Jan 2020

Ofwat NAV Policy - Frequently Asked Questions

This document is designed to complement the following documents:

- New appointment and variation applications - a statement of our policy (July 2019)
- Conclusions on NAV policy statement (July 2019)
- New appointment and variation applications - a statement of our policy - draft for consultation (November 2018)
- Revision to NAV policy guidelines (November 2018)
- Application guidance for new appointments and variations (September 2018);
- New appointments and variation applications – the terms of reference for independent professional advisors providing site status reports (February 2011); and
- Bulk charges for NAVs: final guidance (May 2018)

Q. How do new appointees (NAV) differ from other water companies?

A. Once we approve a new appointment, the NAV becomes subject to the same duties and obligations that apply to all other appointed companies. These are set out in the Water Industry Act 1991 (WIA91) and in the company's conditions of appointment.

Given their size, we seek to minimise the regulatory burden on the companies, in particular by suspending some of their conditions of appointment. We will not suspend any condition of appointment if we consider that doing so was not in the interests of consumers. In general, we can bring a suspended condition of appointment into effect by giving notice to the appointee.

One of the conditions of appointment that is largely suspended is condition B (Charges). This regulates the price control process for large companies. NAVs are not subject to the price control. Instead, their charges to customers are capped

against the equivalent charge of the relevant incumbent water and/or Sewerage Company.

Q. How do NAVs supply services?

A. NAVs that lack their own water source or their own treatment works will need to purchase bulk supplies of these services from another water and / or sewerage company so that they can supply their customers.

We have reviewed the way in which we deal with bulk pricing, and following consultation, we published the Bulk charges for NAVs: final guidance in May 2018. This sets out how we will conduct a determination under section 40 or 110A of the WIA91 where the existing appointee and new appointee cannot agree on terms of their bulk agreement. We will base our determination on a wholesale-minus approach. This sets the bulk supply charge lower than the incumbent's relevant wholesale charge for customers on the site by an amount that reflects the costs an efficient NAV would incur in serving the site.

Q. How do companies recover charges for new infrastructure?

A. Under section 146 of the WIA91, all appointed companies can charge for first-time connections to their water and sewerage network where that connection is for domestic purposes.

The purpose of these charges, which we refer to as infrastructure charges, is to fund enhancements of the company's network to meet extra demand over time because of new connections. Following our Charging rules for new connection services (English undertakers) for English companies these charges can include costs new developments impose on assets further upstream.

Generally, infrastructure charges charged by incumbent companies to NAVs are dealt with in bulk supply agreements, with NAVs agreeing to levy such charges on their customers (in this case typically developers) and pass them through to the incumbents. We support this approach as it is generally an incumbent company that owns the relevant network that may need to be enhanced.

In Bulk charges for NAVs: final guidance we made changes to how we expect the income offset to be applied. The income-offset was previously applied to the requisition charge (the charge for onsite work), but this meant that when a new appointee undertook the onsite work it did not benefit from the income offset, and

was less able to compete against incumbents. This guidance requires incumbent companies to apply the income offset against the infrastructure charge which new appointees pay to the incumbents if they take bulk services. Our changes therefore ensure that NAVs taking a bulk supply are not disadvantaged by the income offset. This change comes into effect for charges on 1 April 2020. Prior to that date, under our guidance, incumbents incorporate the payment of the income-offset in bulk agreements. Currently it is not practical to implement a similar transfer to new appointees with no bulk supply agreements as there is no relevant charge those new appointees pay to the incumbents to which the income offset could be applied.

Q. How is surface water drainage managed?

A. Water and sewerage companies have to remove and process the water that falls on properties and then flows directly or indirectly into public sewers, the provision of which is their responsibility. This is known as surface water drainage.

The companies can levy a charge for surface water drainage, which covers the cost of taking away and treating surface water that runs from properties into the company's drains. This includes water that flows through gutters or that runs into the road and ends up in a public sewer.

If any surface water from premises within the NAV's site boundary enters into a public sewer owned by the incumbent company, then the NAV should pay a cost-reflective surface water drainage charge. This charge should form part of the bulk agreement.

For the purpose of surface water drainage charging, it is not relevant if the water enters the public sewer directly or indirectly. We welcome innovative and more sustainable approaches from all appointees to address surface water drainage. We consider that, if the drainage system that a NAV installs results in less surface water entering the incumbent company's sewers, this should be recognised in the charge paid for the service concerned.

