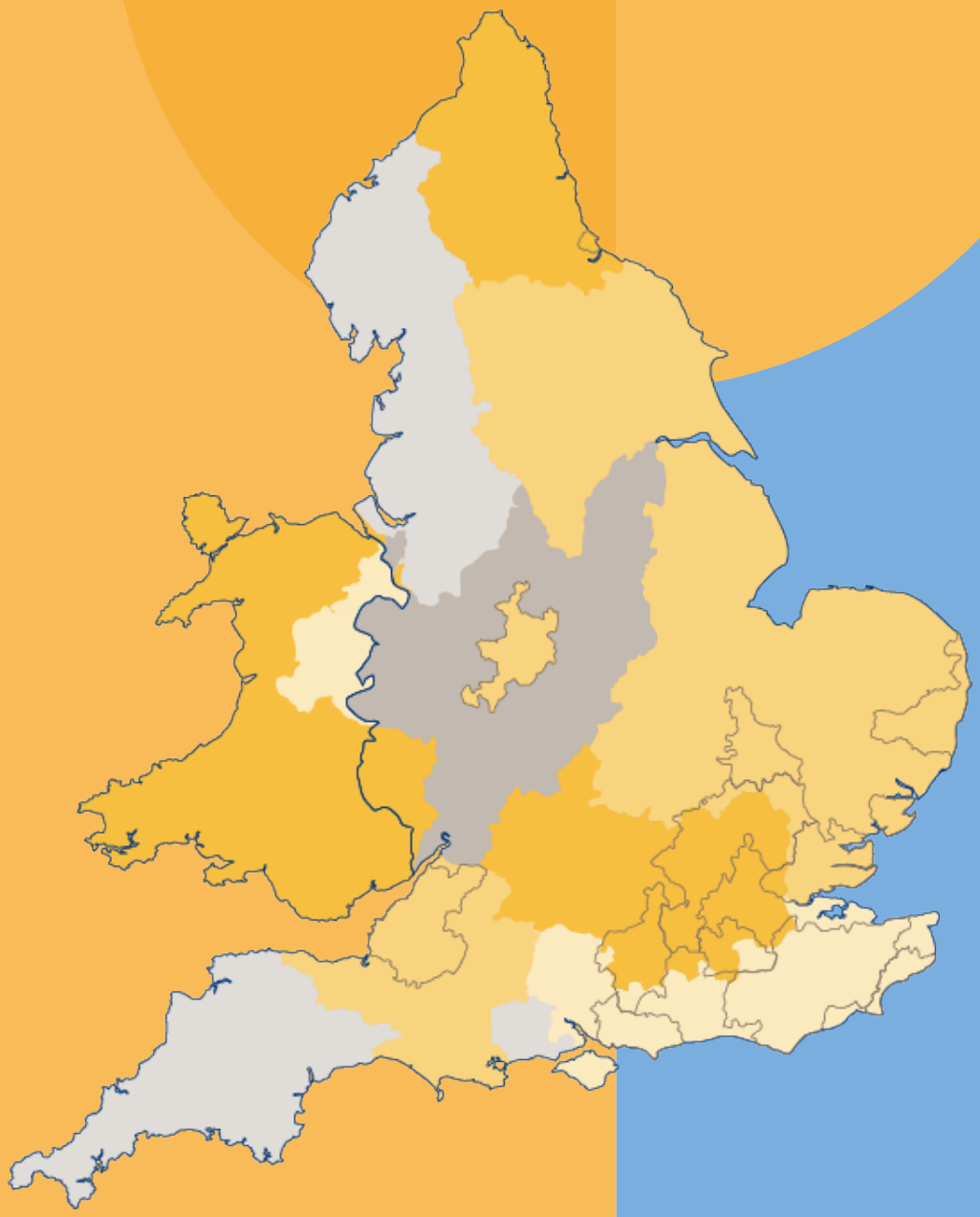
July 2019

Trust in water

PR19 draft determinations

SES Water draft determination



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PR19 draft determinations: SES Water draft determination

About this document

This document, together with the 'Notification of the draft determination of price controls for 'SES Water', sets out for consultation the details of the draft determination of price controls, service and incentive package for SES Water for 2020 to 2025. All figures in this document are in 2017-18 prices except where otherwise stated.

The draft determination sets out:

1. the outcomes for SES Water to deliver;
2. the allowed revenue that SES Water can recover from its customers; and
3. how we have determined allowed revenues based on our calculation of efficient costs and the allowed return on capital.

The draft determination covers three price controls for the 2019 price review (PR19):

- water resources;
- water network plus; and
- residential retail.

This draft determination is in accordance with our PR19 methodology, our statutory duties and the UK Government's statement of strategic priorities and objectives for Ofwat. We have also had regard to the principles of best regulatory practice, including the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted.

All of the responses to the initial assessment of business plans, including all of the companies' revised business plans, provided by 1 April 2019 are taken into account in our decisions where relevant. Where appropriate, we explicitly set out our response to points and issues raised by respondents.

Our decisions also take into account the representations made on the fast track draft determinations where points and issues raised are relevant to the slow track and significant scrutiny draft determinations. We will deal with the other elements of the representations on the fast track draft determinations as part of the final determinations.

We have not necessarily been able to take full account of all late evidence, submitted after 1 April 2019 business plans, and we will consider this information for the final determination.

The appendices to this document provide more detail and form part of the draft price control determination:

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

- PR19 draft determinations: SES Water - Outcomes performance commitment appendix
- PR19 draft determinations: SES Water - Accounting for past delivery appendix
- PR19 draft determinations: SES Water - Allowed revenue appendix

For all other documents related to the SES Water draft determination, please see the draft determinations webpage.

How to respond

Written representations on the draft determinations should be provided to us by 10am on 30 August 2019. Representations can be made by all stakeholders. Representations can be sent either to our PR19 inbox (PR19@Ofwat.gov.uk) or by post to our Birmingham office address: Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA.

To ensure transparency, we expect companies to publish their representations in full. We also intend to publish all the written representations we receive on our website once our final determinations are made.

