

July 2019

Trust in water

PR19 draft determinations

**Southern Water – Targeted controls, markets
and innovation actions and interventions**

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PR19 Draft Determinations: Southern Water– Targeted controls, markets and innovation 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 ‘SRN’ denotes the company Southern 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 ‘SRN’ denotes the company Southern 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 Southern Water draft determination, please see the [draft determinations webpage](#).

Table 1: Southern 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
Targeted controls, markets and innovation	SRN.CMI.A1	Required	The proposed split of fixed and variable revenues for the bio-resources revenue control has not been sufficiently evidenced, particularly where cost lines are partly incremental and partly fixed. We are also intervening to ensure that the bioresources revenue adjustment is set on a broadly comparable basis to avoid setting revenue controls that may distort the development of trades. We will set out our view in the draft determinations based on the updated tables Bio1, Bio3 and Bio4. We will treat the funding of the 2020 RCV (run-off, returns and tax) as fixed for these purposes, along with revenues to recover local authority rates; some fees; and a proportion of direct and indirect costs of bioresources treatment and transport.	1 April 2019	We issued an industry query response in March 2019 setting out further details about the broad approach to be followed consistent with the methodology that would be applied to the fast track companies. Southern Water sets out its approach, along with other companies and we have reviewed this evidence. Southern Water revised its methodology. It has defined variable costs as costs that are affected by sludge volumes including all power, chemicals, direct labour, fuel, treatment costs and transportation. It has assumed that all capital expenditure (maintenance and enhancement) is	Intervention required. We are intervening because our assessment of the companies’ business plans revealed an inconsistent approach between companies in their calculation of the bioresources revenue requirements to recover fixed and variable costs. This resulted in a wide range of suggested splits between the fixed and variable revenue component. As with fast track companies, a consistent approach to the fixed/variable split is essential to ensure that	We are intervening to set the level of the split between fixed and variable costs. Our detailed approach is set out in ‘Our methodology for the classification of bioresources costs’.

					a fixed cost. It has treated all the RCV related revenue components as fixed together with local authority rates, indirect operating costs (overheads) and direct service contracts.	the company is correctly remunerated by our modified average revenue control for outturn sludge volumes that differ from its original forecasts.	
	SRN.CMI.A2	Required	The company should provide a commitment to provide a detailed work programme by end August 2019 to assure us that the company will deliver appropriate drainage and wastewater management plans. The programme should ensure that the company can prepare and consult on its first drainage and wastewater management plan no later than the summer of 2022 to enable revised plans to be prepared in early 2023 to inform PR24 business plans.	1 April 2019	The company has provided a commitment in its 1 April 2019 submission.	No intervention required.	N/A
	SRN.CMI.A3	Required	The company has not provided information or provided insufficient detail of the arrangements for risk sharing with customers relating to the development of large new water resource options (Fawley desalination plant and Havant Thicket). The company should develop appropriate risk sharing arrangements or provide further detail to ensure that customers are adequately protected from large scale risks. In relation to the development of Havant Thicket reservoir to facilitate new supplies to the company, please explain how the proposed commercial arrangement would protect customers over the longer term.	1 April 2019	<p>The company has proposed, penalty-only outcome delivery incentives to manage the delivery risks related to Havant Thicket and Fawley Desalination plant.</p> <p>The company has described how the commercial arrangements regarding the Havant Thicket reservoir could protect customers over the longer term.</p>	<p>Intervention required.</p> <p>Fawley desalination plant forms part of the strategic regional water resource solutions. We have applied an end-of-period mechanism to these schemes to protect customers from delivery risks.</p> <p>Havant Thicket is a critical new strategic water resource scheme which is time critical. We have intervened in Portsmouth Water to fund this through a separate price control. We shall consider, as part of this process, how best to manage delivery risks.</p> <p>Southern Water have provided adequate information at the current time regarding the commercial arrangements regarding Havant Thicket.</p>	<p>We have intervened to remove outcome delivery incentives from these schemes.</p> <p>We set out further reason for this justification in the 'Strategic regional water resource scheme appendix' and the 'Havant Thicket policy issues appendix'.</p>
	SRN.CMI.A4	Required	The company should update its bid assessment framework document to provide greater clarity on the process for appeals and explain how the process ensure that there is no bias in the assessment.	15 July 2019	The company satisfactorily addresses the action we set. Southern Water provide more detail on how it will treat third parties fairly; the appeals process and auditing arrangements.	No intervention required.	N/A
	SRN.CMI.A5	Required	<p>Peacehaven Indirect Potable Water Reuse</p> <p>A summary of the key elements of the Peacehaven Indirect Potable Water Reuse scheme. This should include all of the relevant scheme information including but not limited to the key deliverables.</p>	1 April 2019	The company provided a high level summary of the key elements of the Peacehaven Indirect Potable Re-use scheme including the key deliverables, projected scheme costs and involvement with South	<p>Action needed.</p> <p>The information provided was sufficient for a technical review of the Peacehaven Indirect Potable Re-use scheme and</p>	We expect Southern Water to undertake further work to review detailed costs and commitments to

