

January 2019

Trust in water

Variation of Icosa Water Services Limited's appointment to include Benhall Mill Road

1. About this document

Variation of Icosa Water Services Limited's appointment to include Benhall Mill Road

On 29 October 2018, 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 Services Limited's ("**SRN**") sewerage services area called Benhall Mill Road in Tunbridge Wells, Kent ("**the Site**").

The consultation ended on 26 November 2018. During the consultation period, we received representations from three organisations, which we considered in making our decision. On 13 December 2018, we granted IWS a variation to its existing appointment to enable it to provide 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 their areas of appointment. 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/or 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 business 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 set out in section 7(4)(a) of the Water Industry Act 1991 (“**WIA91**”). IWS will serve the Site by way of a bulk discharge agreement with SRN.

3.1 The consent criterion

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

We have an email from SRN, dated 22 June 2018, confirming that it consents for IWS to take over the Site. We are therefore, satisfied that the application meets the consent criterion.

3.2 Retail exit

On 1 April 2017, the non-household retail market was opened to competition. SRN chose to exit the non-household retail market, which means that all non-household customers in its area of appointment must be supplied by a company holding a retail license (a retailer). Under the Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations 2016 (the Retail Exit Regulations), once a water or sewerage company exits the non-household retail market, its area of appointment becomes a 'retail exit area'. In a retail exit area, non-household customers must be supplied by a retailer and water and sewerage companies are prohibited from providing retail services to those customers. Although the Retail Exit Regulations make an exception if a variation is granted in respect of a site where there are no served premises, where there are served premises, the site will remain a retail exit area.

As a result, the Site will remain a retail exit area and IWS will not be able to provide retail services to non-household customers on the Site. There is currently one non-household customer on the Site and IWS has confirmed that this customer will be supplied by a retailer rather than by IWS.

3.3 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 either assess the risk of financial viability on a

site-by-site basis or in appropriate cases, we consider a number of sites as a package. We also consider the financial position of the company as a whole.

In this case, we considered the financial viability of the Site as a package with four other applications: Common Road, West End Lane, Barty Farm and Rochester Riverside. Based on the information available to us, we concluded this package of sites 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.

3.4 Assessment of 'no worse off'

IWS will charge customers equivalent charges to 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 IWS instead of by SRN.

3.5 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, with the revenues it might expect from the proposed arrangement with IWS.

In this case, we have calculated that if we grant the Site to IWS, there is unlikely to be any impact on the bills of SRN's existing customers.

This analysis 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.

3.6 Developer choice

Where relevant, we take into consideration the choices of the site developer. In this case, the developer, Countryside Properties, said that it wanted IWS to be the sewerage company for the Site.

4. Responses received to the consultation

We received three responses to our consultation; from SRN, the Environment Agency (“**EA**”) and the Consumer Council for Water (“**CCW**”). We considered these responses before making the decision to vary IWS' appointment. The points raised in these responses are set out below.

4.1 SRN

SRN responded to advise that it has no comments or objection to the consultation.

4.2 EA

The EA responded to the consultation highlighting the following:

- That there should be no occupation of properties until connections to SRN's sewerage network are in operation and any necessary downstream improvements have been made;
- Additional flows from the new development should not lead to a deterioration in performance of SRN's downstream sewerage assets; and
- If IWS is considering the provision of a new treatment works, a discharge permit will be required.

We forwarded the above comments to IWS for its consideration. It provided a response and the EA subsequently confirmed it is satisfied that the application can proceed.

4.1 CCWater

Overall, CCWater agrees with Ofwat's assessment that customers will be no worse off if served by IWS instead of SRN. CCWater considers that IWS' levels of service are appropriate as they meet or improves upon many of the service standards offered by SRN. CCWater also stated that it expects IWS to review its services as its customer base grows, especially in relation to any provisions for customers in debt or financial hardship.