In view of this, if respondents consider that some of the information in their representations should not be disclosed (for example, because they consider it is commercially sensitive information) they should identify that information and explain why. We would expect strong, robust reasons that are specific to the information concerned. We will take such explanations into account, but we cannot give an assurance that information included in representations will not be disclosed.

Where companies are making representations, they should consider what further evidence may be necessary to submit with their representations as a result of this draft determination. Where companies consider that we have not appropriately considered any points previously raised by the company, companies should include this within their representations. Companies should provide a completed ‘All company representation pro forma’ alongside any representations.

We will publish SES Water’s final determination on 11 December 2019 after considering representations (from all stakeholders) on the draft determination and other relevant matters. If SES Water accepts the final determination, it will be accepting that it has adequate funding to properly carry out the regulated business, including meeting its statutory and regulatory obligations, and to deliver the outcomes within its final determination.

Contents

1 Summary

Through PR19 we are enabling, incentivising and challenging water companies to address the key issues facing the sector of climate change, a growing population and ever increasing customer expectations about service. We expect companies to look well beyond the five year price review period to meet needs of future customers and protect and improve the natural environment.

Our PR19 methodology set out a framework for companies to address these challenges, with particular focus on improved service, affordability, increased resilience and greater innovation. Our draft determinations are based on our detailed review of the revised business plans submitted to us on 1 April 2019. We are intervening, where required, to protect customers.

1.1 What the draft determination will deliver

Our draft determination for SES Water will cut average bills by 15.3% in real terms in the 2020-25 period compared to the company's proposed 4.9% reduction. Table 1.1 below sets out the difference in bill profile between the company's business plan submission in April 2019 and our draft determination. Average bills are lower than proposed by SES Water, reflecting our view of efficient costs. Further details on bills are set out in section 6.

Table 1.1: Bill profile for 2020-25 before inflation

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Company plan (April resubmission)	£190	£182	£182	£182	£182	£180
Draft determination	£190	£161	£161	£161	£161	£161

Our draft determination allows SES Water £24 million to invest in improvements to service, resilience and the environment. Key parts of this allowance are:

- £19.5 million for installing more than 80,000 meters;
- £2.6 million on reducing demand for water; and
- £1.7 million on replacing lead pipes.

Further details on our cost allowances are set out in section 3.

Our draft determination package includes a full set of performance commitments, specifying the minimum level of service that SES Water must commit to deliver for customers and the environment. Each performance commitment also has a financial or reputational incentive to hold the company to account for delivery of these commitments.

The performance commitments require SES Water to deliver service improvements by reducing water supply interruptions and deliver environmental benefits by reducing per capita consumption, interruptions to supply and leakage. SES Water will also provide more support for vulnerable customers by 2024-25. Further details of performance commitments are set out in Table 1.2 below and in section 2.

Table 1.2: Key commitments for SES Water

Area	Measure
Overall incentive package	Overall, the likely range of returns from the outcome delivery incentive package in our draft determination equates to a return on regulatory equity range of -2.70% (P10) to +0.52% (P90).
Key common performance commitments	• 15% reduction in annual level of leakage by 2025 from the 2020 level[1]. • 7% reduction in per capita consumption by 2024-25. • 7% decrease in water supply interruptions by 2024-25.
Bespoke performance commitments	• 15% increase in the share of customer contacts, including enquiries and complaints that are resolved on first contact by 2024-25. • 29% increase in the number of projects completed to deliver the outcomes associated with the Water Industry National Environment Programme (WINEP) by 2024-25.

Note: The calculations behind these numbers are outlined in the 'SES Water - Outcomes performance commitment appendix'.

1.2 Allowed revenues

Our draft determination sets allowed revenue or average revenue for each of the price controls. Table 1.3 shows the allowed revenues in the draft determination across each price control. Further details on our calculation of allowed revenues are set out in section 4.

[1]Whilst the figures in the tables of the 'SES Water - Outcomes performance commitment appendix' which relate to this performance commitment reflect that it is measured on a three-year average to smooth annual variations due to weather, the overall performance commitment target is a reduction in average annual leakage of 15% (from 2019-20 baseline) by 2024-25

Table 1.3: Allowed revenue, 2020-25 (£ million)

	Water Resources	Network plus - water	Wholesale Total	Residential retail
Final allowed revenues (£ million)	25.3	225.1	**250.4**	24.1

Note: retail revenue is the sum of the margin, retail costs, and adjustments. The residential retail control is an average revenue control. We have included forecast revenue (in real terms) for this control to illustrate the total revenue across all controls.

As set out in the Cost of capital technical appendix, we are updating our assessment of the cost of capital for SES Water's draft determinations. The updated cost of capital is 3.19% (on a CPIH basis, 2.19% on a RPI basis) at the level of the Appointee, a reduction of 0.21% from our early view set out in the PR19 methodology.

We consider that SES Water's draft determination is financeable, based on an efficient company, with the notional capital structure, and is sufficient to deliver its obligations, including to ensure a long-term resilient service. Each company is responsible for ensuring its capital and financial structure allows it to maintain financial resilience over the short and the long term. We expect SES Water to take account of this requirement and of the reasonably foreseeable range of plausible outcomes of their final determination including evidence of further downward pressure on the cost of capital in very recent market data. We expect SES Water to provide appropriate Board assurance that it will remain financeable on a notional and actual basis and can maintain its long-term financial resilience in its response to our draft determination. Further detail on our assessment of financeability is set out in section 5.

We have encouraged companies to take greater account of customers' interests – and to transparently demonstrate that they are doing so in the way they finance themselves, pay dividends to their shareholders, and determine performance related executive pay. SES Water has committed to meeting the expectations set out in our 'Putting the sector in balance position statement'. It has confirmed it will apply our gearing outperformance mechanism and expects to maintain gearing below 70% during 2020 -25. The company is taking steps to demonstrate how its dividend and performance related executive pay policies in 2020-25 will align with customer interests. However we expect the company to continue to take steps in these areas to meet our expectations so that customers can have more trust in the water sector.

