019.

We received 31 responses. Eighteen respondents were private residents from the IoS, a further six were also business owners on the IoS, six were other organisations (Natural England, Council of the IoS, IoS Wildlife Trust, CCWater, the Environment Agency and the Drinking Water Inspectorate), and one was from a water retailer. Two respondents requested their responses not be shared further or published.

No responses received to the consultation objected to the proposal to vary SWW's licence, and most explicitly supported it. Key issues that were raised included unmetered charging and the allocation of non-household customers in the business retail market. These, together with a number of other issues, are set out in this chapter.

3.2 Unmetered charges for IoS household customers

Households on the islands of St Mary's and Bryher, who are customers of the Council, currently have unmetered billing. These are a flat fee, though with a lower fee for single occupancy. Households on the other islands and all business customers have metered billing.

We consulted on the basis that SWW's unmetered charges would be equivalent to those on the mainland. We explained that while most household bills would be stable or decrease in real terms, some bills will increase. These would principally be larger households currently on the Council's flat rate water and wastewater charge. SWW would have a strategy for handling significant bill increases on the IoS, which would include providing information on the likely savings gained by metered billing, and phasing some increases in over more than one year.

In response to our consultation, CCWater said that there was a need to establish how unmetered charges would be set and to manage the expectations of customers

about future charges. It said that new customers on the IoS should be treated the same as current SWW customers and not given any undue preferential benefit.

IoS properties do not have rateable values in an equivalent dataset to that used as the basis for most unmetered bills for SWW's existing customers. SWW currently sets unmeasured charges for unrated properties on the basis of the average rateable values in its area. For water and wastewater, the charge is more than double the Council's equivalent charge. For water only services the charge is around 16% higher than the Council's equivalent charge.

Following our consultation SWW submitted a proposal to us for its unmetered charges, as shown in table 1. To manage the potential large increases in bills, SWW proposed to phase in its mainland unmeasured charges for properties with no rateable value over two years, with the full equivalent charges to the mainland being levied from April 2022 ('Year 3') onwards.

Table 1: Indicative bills for Isles of Scilly unmetered customers

Islands affected	Water (Bryher and St Mary's)	Water and Wastewater (St Mary's)
Current Council tariff	£358.50	£563.10
South West Water:		
Year 1 (based on RV=£50)	£257*	£590*
Year 2 (based on RV=£75)	£283*	£724*
Year 3+ SWW charge for properties without RV (based on RV Flat £150, House £200)	Flat: £426* House: £511*	Flat: £1126* House: £1394*
Average bill if switch to metering	£205**	£459**

*Derived from 2019-20 charges.

**This was SWW's estimate of metered bills, presented in the consultation, using 2018-19 charges, based on average consumption for the relevant islands and average national leakage levels. As the table shows, on average households can expect to have lower charges if they switch to metered billing. Meters generally encourage more efficient use of water and help customers manage their bills.

SWW plans to make all customers aware of the availability of free household water meters in its initial customer engagement programme in November/December 2019. It commits to installing meters within three months of the request being made, or within three months of the start of operations (i.e. by end of June 2020) if the request is made prior this.

All unmetered household customers will be advised of the future changes in the unmeasured charges and will be advised of the potential savings of switching to a metered bill. SWW will also offer those customers the opportunity to have a dual bill, setting out what their bill would have been if they had switched to a metered rate. This will enable customers to make an informed choice on their preferred method of billing.

SWW will be making customers aware of billing choices, as well as its affordability schemes, payment plans, and its priority services register.

As with the mainland, customers who request a meter and switch to metered billing will have two years within which they can opt to switch back to an unmetered tariff if they consider a metered tariff is not right for them.

We are content with SWW's plans for billing unmetered customers given its complementary plans to support customers in making an informed choice whether to switch to metered billing and to facilitate them doing so.

3.3 Retail services for business customers

We consulted on the basis that arrangements for business customers (or 'non-households') would be equivalent to the rest of England. In particular, because SWW has exited the non-household retail market, they would be served directly by one or more licensed retailers, who are responsible for customer services including billing and meter reading. They would be subject to the same price and non-price protections as the rest of England. They would also be able to switch retailer.

In response to our consultation CCWater noted the importance of non-household data being correct and of all eligible non-household customers being informed about and being able to engage with the retail market when SWW takes over. CCWater said that it was not clear from the consultation what the plans are to ensure that all non-household customers are identified and registered with a retailer at the point they become eligible.

WaterPlus also responded to our consultation on points relating to business retail. WaterPlus asked for clarification on:

- the process Ofwat intends to follow to allocate business customers;
- how SWW will address the issue of retail cost to serve being higher on the IoS compared to the rest of England; and
- how price protections will be applied to customers with no associated retailer upon transfer to the allocated retailer.

We have been supporting Defra and **MOSL** (the market operator for the water retail market in England) in designing an open and transparent process that ensures, should the licence variation go ahead, that all non-households on IoS have a retailer from 1 April 2020. Having considered various options, the preferred approach being considered is to use the 'gap-site' process run by MOSL. Under this process, retailers would have the choice to opt in to supply customers in SWW's area if 'gap' sites are identified – ie non-household premises which are not being supplied by a retailer. MOSL would then randomly allocate customers to retailers that had opted in for that area (eligible suppliers).