			<p>A summary of the projected scheme costs clearly identifying the costs for each phase of the scheme by year. These should clearly identify the incremental costs to Southern Water.</p> <p>An economic analysis of the scheme including a Net Present Value analysis using the standardised assumptions provided in Table A. This analysis should clearly identify any additional benefit to customers of progressing this scheme outside of DPC.</p>		<p>East Water. It provided an updated technical assessment that identified some options as more suitable for DPC.</p> <p>The company provided an NPV analysis comparing the DPC versus in-house delivery for the scheme. The company's analysis indicated that should this alternative option be selected it may offer better value using a DPC process based on the NPV analysis.</p>	<p>was more convincing than the original assessment.</p> <p>The NPV analysis provided sufficient information to allow a high level review but insufficient detail to be able to confirm the absolute values.</p> <p>The company's proposal that this scheme, should it be selected, could be suitable for progression on a DPC process was supported by sufficient evidence and was generally convincing.</p>	<p>ensure, if selected, delivery is via the most efficient route, and to re-assess delivery via DPC if there are significant changes to these schemes or the value for money assessment, to ensure that customers continue to receive the best value.</p>
	SRN.CMI.A6	Required	<p>Slowhill Copse Industrial reuse</p> <p>A summary of the key elements of the Slowhill Copse Industrial Reuse scheme. This should include all of the relevant scheme information including but not limited to the key deliverables.</p> <p>A summary of the projected scheme costs clearly identifying the costs for each phase of the scheme by year. These should clearly identify the incremental costs to Southern Water.</p> <p>An economic analysis of the scheme including a Net Present Value analysis using the standardised assumptions provided in Table A. This analysis should clearly identify the any additional benefit to customers of progressing this scheme outside of DPC.</p>	1 April 2019	<p>The company provided a high level summary of the key elements of the Slowhill Copse Industrial Reuse scheme including the key deliverables, projected scheme costs.</p> <p>The company provided an NPV analysis comparing the DPC versus in-house delivery for the scheme. The company's analysis indicated that should this alternative option be selected it may offer better value using a DPC process based on the NPV analysis.</p>	<p>Action needed.</p> <p>The information provided was sufficient for a technical review of the Slowhill Copse Industrial Reuse scheme.</p> <p>The NPV analysis provided sufficient information to allow a high level review but insufficient detail to be able to confirm the absolute values.</p> <p>The company's proposal that this scheme, should it be selected, could be suitable for progression on a DPC process was supported by sufficient evidence and generally convincing.</p>	<p>We expect Southern Water to undertake further work to review detailed costs and commitments to ensure, if scheme is selected, delivery is via the most efficient route, and to re-assess delivery via DPC if there are significant changes to these schemes or the value for money assessment, to ensure that customers continue to receive the best value.</p>
	SRN.CMI.A7	Required	<p>Inter-zone transfers (Hampshire)</p> <p>A summary of the key elements of the Inter-zone transfers (Hampshire) scheme proposed for AMP7 and AMP8. This should include all of the relevant scheme information including but not limited to the key deliverables.</p> <p>A summary of the projected scheme costs clearly identifying the costs for each phase of the scheme by year. These should clearly identify the incremental costs to Southern Water.</p> <p>An economic analysis of the scheme including a Net Present Value analysis using the standardised assumptions provided in Table A. This analysis should</p>	1 April 2019	<p>The company provided a high level summary of the key elements of the Inter-zone transfers (Hampshire) scheme including the key deliverables, projected scheme costs.</p> <p>The company did not provide a Net Present Value analysis comparing the DPC versus in-house delivery for the scheme.</p> <p>The company's technical analysis indicated that the reasons for rejection were due to the physical,</p>	<p>Action needed.</p> <p>The technical rejection of the analysis of the Interzone transfers (Hampshire) scheme by the company was supported by insufficient evidence on the reasons why physical, operational and contractual interfaces could not be managed by the company.</p>	<p>We expect Southern Water to undertake a further review of the suitability of this scheme for DPC during its assessment of the Thames Southern transfer scheme, and to review detailed costs and commitments to ensure, if scheme</p>