In the 'Putting the sector in balance' position statement we also encouraged companies to adopt voluntary sharing mechanisms particularly where, for example, companies outperform our costs of debt assumptions. SES Water has not proposed any voluntary sharing mechanisms. However, the company does provide a payment matching scheme through its ClearStart Scheme.

1.3 Where we intervene

Our initial assessment of SES Water's plan on 31 January 2019 assessed the plan slow track. We identified a number of areas where material interventions were required to protect customers' interests. In its 1 April 2019 revised business plan, SES Water has not adequately addressed our concerns. In our draft determination we intervene in SES Water's plan in the following areas:

- We align total expenditure (totex) allowances to our view of efficient costs using the comparative information available to us. In SES Water's case, this results in a 18.3% reduction in costs as it did not provide convincing evidence to explain why its proposed costs were higher. This saves customers £54 million.
- We disallow allow enhancement expenditure for leakage as the company is not forecasting to go beyond upper quartile performance. SES Water must deliver this performance commitment at no additional cost to customers, with outperformance rewarded through the outcome delivery incentive framework.
- We remove outperformance payment for the mains repair common performance commitment.
- We significantly increase performance and reduce outperformance for a number of bespoke performance commitments.
- We bring forward £1 million of pay as you go revenue to maintain notional company financeability.
- We remove the company specific adjustment to the cost of debt.
- We decrease net PR14 reconciliation revenue as a result of the service incentive mechanism.

We set out further detail of our interventions in this document and in the SES Water actions and interventions documents.

2 Outcomes

The outcomes framework is a key component in driving companies to focus on delivering the objectives that matter to today's customers, future customers and the environment in the 2020-25 period and beyond. Outcomes define the service package that companies should deliver for their customers and their incentives to do this.

There are two key elements of the outcomes framework: performance commitments and outcome delivery incentives. Performance commitments specify the services that customers should receive and set out in detail the levels of performance that the companies commit to achieve within the five year period from April 2020 to March 2025. Outcome delivery incentives specify the financial or reputational consequences for companies of outperformance or underperformance against each of these commitments. (They are referred to as 'out' where there is a payment to the company for better than committed performance, 'under' where there is a payment to customers where there is worse than committed performance, or 'out-and-under' incentives, depending on their design). Most outcome delivery incentives will be settled at the end of each year to bring incentives closer to the time of delivery of the service ('in-period' incentives) and some will be settled once at the end of the five year period ('end-of period' incentives). The outcomes framework gives companies the freedom to innovate and explore to find the most cost-effective way of delivering what matters to their customers.

The outcomes framework sits in the broader context of the company's statutory and licence requirements for service delivery. Independently of the outcomes framework, each company also has to ensure that it complies with its legal obligations, or risk enforcement action. If a company's performance falls below the level set for a performance commitment (irrespective of the existence of any deadband or collar), we will consider whether this is indicative of wider compliance issues to the detriment of consumers and whether enforcement action, with the potential for remedial and fining measures, is warranted.

Please see the 'Delivering outcomes for customers policy appendix' for further details on our policy decisions on cross-cutting issues such as common performance commitments and outcome delivery incentive rates.

2.1 Customer engagement

In our PR19 methodology we set out our expectations that companies should demonstrate ambition and innovation in their approach to engaging customers as they develop their business plans. This includes direct engagement with customers to develop a package of performance commitments and outcome delivery incentives.

We expect customer challenge groups to provide independent challenge to companies and independent assurance to us on: the quality of a company's customer engagement; and the degree to which this is reflected in its business plan.

We continue our assessment of customer engagement evidence following each company's submission of its response to our initial assessment of its plan in April. We find variability in both the quality of engagement undertaken by companies and the extent to which customers' views are reflected in company proposals.

SES Water demonstrates elements of a high quality approach to customer engagement, such as using a range of data sources including 'business as usual' data. However there are some areas of concern such as insufficient evidence of engaging with customers regarding their appetite for risk or use of comparative information to help customers make informed decisions. We cannot see clearly how the results of customer engagement are reflected in its business plan and ongoing business operations.

Following our initial assessment of the plan, SES Water has decided to not undertake new customer engagement. Instead, the company commissioned a report which reviews outcome delivery incentive calculations, including triangulation with more recent data sources. We are not able to validate the independence of the submitted report. However, we welcome the additional assurance it provides. We recognise that SES Water has adopted suggestions from the report regarding outcome delivery incentives for a number of performance commitments. The SES Water's customer challenge group states that the report 'provides positive assurance on the reasonableness of the performance commitment/outcome delivery incentive rates and that marginal benefit estimates are reflective of the willingness to pay results in the original submission'.

SES Water has not undertaken new customer engagement in relation to customers' support for long-term bill profiles, saying that it has 'not been able to perform further customer engagement in this area, due to the limited time available to [it] to resubmit [its] plan, but [it] commit[s] to ongoing engagement with [its] customers about affordability issues'. We note that other companies have completed new customer research on long-term bill profiles within the same period. The customer challenge group has commented that 'it would have been more helpful to have undertaken further research pre-September submission' but the group accepts that new research is 'unlikely to be assured as being "conducted in line with the social research best practice"'.

Although not requested following our initial assessment of plans, SES Water has undertaken specific research about customers' views on paying a small company premium. The results appear to be statistically robust and demonstrate customer support for the premium. However, we find evidence that the research approach led participants to understand that the premium amount is already included in current bills.

2.2 Performance commitments and outcome delivery incentives

SES Water's performance commitments and outcome delivery incentives for the 2020-25 period are listed in Table 2.2 and Table 2.3. The detail of these performance commitments and outcome delivery incentives are set out in the 'SES Water - Outcomes performance commitment appendix'. The performance commitments and outcome delivery incentives include the revisions accepted by the company in response to our 31 January 2019 initial assessment of business plans and any additional interventions we are making in the draft determination.

The material interventions we are making in the draft determination are set out in Table 2.1 below. 'SES Water – Delivering outcomes for customers actions and interventions' sets out in detail our interventions in the company's performance commitments and outcome delivery incentives following our 31 January 2019 initial assessment of plans.

