

August 2019

Trust in water

## **Variation of Icosa Water Services Limited's appointment to include Cuckoo Meadows, Phase 3 in East Sussex**

## 1. About this document

### Variation of Icosa Water Services Limited's appointment to include Cuckoo Meadows, Phase 3

On 11 July 2019, Ofwat began a [consultation](#) on a proposal to vary Icosa Water Services Limited's ("**Icosa**") appointment to become the sewerage services provider for a development in Southern Water Services Limited's ("**SRN**") sewerage services area. The site is called Cuckoo Meadows, Phase 3 in East Sussex ("**the Site**").

The consultation ended on 8 August 2019. During the consultation period, we received representations from two organisations, which we considered in making our decision. On 13 August 2019, we granted Icosa 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 water and/or 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, Icosa 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 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**

Icosa applied to be the sewerage services appointee for the Site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). Icosa will serve the Site by way of bulk discharge agreement with SRN.

#### **3.1 Unserved 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.

Icosa provided an independent report which confirmed that the Site is unserved. The independent report indicated that there was one property within the south eastern corner of the boundary, known as Upper Horse Lungers Farm, which SRN had considered may be served. The developer confirmed to the independent reporter that this property was demolished to make way for the development and the reporter saw no evidence of this property when they visited the Site. The report concluded that there were no connected properties on the Site. Icosa has also confirmed that there is no connection available for use on the Site.

On 28 May 2019, SRN confirmed that it agreed with the conclusions of the independent report, including that the property known as Upper Horse Lungers Farm had been demolished.

Having reviewed the information provided in relation to this Site, and taking into account the independent report and subsequent confirmations from Icosa and SRN, we consider the Site to be unserved.

#### **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 Icosa 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'**

Icosa will offer charges equivalent to those of SRN, that is, it will not offer a discount.

With regard to service levels, we have reviewed Icosa's Codes of Practice and its proposed service levels and compared these to SRN's Codes of Practice and performance commitments. Based on this review, we are satisfied that customers will be offered an appropriate level of service by Icosa and that overall customers will be 'no worse off' being served by Icosa 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 charges 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 SRN's customers. 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 it to serve the Site, with the revenues it might expect from the proposed arrangement with Icosa.

In this case, we have calculated that if we grant the Site to Icosa, there may be a potential impact on the sewerage 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, Bovis Homes (South Eastern) Limited, said that it wanted Icosa to be the sewerage company for the Site.

## **4. Responses received to the consultation**

We received two responses to our consultation; from the Consumer Council for Water and the Environment Agency. We considered these responses before making the decision to vary Icosa's appointment. The points raised in the response are set out below.

### **4.1 The Consumer Council for Water**

Overall, CCWater agrees with Ofwat's assessment that customers will be no worse off if served by Icosa instead of SRN. CCWater accepts that given Icosa's relatively small size and customer base, it may be appropriate for Icosa to tailor some of the services that it provides. Until it can provide a social tariff, CCWater stated that it would expect Icosa to offer appropriate, flexible support to any individual customers in financial difficulty that would otherwise benefit from a social tariff. CCWater expects that this should not be at the expense of Icosa's other customers.

CCWater noted that there would be a very low cost passed on to SRN's existing customers although it did not see that they would receive any significant benefit. CCWater also highlighted that it is disappointed that there is no direct financial benefit to customers on the Site as a result of having Icosa as its sewerage services provider in that customers on the Site will not receive a discount.

### **Our response**

One of Ofwat's 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 served by the previous incumbent. This requirement has been met by Icosa in its proposal to improve the levels of service and match the pricing set by SRN. We do not require applicants to offer a better service and price than the previous incumbent.

### **4.2 The Environment Agency**

The Environment Agency responded to our consultation to advise that it has no further comments or objections.

## **5. Conclusion**

Having assessed Icosa's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to Icosa's area of appointment to allow it to serve the Site for sewerage services. This appointment became effective on 14 August 2019.

## Appendix 1: Site Map



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