CCWater highlighted that there is no direct financial benefit to customers on the Site as a result of having IWS as their sewerage services provider in that customers on the Site will not receive a discount. However, it noted that IWS meets or improves upon many of the service standards offered by SRN. CCWater also noted that there

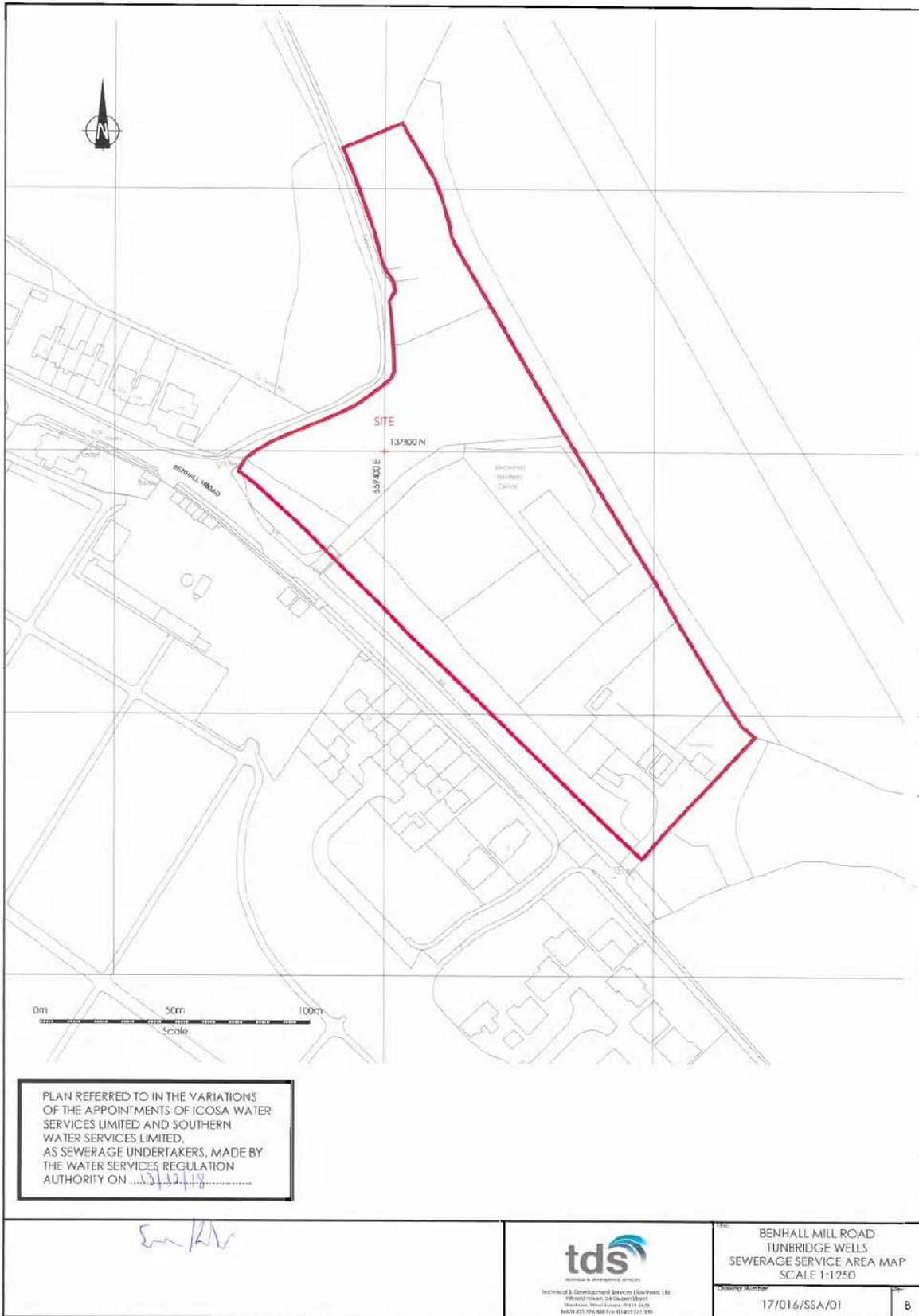
would be a no cost passed on to the incumbent's existing customers although it did not see that they would receive any significant benefit arising for SRN's customers.

One of Ofwat's key policies is that customers should be 'no worse off' if a new appointment or variation 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 served by the previous incumbent. This requirement has been met by IWS in its proposal to match or improve upon 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 incumbent.

5. Conclusion

Having assessed IWS's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to IWS's area of appointment to allow it to serve the Site for sewerage services. This appointment became effective on 14 December 2018.

Appendix 1: Site Map



\\17016\Benhall Mill Road, Tunbridge Wells\TDS Drawings\Drawings\17016-SSA-01.dwg David Hollington 04/09/2017 14:25:42

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