Table 2.1: Summary of key interventions on outcomes

Intervention description
Accepting the company's leakage reduction proposals of 15% on an annual average basis, which will take it to performance that is better than industry upper quartile (UQ) for urban companies by 2024-25. Reducing underperformance and outperformance rates in relation to leakage. The company's proposed rates were outliers and relatively higher compared to both other companies' proposed rates at PR19 and the company's own 2015-2020 leakage outcome delivery incentive.
Accepting the company's plan to deliver a 7% reduction in per capita consumption, which is better than the upper quartile percentage reduction for all companies. This will achieve a Per Capita Consumption (PCC) of 136 l/h/d by 2024-25 – better than the Department for Environment, Food and Rural Affairs' (DEFRA) aspiration. Removing outperformance payments in relation to per capita consumption as the company has not provided sufficient evidence of customer support.
Requiring a 7% improvement in upper quartile performance commitment levels for water supply interruptions as the company is currently at the frontier. We are setting an industry wide glide path for all years before 2024-25. Reducing underperformance and outperformance rates in relation to water supply interruptions, which were outliers and relatively higher when compared to both other companies' proposed rates at PR19 and the company's own PR14 outcome delivery incentive.
Removing outperformance payments for mains repairs as the company has not provided sufficient evidence of customer support.
Reducing the underperformance and outperformance rates of the company's proposal for a financially significant outcome delivery incentive relating to the risk of supply failures and the number of customers being supplied by more than one treatment works, to better reflect customer impacts of early or late delivery. This reduces outperformance by £0.4m and underperformance by £0.5m.
Accepting the company's proposal for financially significant outcome delivery incentive relating to the first contact resolution and the number of customers being supplied by more than one treatment works.
Introducing an underperformance-only outcome delivery incentive to protect customers if the company fails to deliver softened water as per its cost adjustment claim and funding during the 2015-20 period. The incentive rate will compensate customers for their additional costs of receiving hard water.

Table 2.2: Summary of performance commitments: common performance commitments

Name of common performance commitment	Type of outcome delivery incentive	Price controls outcome delivery incentives will apply to
Water quality compliance (CRI) [PR19SES_A.4]	Financial - Under; In-period	Water network plus
Water supply interruptions [PR19SES_A.1]	Financial - Out & under; In-period	Water network plus
Leakage [PR19SES_C.4]	Financial - Out & under; In-period	Water network plus
Per capita consumption [PR19SES_E.1]	Financial - Under; In-period	Water network plus
Mains repairs [PR19SES_A.2]	Financial - Under; In-period	Water network plus
Unplanned outage [PR19SES_C.3]	Financial - Under; In-period	Water network plus
Risk of severe restrictions in a drought [PR19SES_C.1]	Reputational	N/A
Priority services for customers in vulnerable circumstances [PR19SES_B.5]	Reputational	N/A
C-Mex: Customer measure of experience [PR19SES_D.2]	Financial - Out & under; In-period	Residential retail
D-Mex: Developer services measure of experience [PR19SES_D.3]	Financial - Out & under; In-period	Water network plus

Table 2.3: Summary of performance commitments: bespoke performance commitments

Name of bespoke performance commitment	Type of outcome delivery incentive	Price controls outcome delivery incentives will apply to
Customer concerns about their water (taste, odour and discolouration contacts) [PR19SES_A.3]	Financial - Under; In-period	Water network plus
Supporting customers in financial hardship [PR19SES_B.1]	Financial - Under; In-period	Residential retail
Vulnerable support scheme awareness [PR19SES_B.2]	Reputational	N/A
Vulnerable support scheme helpfulness [PR19SES_B.3]	Reputational	N/A
Void properties [PR19SES_B.4]	Financial - Out & under; In-period	Residential retail
First contact resolution [PR19SES_D.1]	Financial - Under; In-period	Residential retail
Greenhouse gas emissions [PR19SES_E.2]	Financial - Under; In-period	Water network plus
Pollution incidents [PR19SES_E.3]	Reputational	N/A
Abstraction incentive mechanism [PR19SES_E.4]	Reputational	N/A
Land based improvement - biodiversity [PR19SES_E.5]	Reputational	N/A
River based improvement - delivery of WINEP [PR19SES_E.6]	Financial - Under; In-period	Water resources; Water network plus
Water Softening [PR19SES_A.5]	Financial - Under; In-period	Water resources
Perception of value for money [PR19SES_B.6]	Reputational	N/A
WINEP Delivery [PR19SES_NEP01]	Reputational	N/A

Figure 2.1 and Figure 2.2 below provide an indication of the financial value of each of SES Water's outcome delivery incentives (taking into account the impact of our draft determination interventions) showing how much the company would have to return to customers if it underperformed to the P10 level and how much the company would gain if it over performed to the P90 level. The figures cover common and bespoke commitments respectively.

Table 2.4 below provides an indication of the financial value of the overall package at the upper and lower extreme levels of performance (expressed as a percentage

point impacts on RoRE (return on regulated equity)) and the overall impact of our draft determination interventions. The estimates are based on the company's own view of the plausible bounds of performance. The P90 is the performance threshold at which there is only a 10% chance of outturn performance being better. The P10 is the performance threshold at which there is only a 10% chance of outturn performance being worse.