Q. How is highway water drainage treated?

A. Highways England, the Welsh Government (Highways Standards) and local highways authorities are responsible for managing the drainage of run-off from motorways and the road network effectively. Section 146 of the WIA91 prohibits sewerage companies from charging Highways England, the Welsh Government (Highways Standards) and local highways authorities for the drainage of highways. Sewerage companies bear the costs of this highway drainage, which means that the generality of customers must cover these costs through their sewerage bills.

Whether highway drainage should be an element of a bulk discharge agreement is a matter to be negotiated as part of a bulk agreement. In such negotiations, companies should take into account the facts of a particular site. This includes:

- whether the site contains or will contain public roads that will drain to the incumbent's sewerage network;
- the relevant costs underlying the prices being negotiated; and
- their legal obligations, including those under competition law.

If a matter is referred to us under section 110A WIA91, we will take into account the following four principles in determining an appropriate bulk discharge price:

1. If a NAV's site contains public roads (roads which have been or may be adopted) and those roads drain to the sewers of an existing appointee, we are likely to consider that it is reasonable for the bulk discharge price to include a contribution to the existing appointee's highway drainage costs.
2. If the NAV's site contains public roads that do not drain to the public sewers of the existing appointee, or there are no public roads on the site, we are likely to consider that it is reasonable for the new appointee not to contribute to the highway drainage costs of the existing appointee.
3. The amount of any highway drainage charges payable should be a matter for commercial negotiation on a case-by-case basis. We expect parties to disclose all relevant information and be as transparent as possible in these negotiations in order to make sure that highway drainage charges are calculated in a way that is cost reflective.
4. A bulk discharge price should be cost reflective, which should take into account any efficient and sustainable drainage solutions which may result in less highway drainage entering the public sewers of the existing appointee. We do not wish to discourage innovation that reduces the amount of surface water draining to public sewers.

Q. Are there national NAVs?

A. Some stakeholders have argued that it would be more efficient if we allowed NAVs to supply multiple sites across England and Wales without an in-depth site-by-site assessment by us. Others have argued in favour of allowing a national appointment, similar to that used in other utility sectors, with applications assessed on a purely company-wide basis. We are not able to adopt this approach as the

WIA91 does not allow national appointments. It only allows for one appointee to replace another to supply specific geographic areas.

Q. Can an existing incumbent water company apply to be a NAV?

A. An application from an associated company would occur when a subsidiary company (of an existing appointee) applied for a new appointment. Although there are no prohibitions to this effect within the WIA91, we consider that allowing applications from associated companies may increase the risks to both customers and to the competitive process among prospective new appointees.

Allowing companies to apply for an appointment within the area of an existing appointee with which they are associated may allow the existing appointee to use the new appointment mechanism to depart from its standard tariffs. As a result, they may gain an advantage over or deter new prospective entrants by offering non-competitive tariffs.

We think that existing appointees should compete with NAVs on the basis of their regional charges and service offerings (and in the case of unserved sites, on the charges of and services involved in installing new infrastructure).

Q. How are infrastructure standards maintained?

A. Once we have granted a new appointment, the new appointee is responsible for the quality of the infrastructure that is laid on that site. If the applicant does not adopt the water mains and service pipes, then current legislation prevents those mains and pipes from becoming connected to the supply system.

The applicant is required to ensure that any infrastructure it lays on a site is laid in accordance with the construction standards of UK Water Industry Research (UKWIR).

To carry out such work, contractors can be accredited under the Water Industry Registration Scheme (WIRS). Under the scheme, Lloyd's Register carries out technical assessments of the service providers who elect to be accredited for contestable works associated with installing the water infrastructure. Further details about WIRS can be found on the Lloyd's Register's website.

We do not require the contractors used by the existing appointees to be WIRS-accredited. This is because we consider existing appointees able to run their own accreditation exercises. If a new appointee could demonstrate to us that it was able

to run its own accreditation scheme, then we would allow them to do so. However, as we want to be sure that infrastructure is laid to an appropriate quality, it must be constructed to at least the industry standards.

Any infrastructure laid that will come into contact with water must comprise only of materials that have been approved for use for such purposes. This is a requirement of Regulation 31 of The Water Supply (Water Quality) Regulations 2018.

The DWI manages the Regulation 31 approval process and carries out technical audits of site assets and water quality compliance data, both of which may be influenced by substandard infrastructure. The applicant is required to liaise with the DWI throughout the process.

Some existing appointees have been reluctant to take over the responsibility for the infrastructure should an applicant fail to obtain a new appointment. This is because, in their opinion, it would put customers at risk and it may not be contractually straightforward to remedy problems. We consider that it would be unreasonable for existing appointees not to take over the responsibility for infrastructure that had been laid in accordance with the industry standards.

