

July 2019

Trust in water

PR19 draft determinations

SES Water – Cost efficiency draft determination appendix

PR19 draft determinations: SES Water - Cost efficiency draft determination appendix

1. Wholesale water activities

1.1 Enhancement

The tables below summarise the adjustments we make to set the efficient level of enhancement totex for the water resources and network plus water price controls. Where appropriate, we reallocate enhancement expenditure between enhancement activities. In the table, we present the company requested cost for each activity where we made a material challenge, after any reallocation that we may have done. Our disallowances to company enhancement proposals include a challenge on the need to invest, on the efficiency of the proposals or on the classification of the expenditure as enhancement (in which case we consider that the expenditure is covered by our base allowance). For draft determinations we make an adjustment to the enhancement allowances to account for an implicit allowance for enhancement opex included within our base models. We set out our method of estimating the opex implicit allowance in 'Securing cost efficiency technical appendix'. Costs for new developments, new connections and addressing low pressure are now considered within wholesale water base ("totex plus") econometric models. We show details of specific areas of material disallowance or efficiency challenge in the table below and we provide details in our published feeder models.

Table 1: Material disallowances of and efficiency challenges to enhancement costs for the water resources price control 2020-25 (£ million of 2017-18)

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	0.9	0.9	0.5
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
-	-	-	

Note 1: During our QA process we identified a non-material error in the favour of the company in the allowance for the catchment management freeform enhancement line. We provide details in the relevant feeder model and we will make the adjustment at final determination.

Note 2: Our enhancement totex allowance is net of an implicit allowance for enhancement opex.

Table 2: Material disallowances of and efficiency challenges to enhancement costs for the water network plus price control 2020-25 (£ million of 2017-18).

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	52.2	52.2	23.2
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
Supply and demand side enhancements: Totals	20.0	2.6	
Resilience	8.9	0.0	
Metering (excluding new connections) for meters requested by optants, customers and businesses	21.1	19.5	

Note 1: Our enhancement totex allowance is net of an implicit allowance for enhancement opex. We have not netted off an implicit allowance for enhancement opex from our allowances for the individual enhancement lines.

1.2 Transition expenditure

SES Water does not request any expenditure under the transition programme.

2. Cost adjustment claims

Table 3 summarises our consideration and allowances for the cost adjustment claims submitted by the company. We give further details in our published cost adjustment claim feeder model for SES Water. In its revised plan SES Water retained its single cost adjustment claim for water softening from its original plan and added two additional new claims for mains replacement and electricity usage. The electricity usage claim is split between the water resources and network plus controls.

Table 3: Cost adjustment claims and our allowed totex adjustments, 2020-25 (£ million of 2017-18)

Description of Claim	Value of company claim	Our allowed adjustment	Rationale for decision
Water softening statutory requirement	12.1	11.5	We allow the majority of the cost adjustment claim, accepting the base modelled allowance does not include these costs. We make some disallowances for efficient delivery to the general operational and maintenance costs the company presents. We specifically challenge the replacement expenditure for Godstone WTW, disallowing expenditure because insufficient evidence has been provided to demonstrate the selected option represents best value. We also intervene to propose a performance commitment associated with this claim and the ongoing softening activity within the draft determination (PR19SES_A.5, Water softening, 'SES Water - Cost efficiency draft determination appendix').
Mains replacement for leakage reduction	13.1	0.0	We reject the claim because we expect an efficient company to achieve sector forecast upper quartile performance by 2024-25 (in both normalised measures of per property and per kilometre of main) within base service. We allow enhancement costs only where a company's performance commitment goes beyond the forecast upper quartile threshold. As this is not achieved by SES

			<p>Water, and the company has not provided evidence of its unique circumstances, we do not allow the requested funding under enhancement. Because no leakage enhancement allowance is made for the company this cost adjustment claim that seeks to justify the unit cost for leakage reduction activities is not relevant and is rejected.</p>
Wholesale electricity usage (water network plus)	<p>3.5 (water resources) 6.9 (water network plus)</p>	0.0	<p>We reject this claim and consider that our base allowance is appropriate. The claim is based on the argument that SES Water’s average pumping head is relatively high, which means it has to pump more water than the average company and as a consequence incurs higher energy cost than reflected in our base allowance.</p> <p>Our analysis shows that while SES Water’s average pumping head is relatively high, it is not an outlier – there are a few companies with a higher average pumping head. Our analysis also shows that while historically SES Water’s energy consumption (per distribution input) is the highest across companies, for 2020-25, it is forecasting a significant reduction to the industry median in water network plus and to around the upper quartile for water resources. This may be evidence that SES Water is able to improve its efficiency in energy consumption, given its average pumping head, as we would expect from companies. Given that SES Water is not an outlier on average pumping head, that there is expectation of lower energy consumption in 2020-25 and that we have a variable that to a degree controls for energy consumption in our econometric models, we reject the claims.</p>

3. WINEP uncertainty mechanism

Our totex allowance for companies includes an allowance for environmental obligations set out in the Water Industry National Environment Programme (WINEP). Some of the requirements in WINEP are not expected to be confirmed until December 2021 at the earliest, after we make our final determinations in December 2019. Unconfirmed requirements in WINEP are known as ‘amber’ schemes.

Where we made an allowance for amber schemes, we use a mechanism to adjust our totex for schemes which are later confirmed as not required.

SES Water has a single scheme in WINEP that is classified as ‘amber’: restoration of the Upper Darent waterbody. In its response to our query SES-IAP-CE-003 the company confirmed that it does not include any expenditure in its business plan in the belief that investigation work yet to be completed will show that there will be no need to carry out any enhancement work. Furthermore, SES Water states that should this assumption prove incorrect, it will carry out the work required sourcing the expenditure from shareholders without recourse to customers. Accordingly, we set no cost adjustment rate for this single scheme, as shown in Table 4 below.

Table 4: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP schemes included in our draft determination (£ million in 2017-18 prices)

Unique ID	Scheme category / name	Company’s totex unit rate	Our allowed totex unit rate
7SES100008	Upper Darent Restoration - BOREHOLES AT WESTWOOD PUMPING STATION	None proposed	0.000

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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July 2019

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