Figure 2.1: Projected P10 penalties and P90 payments for common performance commitments over 2020-25 (£ million)

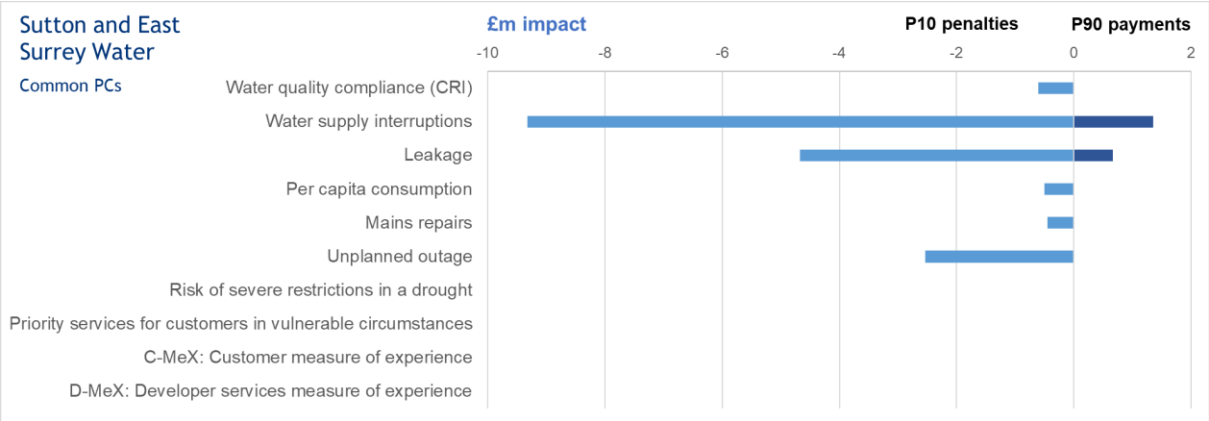


Figure 2.2: Projected P10 penalties and P90 payments for bespoke performance commitments over 2020-25 (£ million)

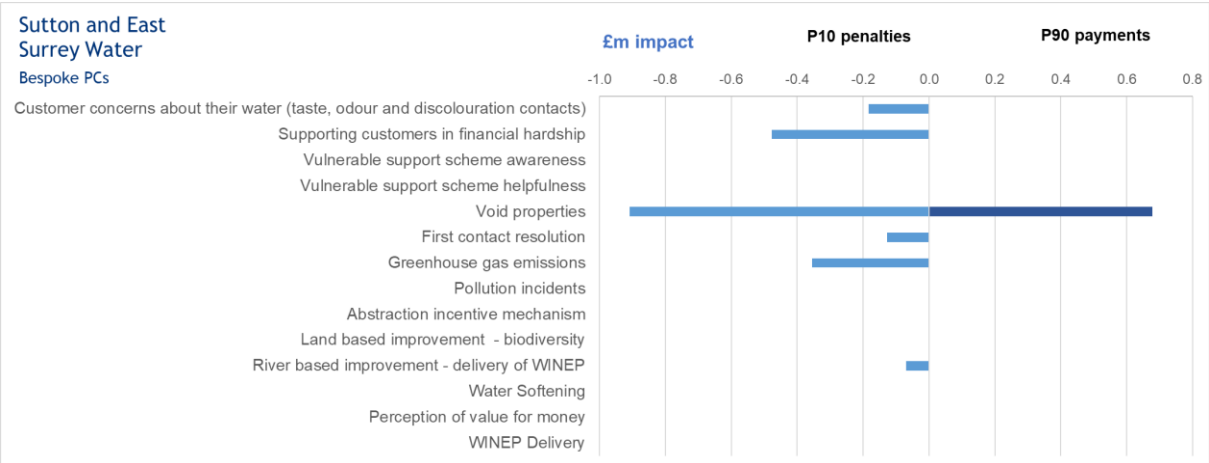


Table 2.4: Impact of draft determination interventions on RoRE range

	April 2019 business plan		Draft determination	
	% of 5 year regulatory equity		% of 5 year regulatory equity	
	P10	P90	P10	P90
SES Water	-0.82	+1.29	-2.70	+0.52

In the PR19 methodology we said that we expect companies to propose approaches to protect customers in case their outcome delivery incentive payments turn out to be much higher than expected. We asked companies in our initial assessment of business plans 'PR19 initial assessment of plans: Delivering outcomes for customers policy appendix' to put in place additional protections for customers where we considered protections were not adequate.

We are applying caps and collars to financially material and/or highly uncertain performance commitments and allowing caps and collars on other performance commitments where company proposals are supported by high quality customer engagement.

The company has accepted our standard sharing mechanism, where 50% of outperformance payments that exceed 3% of return on regulatory equity (RoRE) in any year are shared with customers through bill reductions in the following year. We accept this proposal. We set out further detail of the mechanism in 'Delivering outcomes for customers policy appendix'.

In our PR19 methodology, we decided to replace the current Service Incentive Mechanism (SIM) with two new mechanisms to incentivise companies to provide a great experience for residential customers (our customer measure of experience or C-MeX) and for developer services customers (our developer services measure of experience, or D-MeX). C-MeX and D-MeX will be operational from April 2020. We set out further details on C-MeX and D-MeX in the 'Delivering outcomes for customers policy appendix'. We will publish our decisions on C-Mex and D-Mex incentive designs for 2020-25 as part of the final determinations in December.

We will finalise the company's performance commitments and outcome delivery incentives in the light of representations on this draft determination, so that these can be reflected as appropriate in the company's final determination to be published in December.

2.3 Linking outcomes to resilience

During the initial assessment of plans, we were concerned that companies' plans lacked a clear line of sight between the risks to resilience identified, the proposed mitigations presented in the plan to tackle these risks, and how these mitigation plans were reflected as service improvements in the form of stretching performance commitments. In this context, we are intervening to ensure SES Water's resilience challenges are reflected in its outcomes and performance commitments, particularly in relation to the incentives attached to its mains repairs and unplanned outage.

Our initial assessment of plans also noted that SES Water provided little evidence that it has assessed the level of development of its systems and services in relation to resilience or the methodology used to assess and prioritise its risks. Overall, the company provided insufficient evidence to demonstrate the benefit that specific investments have in mitigating quantified levels of risk (and/or in increasing system resilience) and supporting stable or improved commitment targets. We expect companies to address this and other issues associated with the way they integrate resilience across their business in the action plans that will be submitted by 22 August 2019 and in their responses to the draft determinations in relation to specific investment proposals. We will take into account the quality of companies' response in our final determinations.

3 Cost Allowances

We set out in our PR19 methodology that we expect company business plans to show a step change in efficiency. In its April business plan SES Water requested total expenditure levels 9% higher than it had incurred historically for totex and 16% higher for residential retail costs. We challenge SES Water's proposed costs on the basis of cost benchmarking with its peers and the wider economy. SES Water has not revised the requested level of costs since our initial assessment of business plans.

