

20 December 2017

Trust in water

Proposal to grant a variation of appointment to Icosa Water Services Limited to enable it to provide sewerage services to a site called Marringdean Road, in Billingshurst, West Sussex

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Contents

1. About this document	3
2. The Site	4
3. The applicant	5
4. The proposal	6
5. Our approach to the assessment of this application	7
6. The application	8
7. Conclusion and next steps	11
8. Site maps	12

1. About this document

We propose granting a variation of appointment to Icosa Water Services Limited (“**IWS**”) as a sewerage company and varying the appointment of Southern Water (“**SRN**”) as a sewerage company. This notice is a consultation on this proposal under section 8(3) of the Water Industry Act 1991.

The consultation period will last for 35 days from the date of publication of this notice. Having considered any representations submitted during the consultation period in response to the consultation, Ofwat will decide whether or not to grant the variations of appointment set out above.

2. The Site

IWS has applied for a variation to its appointment to be able to provide sewerage services to a site called Marringdean Road (“**the Site**”), Billingshurst, West Sussex, which is in SRN’s sewerage services area. A map of the site is included in section 8.

The Site comprises of 87 residential properties. There are no non-household properties on the development.

3. The applicant

On 20 October 2016, Icosa Water Limited was appointed as a water and sewerage undertaker for a site called West Raynham in Norfolk, which previously had a private water and wastewater supply. On 20 December 2016, IWS (the applicant), which is a subsidiary of Icosa Water Limited, applied to take over the appointment for the West Raynham site with the consent of Icosa Water Limited. IWS was appointed as a water and sewerage undertaker for the West Raynham site.

4. The proposal

Ofwat proposes to:

- grant a variation of appointment to IWS as sewerage company; and
- vary the appointment of SRN as a sewerage company by excluding the Site from its sewerage services area.

By means of the above, IWS will become the sewerage services supplier for the Site.

5. Our approach to the assessment of this application

The new appointment and variation mechanism, set out in primary legislation¹, provides an opportunity for entry and expansion into the water and sewerage sectors by allowing one company to replace the existing appointee as the provider of water and / or sewerage services for a specific area. This mechanism can be used by new companies to enter the market and by existing appointees to expand their businesses.

When considering applications for new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our statutory duty to protect consumers, wherever appropriate by promoting effective competition. In particular, in relation to unserved sites, we consider that we must ensure that the future customers on a 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 that:

- customers, or future customers, should be no worse off than if the site had been supplied by the existing appointee; and
- Ofwat 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.

We clarified these two policy principles in February 2011 when we published our New appointments and variations – [policy](#) and [process](#) documents. In November 2012, we published our '[Statement on our approach for assessing financial viability of applications for new appointments and variations](#)'. This states 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.

When we assess whether customers will be no worse off as a result of the appointment, we not only consider the customers on the site but also the generality of customers. These include not only the customers of the existing provider but also customers more generally across England and Wales, who in our view benefit from the effective operation of the new appointment and variation mechanism.

¹ The legal framework for new appointments is set out in the Water Industry Act 1991 (WIA). Section 7 of the WIA sets out the criteria by which an appointment or variation may be made. Section 8 sets out the procedure for making that appointment or variation.

6. The application

IWS has applied to be the sewerage company for the Site under the unserved criterion, set out in section 7(4)(b) Water Industry Act 1991 (“**WIA**”).

6.1 Consented status of the Site

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

We have an email from SRN, dated 12 May 2017, confirming that it agrees with IWS’ report showing that the Site is unserved.

6.2 Protecting customers

Ofwat acts to protect consumers, especially those who are unable to choose their supplier. In assessing applications to supply new development sites, Ofwat acts on behalf of both existing customers as well as potential new customers who are not yet on site, to protect their interests. The fact that future customers on a site have not directly chosen their supplier is not a position unique to new appointments and variations – only business, charity and public sector customers in England and Wales are able to choose their supplier².

Recognising this, our assessment of an applicant’s proposals includes analysis of its plans to ensure customers will be at least no worse off in terms of their annual bills and levels of service than if they had been supplied by the existing appointee in whose geographical area the relevant site sits. We will continue to protect customers on a site by regulating the new appointee’s prices and service levels.

6.3 Price

IWS proposes to match the charges to customers on the site of SRN – i.e. – it will not offer a discount.