			clearly identify any additional benefit to customers of progressing this scheme outside of DPC.		operational and contractual interfaces of the scheme.	The company's decision not to include a Net Present Value as requested did not support the case that this scheme was unsuitable for a DPC process.	is selected, delivery is via the most efficient route to ensure that customers receive the best value.
	SRN.CMI.A8	Required	<p>Fawley Desalination plant</p> <p>A summary of the key elements of the Fawley Desalination plant proposed for AMP7 and AMP8. This should include all of the relevant scheme information including but not limited to the key deliverables.</p> <p>A summary of the projected scheme costs clearly identifying the costs for each phase of the scheme by year. These should clearly identify the incremental costs to Southern Water.</p> <p>An economic analysis of the scheme including a Net Present Value analysis using the standardised assumptions provided in Table A. This analysis should clearly identify any additional benefit to customers of progressing this scheme outside of DPC.</p>	1 April 2019	<p>The company provided a high level summary of the key elements of the Fawley Desalination scheme including the key deliverables, projected scheme costs.</p> <p>The company provided a Net Present Value analysis comparing the DPC versus in-house delivery for the scheme with further elements of an iterative business case. The company's assessment of this scheme concluded that it could offer better value using a DPC process based on the NPV analysis.</p>	<p>Action needed.</p> <p>A review of the technical and NPV analysis for the Fawley Desalination scheme was carried out on the decision to progress the scheme under DPC. The Net Present Value analysis provided sufficient information to allow a high level review but insufficient detail to be able to confirm the absolute values.</p> <p>The company's decision that this project was likely to offer the best value for money for customers through a DPC procurement process was supported by a well-evidenced and convincing assessment.</p>	We expect Southern Water to undertake further work to review detailed costs and commitments to ensure, if scheme is selected, delivery is via the most efficient route, and to re-assess delivery via DPC if there are significant changes to these schemes or the value for money assessment, to ensure that customers continue to receive the best value.
	SRN.CMI.A9	Required	The company should explain how it will work together with neighbouring companies to explore strategic water resource options and knowledge sharing on demand-side measures.	1 April 2019	<p>The company has provided an appropriate response. The response included how the company would:</p> <ul style="list-style-type: none"> • build a framework to develop strategic water resources options; • take a range of measures, including working up access prices, to encourage third-party options to come forward; and • share demand-side and other learnings by WRSE setting up an appropriate work programme. <p>However, we note that there is still a degree of uncertainty regarding its WRMP in terms of option</p>	No intervention required.	N/A

					selection, sizing and levels of service for customers.		
	SRN.CMI.B1	Advised	<p>The company should provide further information on potential bioresources trades with other companies.</p> <p>The company should consider how it can collaborate with other companies to maximise the opportunities for research to address common challenges (eg leakage detection, water efficiency and wastewater treatment processes) rather than companies progressing research independently.</p>	1 April 2019	<p>The company satisfactorily addresses the action we set on bioresources trades. The company provides more detail on bioresource trading opportunities in its April 2019 plan. It states that since September 2018 it has continued developing its sludge trading opportunities with its neighbours. For example, it mentions an opportunity to enter into a substantive sludge trading arrangement with Wessex/GENeco to facilitate the movement of sludge between Wessex Water's Poole STC and Southern Water's Millbrook STC.</p> <p>The company provides good evidence of a number of collaboration initiatives, for example from July 2018 Southern Water have been sharing insights with Thames Water on its respective approaches to water re-use. The company also provides evidence of collaboration with Severn Trent and Thames Water on the topic of Phosphorous removal. Southern Water also provides details of collaboration with Eastleigh Borough Council on the River Itchen Challenge. The company also provides evidence of the resources it invests in collaborative innovative projects.</p>	<p>No intervention required.</p> <p>We remain concerned that the company is not maximising the opportunities available from collaborating to address common challenges. We will promote innovation in the sector as part of our on-going work on innovation.</p>	N/A

Table 2: Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
N/A	N/A	N/A

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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