Our approach to setting total expenditure (totex) allowances is detailed in our publication 'Securing cost efficiency technical appendix'. In addition to challenging companies to be more efficient we have also, where appropriate, set safeguards to protect customers if specific investments are not delivered as planned.

In the 'SES Water – Cost efficiency draft determination appendix' we provide more detailed information on our cost challenge for enhancement expenditure, our allowance for cost adjustment claims and transitional expenditure and how we will deal with the uncertainty in WINEP.

3.1 Wholesale total expenditure

Table 3.1 shows the totex allowances by year and by wholesale price control for the period 2020-25. We have phased our allowed totex over 2020-25 using the company business plan totex profile.

Table 3.1: Totex[1] (excluding pension deficit recovery) by year for wholesale controls, 2020-25 (£ million, 2017-18 CPIH deflated prices)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total	Company view - total
Water Resources	4.8	4.8	4.6	4.4	4.3	22.9	23.7
Water network plus	41.8	45.7	41.4	36.9	36.1	201.9	244.7
Total	**46.6**	**50.5**	**46.0**	**41.3**	**40.4**	**224.8**	**268.4**

1 Totex includes all costs except pension deficit recovery costs. This includes third party costs, operating lease adjustments, allowances related to the development of strategic regional water resource solutions and costs that are assumed to be recovered through grants and contributions.

Table 3.2 sets out the build-up of our totex allowance from base and enhancement costs. Base expenditure refers to routine, year on year costs, which companies incur in the normal running of their business. Enhancement expenditure refers to investment for the purpose of enhancing the capacity or quality of service beyond base level.

For draft determinations, we have changed the scope of costs included under base expenditure compared to the initial assessment of plans. Our base costs now include costs associated with the connection of new developments (i.e. new developments and new connection costs) and costs for addressing low pressure.

Table 3.2: Totex by wholesale price control and type of cost, 2020-25 (£ million, 2017-18 CPIH deflated prices)

	Our cost allowance			Company view
	Water resources	Water network plus	Total	Total
Base expenditure[1]	22.4	168.7	191.2	196.2
Enhancement expenditure	0.5	23.2	23.7	53.1
Third party costs	0.0	10.1	10.1	10.1
Total – excluding pension deficit recovery	**23.0**	**202.0**	**224.9**	**259.4**
Pensions deficit recovery costs[2]	0.0	0.0	0.0	-
Total	**23.0**	**202.0**	**224.9**	**259.4**

1. We display base costs under the new definition. Company business plan base costs exclude enhancement opex.
2. We are displaying pension deficit recovery costs separately as they are not included in the calculation for PAYG (see section 4).
3. Table 3.2 does not include operating lease adjustments, allowances related to the development of strategic regional water resource solutions. Any ex-ante cost sharing adjustments and costs that are assumed to be recovered through grants and contributions are also excluded. This is to allow a simpler comparison with base and enhancement costs. Table 3.6 sets out a reconciliation of inclusions and exclusions in totex for cost sharing and for the financial model.
4. The company view of pension deficit recovery costs is the full cost, not just the cost the company expects to include within price controls.
5. The table above omits £9.03m for water softening from the company view of base costs. These costs have been included in our assessment.

3.2 Base expenditure

Table 3.3 shows our challenge to company proposed base expenditure. We distinguish between ‘modelled base costs’ and ‘unmodelled base costs’. We challenge modelled based costs based on comparative assessment (using econometric models). Our efficiency challenge is based on cost performance within the sector as well as evidence from the wider economy.

Unmodelled base costs include business rates; abstraction charges and costs to meet the Traffic Management Act where applicable. Our assessment of these costs sits outside of our econometric models and we explain our approach in ‘Securing cost efficiency technical appendix’.

Table 3.3: Base totex expenditure, 2020-25 (£ million, 2017-18 CPIH deflated prices)

Price Control	Company business plan - base cost	Modelled base costs efficiency adjustment	Unmodelled base costs adjustment	Base cost allowance
Water Resources	21.8	0.7	0.0	22.4
Water Network plus	174.4	-5.7	0.0	168.7
Total	196.2	-5.0	0.0	191.2

1. Base costs include operating and maintenance costs as well as new development, new connections and addressing low pressure costs. Company business plan base costs exclude enhancement opex.
2. The table above omits £9.03m for water softening from the company view of base costs. These costs have been included in our assessment.

3.3 Enhancement expenditure

Table 3.4 summarises our allowances for enhancement expenditure.

Our draft determination allows SES Water £24 million to invest in improvements to service, resilience and the environment. Key parts of this allowance are:

- £19.5 million for installing more than 80,000 meters;
- £2.6 million on reducing demand for water; and
- £1.7 million on replacing lead pipes.

The most material areas of cost challenge for SES Water are in leakage and resilience.

For leakage our expectation for base service levels is that an efficient company should achieve industry forecast upper quartile performance by 2024-25 in both normalised measures (per property and per kilometre of main). This performance is funded through the base allowance. 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 Water, we do not allow the requested funding under enhancement and we reject the related cost adjustment claim. As a result of this the company costs adjustment claim for mains replacement is rejected in full. Companies are able to earn outperformance payments if they deliver leakage reductions beyond their stretching performance commitment levels.

Following our initial assessment of business plans we indicated that we would make allowances for SES Water's proposed investments in resilience enhancement. During the time intervening between our initial assessment and draft determinations we have considered the evidence presented by the company in more detail, particularly in the context of the company's water resources management plan, and we now make no allowance for resilience enhancement. We disallow the 'Bough Beech and pump station upgrades' and 'network enhancement' investments which mitigate the risk of failing to supply customers in the case of severe drought and critical asset failure, respectively. The company provides insufficient evidence to justify the need to invest in enhanced resilience for customers. To demonstrate the need for the investment in drought resilience, we expect SES Water to demonstrate that supply side solutions are needed in addition to the demand side solution within its water resources management plan. To demonstrate the need for investment in critical asset failure, we expect the company to demonstrate specific and plausible failure modes that are low probability, not within management control or funded through other areas of enhancement, for example the security and emergency measures directive. We invite SES Water to consider our assessment and present further evidence in response to draft determinations.

