

26 March 2018

Trust in water

Variation of Icosa Water Services Limited's appointment to include Cheriton Road, Eastleigh

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1. About this document

Variation of Icosa Water Limited's appointment to include Cheriton Road

On 24 October 2017, Ofwat began a consultation on a proposal to vary Icosa Water Services Limited's ("**IWS**") appointment to become the sewerage services provider for a development in Southern Water Limited ("**SRN**") sewerage services area called Cheriton Road in Eastleigh ("**the site**").

The consultation ended on 21 November 2017. During the consultation period, we received representations from one organisation, which we considered in making our decision. On 19 March 2018, we granted IWS 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 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, IWS applied to replace SRN 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 non-household 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

IWS applied to be the sewerage services appointee for the site under the consent criterion section 7(4)(a) of the Water Industry Act 1991 (“**WIA91**”). IWS will serve the site by way of bulk discharge agreement with SRN.

3.1 The consent criterion

To qualify under the consent criterion, an applicant must provide a letter of consent from the existing appointee consenting to the application and consenting to the variation of its area of appointment corresponding to the applicant's application.

We have an email from SRN, dated 5 June 2017, confirming that it provides consent for IWS to take over the site from SRN, subject to the conclusion of a bulk discharge agreement.

3.2 Financial viability of the proposal

We will only make an appointment if we are satisfied that the proposal poses a low risk of being financially non-viable. We assess the risk of financial viability on a site-by-site basis and also consider the financial position of the company as a whole.

Based on the information available to us, we concluded the site demonstrates sufficient financial viability, and IWS 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’

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

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

3.4 Effect of appointment on SRN'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 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 on customers of SRN. 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 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.

In this case, we have calculated that if we grant the site to IWS, there may be a potential impact on the bills of SRN's existing customers of £0.001.

This impact does not take into account the potential spillover 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, the developer said that it wanted IWS 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 these responses before making the decision to vary IWS's appointment. The points raised in the response are set out below.

4.1 Consultation

CCWater

In its response to consultation, CCWater stated that it was disappointed that customers will not receive any financial benefit from having IWS as its service provider as opposed to SRN. However, CCWater supports the application as IWS improves on most of the service standards offered by SRN.

CCWater also highlighted that a small cost will be passed on to SRN's customers. Whilst it notes that this is a very low cost, there has been no material evidence of a significant benefit for those customers arising from a NAV appointment.¹

Our response

One of the 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 IWS in its proposal to improve the levels of service and match the pricing set by SRN.

We do not require applicants to better the service and price of the previous incumbents.

¹ A copy of CCWater's full response can be found [here](#).

5. Conclusion

Having assessed IWS' application, and having taken account of the response we received to our consultation, we decided to grant a variation to IWS' area of appointment to allow it to serve the site for sewerage services. This appointment became effective on 20 March 2018.