Q. How does competition for new appointments work?

A. Public notice is served by the applicant under section 8 of the WIA91 and we do not publish any details of the site until we consult on the application. We include more details about the site and developer (subject to their consent) on our website when an application reaches the consultation stage.

Historically stakeholders have suggested that we should assess a number of applications to serve the same site in order to enable us to pick the one that offers the best deal for customers.

This argument is most frequently made in relation to applications under the unserved criterion, where the choice of supplier is routinely made (and has to be made, because there are no end-customers on the site) by the developer. We do not adopt this approach when assessing applications because developers generally hold a competitive process when they choose between new and existing appointees. We have limited means of requiring developers to accept our choice and because of this, we consider it preferable that the developer chooses a supplier and that supplier then applies to us for an appointment or variation.

We think an alternative approach may favour the existing appointee rather than new applicants in that, if we did not grant an appointment or variation to the developer's choice of supplier, the existing appointee would become the default supplier.

Q. What happens if an appointee's business fails?

A. Should an appointee's business fail, the special administration process that applies to all appointees will come into play.

If a court makes a special administration order because an appointee's business has failed, a special administrator will be appointed to manage the affairs, business and property of the appointee in accordance with sections 23-25 of the WIA91 with the purpose of either rescuing the business or transferring the business of the appointee to another appointed company. This ensures that customers will continue to receive secure and reliable water supply, sewerage services or both.

Q. How do we ensure essential services are maintained?

A. The Security and Emergency Measures (Water and Sewerage Undertakers) Direction 1998 (SEMD 1998) imposes a duty on water and sewerage undertakers to keep up to-date plans for the provision of essential water and sewerage services at all times. For water services, this includes using alternative means to provide consumers with a minimum supply in the event of an unavoidable failure of a piped supply. For sewerage services, it means guarding against and dealing with discharges from sewers into water bodies that may be used for abstraction or where aquatic life may be adversely affected, or onto land where such discharge may cause pollution or affect the area's amenities.

To this end, the undertakers must ensure that all facilities required for the implementation of their plans are provided. Should the need arise or should the undertakers be so required by the Secretary of State or (in the case of relevant undertakers whose areas are wholly or mainly in Wales) the Welsh Ministers, they must take action to implement (or activate) their plans.

To ensure that their plans, operations, facilities and services are complementary and coordinated, the undertakers should, to the necessary extent, consult other water and sewerage undertakers, the Environment Agency, the Natural Resources Body for Wales, local authorities, health authorities, the police and any other bodies likely to be involved in handling an emergency.

Each year, the undertakers are required to provide the Secretary of State or the Welsh Ministers with a statement confirming that the requirements of the Direction to prepare plans and provide facilities have been met. They must also report on actions

taken pursuant to the Direction at such times and in such form as may be specified by the Secretary of State or the Welsh Ministers.

To help delivery of the SEMD, the UK Government periodically issues guidance that the undertakers must follow. Current guidance states that the minimum supply of water must be 10 litres of drinking water per person per day or, in the case of a prolonged incident, 20 litres per person per day. This is normally delivered to consumers in bottles or from tankers at nearby locations. This compares with average consumption of about 150 litres of water per person per day during normal conditions.

Additionally, the Security and Emergency Measures (Water Undertakers) Direction 2017 (SEMD 2017) provides for arrangements between water undertakers and water supply licensees. In certain circumstances, the undertakers are obliged to supply the licensees with water so that they can provide their own customers with water resources due to an emergency or security event. SEMD 2017 further provides for use by the licensees of the undertakers' facilities, the undertakers' duty to notify all such persons as may be affected by an emergency or a security event as well as reporting obligations.

The SEMDs are issued under section 208 of the Water Industry Act 1991. Under that section, the Secretary of State or the Welsh Ministers may give to undertakers and licensees general or specific directions in the interests of national security or to mitigate the effects of any civil emergency which may occur. The duty to comply with the SEMDs is enforceable by the Secretary of State or the Welsh Ministers under section 18 of the Act.

In meeting these requirements, applicants will need to have two persons security cleared and submit annual compliance reports, both through Defra.

Once appointed as a water company, the applicant will also become a responder under the Civil Contingencies Act 2004. This confers other statutory duties, and details should be obtained from the Cabinet Office.

Any further questions?

Please contact the NAV policy team with any questions at the address below.

Email NAVpolicy@ofwat.gov.uk