'SES - Cost efficiency draft determination appendix' sets out in more detail the cost allowances by investment area for each price control, and we give full details in our published models.

Table 3.4: Enhancement totex expenditure, 2020-25 (£ million, 2017-18 CPIH deflated prices)

Service	Company requested totex	Scope and efficiency adjustment	Our allowance
Water Resources	0.9	-0.4	0.5
Water Network plus	52.2	-29.0	23.2
Total	53.1	-29.4	23.7

3.4 Cost sharing

When a company overruns its totex allowance, the additional cost incurred above our allowance will be shared between its investors and customers. When a company spends less than its totex allowance, it will share the benefits with customers.

For the draft determinations we calculate each company's cost sharing rates based on the ratio of the company's view of costs in its September 2018 business plan

relative to our view of efficient costs. For the final determinations we propose to calculate the company's view of costs based on a 50% weight on the company's final cost proposals in its representation to the draft determination and 50% weight on the September 2018 business plan. We explain our approach to calculating cost sharing rates in the 'Securing cost efficiency technical appendix'.

Table 3.5: Totex cost sharing for cost performance for 2020-25, %

	Water resources	Network plus - water
Cost sharing rate – outperformance	35.0%	35.0%
Cost sharing rate – underperformance	65.0%	65.0%

Table 3.6 sets out the costs that are subject to cost sharing. We apply cost sharing to net totex. Net totex excludes grants and contributions, costs of operating leases, strategic regional water resources development costs, third party costs and pension deficit recovery cost.

We adjust allowed costs to reflect a change in the accounting treatment of leases, which causes some assets formerly recognised as operating leases to be recognised on the company's balance sheet. In doing so, we have followed the approach set out in IN 18/09 Guidance for reporting operating leases in PR19 business plans. SES Water did not propose any adjustment.

Table 3.6: Totex subject to cost sharing rates – 2020-25, £ million[1]

	Water resources	Network plus – water	Company view
Gross totex (excluding third party costs)	22.9	191.8	267.4
Grants and contributions	0.0	-8.7	-22.7
Operating leases adjustment	0.0	0.0	0.0
Net totex (subject to cost sharing)	**22.9**	**183.1**	**244.7**
Strategic regional water resource solutions[2]	0.0	0.0	0.0
Third party costs	0.0	10.1	10.1
Ex-ante cost sharing adjustment	**0.0**	**0.0**	**0.0**
Net totex (for financial model)	**22.9**	**193.2**	**254.8**

[1] Table 3.6 does not include pension deficit repair expenditure, as this is not included in cost sharing.
[2] The standard totex cost sharing does not apply to strategic regional water resource solution expenditure, see 'Strategic regional water resources solution appendix' for more details.

3.5 Transition expenditure

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

3.6 Residential retail

We determine the residential retail control from the expenditure set out in Table 3.7 using an econometric modelling approach to set our allowance. The residential retail draft determination does not include any of our allowed pension deficit recovery costs. These costs have been wholly allocated to wholesale controls.

Table 3.7: Expenditure, residential retail, 2020-25 (£ million, nominal)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Residential retail	5.3	5.3	5.3	5.3	5.3	26.7
Company view	7.4	7.4	7.5	7.5	7.5	37.4

Note: The residential retail control is an average revenue control. Allowed cost and the associated allowed revenue is based on a forecast of the number of customers. There will make an end-of-period true up based on the actual number of connected households.

3.7 Direct procurement for customers

We set out in our PR19 methodology that we expected company business plans to consider direct procurement for customers where this is likely to deliver the greatest value for customers. Direct procurement for customers promotes innovation and resilience by allowing new participants to bring new ideas and approaches to the delivery of key projects. Companies were to consider direct procurement for customers for discrete, large-scale enhancement projects expected to cost over £100 million, based on whole-life totex.

There is sufficient evidence that there are no projects suitable for a direct procurement for customers' process within SES Water's proposed plan. We expect SES Water to consider direct procurement for customers for future schemes to ensure delivery is via the most efficient route to ensure that customers receive the best value for money.

4 Calculation of allowed revenue

This section sets out the calculation of allowed revenue for each of the price controls, based on our assessment of efficient costs. We set out in section 4.1 the components of allowed revenue for each of the price controls. We then set out information relevant to the calculation of the components of that allowed revenue in sections 4.2 and 4.4.

4.1 Allowed Revenue

We calculate revenue separately for each of the wholesale controls and for the residential retail control. We set out the calculation of five year revenues for each of these controls in this section.

Wholesale controls

For the wholesale controls (that is water resources and water network plus), allowed revenue is calculated based on the following elements, not all elements are applicable to all wholesale controls as set out in Table 4.1.

- Pay as you go (PAYG) – this reflects the allocation of our efficient totex baseline to costs that are recovered from revenue in 2020-25. The proportion of totex not recovered from PAYG is added to the regulatory capital value (RCV) which is recovered over a longer period of time.
- Allowed return on capital – this is calculated based on our assessment of the cost of capital multiplied by the average RCV for each year.
- RCV run-off – this reflects the amount of RCV that is amortised from the RCV in the period of the price control.
- PR14 reconciliations – this reflects the application of out/underperformance payments from PR14 through revenue adjustments in 2020-25.
- Corporation tax allowance – this is estimated from projected corporation tax rates, profit forecasts and assumed levels of tax relief contained in our financial model for the draft determination.
- Grants and contributions – this represents revenue that we expect to be received from developers and other customers in respect of work undertaken by companies to service new developments. It will include income from connection charges and infrastructure charges. This does not necessarily agree to the total grants and contributions deducted from totex, as only the income relating to the price control is included here.

- Non-price control income – income from charges excluded from the price controls. For example, this includes bulk supplies, standpipes, unmeasured cattle troughs, and other services. We deduct the forecast income from these charges from the allowed revenue, because costs relating to these charges are included in the calculation of allowed revenue.
- Revenue re-profiling – this reflects the change in revenue in 2017-18 prices as a result of adjustments made to annual revenues to smooth the final bill profile consistent with customer preferences. The financial model calculates revenue adjustments on a net present value (NPV) neutral basis.