² The majority of business, charity and public sector customers (“Business Customers”) where the area of the relevant appointed company is not wholly or mainly in Wales (and whose premises are, or are likely to be, supplied with at least 50 MI where the relevant area is wholly or mainly in Wales) can effectively switch suppliers of water and/or sewerage from 1 April 2017.

6.4 Levels of service

Every appointee is required under conditions G and I of its conditions of appointment to publish Codes of Practice on debt and leakage and a Customer Code for its household customers which has been approved by Ofwat. We have assessed IWS's proposed Codes of Practice and Customer Code, and our view is that these are of an appropriate standard. Our view is that customers on the Site would be no worse off in relation to the points covered by the above Codes of Practice and the Customer Code than they would be if SRN were to be the customers' water and sewerage supplier.

6.5 Environment Agency (EA) and Drinking Water Inspectorate (DWI)

We take the views of these organisations into account before progressing to formal consultation on an application for a new appointment. Both the EA and DWI informed us that they are content for us to consult on this application³.

6.6 Incumbent's existing customers

In considering whether customers will be no worse off, we also considered the potential effects of this new appointment on the prices that SRN'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. 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.

We have assessed the potential magnitude of this impact by comparing how much SRN 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 IWS.

We recently updated the approach we take to estimating the impact of granting a new appointment or variation on the annual bills of the incumbent's customers. We updated the approach to reflect the current price setting regime and the latest

³ The Environment Agency and the Drinking Water Inspectorate will also be formally consulted on the proposals, as they are on the list of organisations which must be formally consulted as set out in section 8(4)(b) of WIA.

financial data we hold. Using this approach, we estimate a potential £0.01 maximum annual increase on the water bills of existing SRN customers if we grant this variation to IWS. This is once the Site is fully built out.

This estimate 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 sites.

Therefore we consider that granting this variation to IWS would have a very small financial impact on customers' bills and could have potential benefits for customers.

6.7 Ability to finance and properly carry out its functions

We have a statutory duty to ensure that efficient appointees can finance the proper carrying out of their functions. When a company applies for a new appointment or variation, it must satisfy us that it is able to carry out all of the duties and obligations associated with being an appointed water and/or sewerage company.

IWS is currently applying to be appointed to serve a number of small sites. Smaller sites generate much lower profit margins than larger sites so demonstrating financial viability of an individual site can be more difficult. We have therefore approached the financial viability assessment on a portfolio basis. This allows some higher risk sites to be balanced by some lower risk sites. This allows the applicant the opportunity to demonstrate the financial viability of more sites overall.

In this case, we considered the estimated revenues and costs of the entire Site relating to sewerage services should the relevant variation be granted and we assessed the financial viability of the application on a portfolio basis with three other applications currently being processed. We did not consider that this Site on its own met our financial viability test, but we did consider that the four sites together are likely to be financially viable.

IWS has provided bank statements, showing a balance that indicates it has sufficient ring fenced security in place for this application in line with our minimum requirements.

On this basis, our view is that the risk of this Site not being financially viable is small and as a result we are currently satisfied that IWS would be able to finance its functions if the variation is granted.

7. Conclusion and next steps

In assessing IWS' application, we have considered the general benefits of new appointments. Our view is that our two key policy principles would be met in this case, as customers would be no worse off, and we consider that IWS would be able to finance, and carry out, its functions. We have also considered the effects of granting the proposed variation on the existing customers of SRN.

We are currently minded to grant the new appointment under the consent criterion. We are consulting on our proposal to do so.

Where to send submissions

Any person who wishes to make representations or objections with respect to the application should do so in writing (which includes by email) to Ben Groom at Centre City Tower, 7 Hill Street, Birmingham, B5 4UA or by email at Ben.Groom@ofwat.gsi.gov.uk

Representations must be received by Ofwat no later than 17.00 hours on 23 January 2018. Further information about how to make representations or objections, including information on the treatment of confidential information, can be obtained from Ofwat at the above address or at <http://www.ofwat.gov.uk/foi/>

Ofwat will only use the information you have provided for the purpose of this consultation. We will retain your information in accordance with Ofwat's retention schedule and will not share with third parties unless we have a legal obligation to do so. For further information please see Ofwat's Privacy Policy in our [Publication Scheme](#).

