

September 2020

Variation of Icosa Water Services Limited's appointment to include Sutton Road, Maidstone

1. About this document

Variation of Icosa Water Services Limited's appointment to include Sutton Road, Maidstone

On 26 May 2020, Ofwat began a consultation on a proposal to vary Icosa Water Services Limited's ("**Icosa Water**") appointment to become the sewerage services provider for a development in Southern Water Services Limited's ("**Southern Water**") sewerage services area called Sutton Road, Maidstone ("**the Site**").

The consultation ended on 23 June 2020. During the consultation period, we received representations from two organisations, which we considered in making our decision. On 3 August 2020, we granted Icosa Water 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, Icosa Water applied to replace Southern Water 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 Water 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 Water will serve the Site by way of a bulk discharge agreement with Southern Water.

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. The Site is a greenfield site and Icosa Water has shared a letter from Southern Water confirming that to its knowledge the Site is unserved. Given the information provided by the application and the incumbent company we are satisfied that the Site may be considered 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 Water 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 Water will match the charges of Southern Water.

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

3.4 Effect of appointment on Southern Water'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 Southern Water'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 Southern Water. 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 Southern Water 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 bulk discharge arrangement with Icosa Water.

In this case, we have calculated that if we grant the Site to Icosa Water, there may be a potential increase in the bills of Southern Water's existing customers of £0.004.

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, Countryside Properties, said that it wanted Icosa Water 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 (“**CCW**”) and from the Environment Agency (“**EA**”). We considered these responses before making the decision to vary Icosa Water's appointment. The points raised in the response are set out below.

4.1 CCW

CCW stated that in general it expects new appointees to provide customers with prices, levels of service and service guarantees that match or ideally better those of the incumbent water or sewerage company.

CCW noted its disappointment that there will be no direct financial benefit to customers from having Icosa Water as their provider of sewerage services given it plans to match the charges of Southern Water. However it expects Icosa Water to generally exceed the service standards of Southern Water. For this reason CCW supports the application and agrees with our assessment that overall customers will be no worse off.

One of our key policies is that customers should be no worse off if a NAV is granted. That is, an applicant must ensure its new customers are made no worse off in terms of charges and service than if they had been supplied by the previous appointee. We do not require applicants to better the service and price of previous incumbents.

CCW noted our conclusion that Southern Water's existing customers would see a potential increase of £0.004 in their sewerage bills as a result of the variation. It notes that whilst this is a very low increase, there is no evidence of significant benefits to the existing customers of Southern Water.

CCW noted that Icosa Water will not be able to offer a social tariff to financially vulnerable customers in the way Southern Water does, but will offer the standard WaterSure tariff for qualifying customers. CCW states that given its relatively small size and customer base it may be appropriate for Icosa Water to tailor some of the services that it provides. CCW set out its expectation that Icosa Water would offer appropriate, flexible support to any customer in financial difficulty who would otherwise have benefitted from a social tariff. CCW expects Icosa Water to offer appropriate flexible support to any individual in financial difficulty who would otherwise benefit from a social tariff. This should not be at the expense of its other customers. CCW expects Icosa Water to research the views of its customers on any proposed cross-subsidy before introducing any social tariffs.

4.2 EA

The EA has no objections to the application, although it made observations about network capacity. It was observed that Southern Water had confirmed that capacity was available to accommodate 100 properties, and indicated that the remaining properties should not be occupied until any necessary downstream improvements had been made. The EA also observed that additional flows from the development must not lead to deterioration in performance of Southern Water's downstream sewerage assets.

Icosa Water confirmed that it was in communication with Southern Water on the solutions to capacity provision that were being actively pursued.

5. Conclusion

Having assessed Icosa Water's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to Icosa Water's area of appointment to allow it to serve the Site for sewerage services. This appointment became effective on 4 August 2020.

Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
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