

July 2019

Trust in water

PR19 draft determinations

**South East Water – Securing cost efficiency
actions and interventions**

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PR19 Draft Determinations: South East Water – Securing cost efficiency actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised actions, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we are making as part of the draft determination.

Each action has a unique reference. The prefix 'SEW' denotes the company South East Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key to these acronyms. Actions whose numbers are preceded with an 'A' denote required actions and actions whose numbers are preceded with a 'B' denote advised actions.

Table 2 below sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix 'SEW' denotes the company South East Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key to these acronyms. Intervention numbers are preceded with a 'C'.

For all other documents related to the South East Water draft determination, please see the [draft determinations webpage](#).

Table 1: South East Water's response to required actions and interventions for draft determinations

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Securing cost efficiency	SEW.CE.A1	Required	We provide our view of efficient costs for the company along with our reasoning. We expect it to address areas of inefficiency, or lack of evidence, in the revised business plan. Where appropriate, we expect it to withdraw investment proposals if either: the need for investment is not compelling; or there is no need for a cost adjustment claim beyond our existing cost baseline.	1 April 2019	South East Water is inefficient at a company level. It did not reduce its costs in the April resubmission, and, except for the residential retail price control, it still has one of the largest gaps between requested expenditure and our allowed expenditure. The company withdrew one cost adjustment claim which we rejected at the IAP, and retained its other claim for diseconomies in treatment plants and abnormal groundwater complexity.	Intervention required. The company did not respond to our efficiency challenge in its resubmitted costs. The expenditure requested was no different with that included in its September business plan.	We provide our view of efficient costs for the company along with our reasoning. We expect the company to continue to address areas of inefficiency and lack of evidence.

	SEW.CE.A2	Required	There is significant investment proposed in the activity to reduce the risk of INNS transfer and therefore the company is required to propose an outcome delivery incentive in order to ensure customer protection for efficient delivery. Should the company propose a performance commitment and outcome delivery incentive, the company should provide evidence to justify the level of the performance commitment and the outcome delivery incentive rates proposed, in line with our Final Methodology. We expect to receive evidence of customer support for outperformance payments, where proposed, and that the incentive rates proposed are reflective of customer valuations.	1 April 2019	The company makes the argument that a separate performance commitment and outcome delivery incentive is unnecessary to ensure customer protection because the INNS investment is already protected via the proposed WINEP performance commitment.	Intervention required. We consider that the proposed performance commitment for WINEP provides insufficient customer protection as the associated outcome delivery incentive is only reputational.	We are updating the definition of this performance commitment to: <ul style="list-style-type: none"> i) only include Green schemes and the Bewl-Darwell Transfer scheme (which is Amber but the EA has confirmed will be Green); ii) set a delivery profile based on the Environment Agency's target completion dates for 59 of the company's green schemes and the Bewl-Darwell Transfer scheme. iii) apply underperformance payments to the revise
	SEW.CE.A3	Required	There may be significant impacts in terms of investment or type of investment as a result of the metaldehyde ban. The company should investigate and agree with the DWI the scale and timing of any potential changes compared to its submitted plans. Significant changes and uncertainty may require an outcome delivery incentive to protect customers in the instance of expenditure not being required. Should the company propose a performance commitment and outcome delivery incentive, the company should provide evidence to justify the level of the performance commitment and the outcome delivery incentive rates proposed, in line with our Final Methodology. We expect to receive evidence of customer support for outperformance payments, where proposed, and that the incentive rates proposed are reflective of customer valuations.	1 April 2019	The company states that there will not be any change to the spending on catchment management schemes. The company comments that their work with product substitution has been the least productive and for this reason less than four percent of the programme going forward focuses on this catchment control method.	No intervention required for Draft Determination but further action needed by the company. We support the proactive catchment management activities and acknowledge these cover multiple drivers. The company appears to employ product substitution but does not specify expenditure in its plans.	Company to provide evidence to confirm DWI agreement with its submitted plans/revised undertakings and that no metaldehyde specific treatment or product substitution costs are included in the requested allowance.
	Advised actions	Advised	No advised actions	N/A			

Table 2: Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
<p>We explain our approach to cost assessment, including the allowances we set for each control, assumption on revenue recovery from grants and contributions, opex-capex split and totex profiling, in 'Securing cost efficiency technical appendix'. We set out other company specific interventions, and the allowances we set for each control, in section 3 of the company's draft determination summary and its cost efficiency appendix.</p>		

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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