Pennon Water Services Limited is the only retailer currently signed-up as an eligible supplier in the SWW area. However, if the 'gap-site' approach is used, we expect MOSL to communicate to all retailers to provide them with the opportunity to opt in as eligible suppliers for the SWW area. After being allocated to a retailer if a customer wishes to switch to a different retailer it can do so at any stage.

We are satisfied that non-household customers will enjoy the same price and non-price protections as non-household customers on the mainland. All retailers must have a scheme of terms and conditions which must comply with the Retail Exit Code (**REC**) issued by Ofwat. The REC includes the requirement for a default tariff. Although the default tariff is currently linked to the tariffs of the previous monopoly company, which would have proved a problem on the IoS, Ofwat intends reissuing the REC later this year. The revised REC will come into effect on 1 April 2020 and we have proposed that it will prescribe the default tariff for each company rather than defining the tariff by reference to the tariff of the previous monopoly company. Our consultation on these changes is on [our website](#).

SWW is in discussions with MOSL to ensure that the retail market for non-households can operate effectively from 1 April 2020. These discussions will confirm responsibilities for preparatory work which will include registering each supply point for non-household customers on the MOSL database. We expect SWW and MOSL to make good progress on this, engage with business customers effectively, and there being at least one retailer prepared to take on business customers, prior to making our final decision on the licence.

3.4 Other issues arising from the consultation

3.4.1 Bill impact for existing SWW customers

The costs of upgrading infrastructure on the IoS amounts to less than 2% of the costs that SWW expects to incur between 2020 and 2025. These proposed costs, and other SWW investment costs, will be recovered by charges levied across SWW's wider customer base. As explained in our consultation, SWW research

suggests that there is broad support amongst SWW's existing customers for SWW to extend its area to include the IoS.

CCWater noted in its response that it has pressed SWW to show that its customers have been adequately informed and engaged on the proposal and that SWW has established its acceptability with customers.

We noted in the consultation that we estimated that the IoS investment would increase bills for each existing customer by on average £2.10 a year between 2020 and 2025, and £4.20 a year between 2025 and 2030, and that this bill increase would be more than offset by the effects of increased efficiency and other changes also agreed as part of PR19. Our [draft determination](#) for SWW, for consultation, included a 15% fall in customer bills before inflation over the five years from April 2020. This fall is inclusive of the IoS investment.

We think that, given this context, for the size of the investment concerned, the dedicated research and engagement with its existing customers that SWW has already undertaken is proportionate.

3.4.2 Private supplies and future customers

Residents on private supplies would be entitled to a connection to SWW's infrastructure after April 2025, and potentially earlier where SWW has sufficient water resource, treatment and network capacity available to enable this. Prior to this new connections will be evaluated on case by case basis and if sufficient resource, treatment and network capacity is available the new connections will be made under the same charging rules that apply to other customers of SWW. It was clear from the responses that residents are concerned about the quality and availability of drinking water on the IoS, and many welcomed SWW's investment programme to address this.

A respondent noted that SWW has not formally committed to taking on any wastewater role on St Martins, Bryher or St Agnes but would welcome it doing so.

Currently premises on these islands have private wastewater arrangements, so SWW will not be adopting wastewater infrastructure there. The same statutory and regulatory arrangements and charges will apply as for those mainland areas that do not have access to a public sewer, as set out in our consultation.

3.4.3 Access to Duchy land

A respondent said that it was important that the implications of the Duchy's ownership of much of the land be understood. They suggested that it might have

financial implications for SWW and consumers, for example in the form of access charges.

Access to Duchy land is not an issue specific to the IoS. Defra is liaising with the Duchy to ensure, amongst other things, that SWW has effective access to Duchy land to carry out its duties.

The respondent also noted that the Duchy is making a significant contribution to SWW as part of its transfer of assets. This is spread over a number of years. The amount is a result of a commercial negotiation and is confidential. It will be offset against the capital costs invested in the islands and will reduce the customer bill impact of the investment

4. Next steps

4.1 Extending legislation

Government is working to extend water legislation to the IoS. This will be done by an Order laid in Parliament, which will apply the Water Industry Act 1991 to the IoS and via secondary legislation. Subject to Parliamentary scrutiny, this legislation is expected to come into effect in November 2019.

Once the legislation applies on the IoS, the Secretary of State for Environment, Food and Rural Affairs or Ofwat (with the consent of or acting under a general authorisation from the Secretary of State) will have the power to vary SWW's area of appointment to include the IoS.

We are minded-to grant the variation once the relevant legislation has been extended, with a view to the variation coming into effect on 1 April 2020. The amendments to the legislation are likely to include provisions that enable SWW to carry out necessary preparatory work on the IoS in the period between November 2019 and April 2020, before the licence variation comes into effect.

4.2 SWW's engagement with customers on the IoS

While SWW engages with all its customers, it has proposed a specific programme of engagement with its new customers on the IoS. It would start with a public information programme prior to April 2020, and the programme of engagement would last throughout the period of the investment plan. SWW would ensure that customers are kept up to date on progress with any issues that may impact them. Engagement would include hall meetings and use of local media. SWW envisages that it would continue to have a high profile in the community indefinitely, to provide water and environmental benefits to support and enhance island life and the tourism economy.

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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