We set out the calculation of the allowed revenue for SES Water's wholesale controls in Table 4.1. We summarise the total of the build-up of allowed revenue as five year totals, however our financial model calculates the allowed revenue on an annual basis for the purposes of our draft determination. We state the allowed revenue for each price control on an annual basis in section 6.

We explain how we calculate PAYG, RCV run-off and the allowed return on cost of capital in section 4.2, the revenue adjustments for PR14 reconciliations in section 4.3, and other elements of allowed revenue in section 4.4.

Table 4.1: Calculation of allowed revenue (£ million)

	Water resources	Water network plus	Total	Company view - total
Pay as you go	18.7	90.6	109.3	126.7
RCV run-off	4.8	91.4	96.1	97.8
Return on capital	1.7	33.3	35.0	41.7
Revenue adjustments for PR14 reconciliations	0.0	0.3	0.3	0.1
Tax	0.3	5.1	5.5	2.5
Grants and contributions (price control)	0.0	8.7	8.7	14.3
Deduct non-price control income	-0.2	-4.5	-4.8	-4.8
Revenue re-profiling	0.0	0.1	0.1	0.0
Final allowed revenues	25.3	225.1	250.4	278.5

We set out the calculation of allowed revenue for each wholesale control on an annual basis in the 'SES Water - Allowed revenue appendix' in Tables 1.1 to Table 1.2

Residential retail control

For the residential retail control, allowed revenue is calculated as retail cost to serve plus net margin on wholesale and retail activities.

- Retail cost to serve – this reflects our efficient view of costs per customer for the retail business.
- Net margin on wholesale and retail activities – this is calculated based on the wholesale revenue applicable to residential retail customers, plus the retail cost to serve, with a net margin applied. Net margins are calculated excluding any adjustments to residential retail (see Table 4.2 below) – the full calculation is set out in our financial models.

- Our methodology set out an early view of the retail margin that applies for the retail price controls. This was used by SES Water in its business plan and is unchanged in our draft determination.

Allowed revenue for the residential retail control is set on a nominal basis and therefore we present the make-up of the allowed revenue in nominal prices in Table 4.2.

Table 4.2: Retail margins (nominal price base)

	2020-25	Company view 2020-25
Total wholesale revenue - nominal (£ million)	266.2	292.5
Proportion of wholesale revenue allocated to residential (%)	83.63%	83.63%
Residential retail costs (£ million)	26.7	37.4
Total retail costs (£ million)	249.3	282.0
Residential retail net margin (%)	1.00%	1.00%
Residential retail net margin (£ million)	2.5	1.9
Residential retail adjustments (£ million)	-2.7	-0.9
Residential retail revenue (£ million)	26.5	37.5

Note: retail revenue is the sum of the net margin, retail costs, and adjustments. Company view may not sum as this may include other adjustments.
Note: The proportion of wholesale revenue allocated to residential customers is provided by the company in the business plan tables. This is provided for each wholesale control separately, so although we have used the same proportions for each control as the company, our interventions on costs in each control mean that the combined proportion is slightly different.

We set out the calculation of residential retail revenue on an annual basis in the 'SES Water - Allowed revenue appendix' in Table 1.3.

4.2 Cost recovery now and in the long term for the wholesale controls

Our totex cost allowances are sufficient to meet an efficient company's operating and capital expenditure. Companies recover this expenditure either in period from current customers using PAYG or add it to the RCV and recover from future generations of

customers using the RCV run-off rates. Consistent with our methodology, we assess how each company's choice of PAYG and RCV run-off rates reflect the levels of proposed expenditure, bill profiles, affordability and customer views relevant to the short and the long term.

To determine the allowed revenue, the PAYG rate is applied to the totex allowance for each wholesale control for each year of the price control. The proportion of the totex allowance that is not recovered in PAYG is added to the RCV and recovered from customers in future periods.

In this section we set out our approach to calculating the PAYG rates, the RCV to which the cost of capital is applied and the RCV run-off rates.

PAYG

We calculate total PAYG totex for each year of each wholesale price control based on the totex allowance for each year multiplied by the relevant PAYG rate for that year. To this we add allowed pension deficit recovery costs to derive total PAYG revenue.

We summarise in Table 4.3 the average PAYG rates across 2020-25 for each wholesale control, and the calculation of total PAYG revenue. The PAYG rates shown in the table are a weighted average across the five years 2020-25, the annual PAYG revenue and PAYG rates for each wholesale control are shown in the 'SES Water - Allowed revenue appendix', Tables 2.1 to 2.2.

To PAYG totex we add the allowed costs for pension deficit recovery set out in Table 3.2 to derive total amount to be recovered in 2020-25 for each price control.

Table 4.3: PAYG allowances for each wholesale control (5 year)

	Water resources	Water network plus	Total	Company view - Total
Totex allowance (£ million)	22.9	193.2	216.1	254.2
Draft determination PAYG rate (%)	81.5%	46.9%	50.6%	
Pay as you go totex (£ million)	18.7	90.6	109.3	126.7
Pension deficit recovery cost (£ million)	-	-	-	-
Total pay as you go (£ million)	18.7	90.6	109.3	126.7
Company plan PAYG rate (%)	80.8%	46.7%		49.9%

SES Water's approach to PAYG rates is to recover in each year an amount equivalent to operating costs. We accept the approach taken by the company and are applying a technical intervention to amend the PAYG rates proposed in the business plan to reflect our view of the mix of operating and capital expenditure following our totex interventions compared with the business plan. We set out how we apply the technical intervention in 'Aligning risk and return technical appendix' and we have published our calculation of the PAYG rates for each company alongside our draft determinations.

Our view of efficient totex is lower than the company's plan and contains a lower proportion of capital expenditure than the company proposed. Therefore, using SES Water's approach to recovering costs, a higher proportion of totex is recovered in the period through PAYG and less is added to the RCV. We further intervene to increase PAYG rates by 0.5% to address a financeability constraint on the basis of the notional company structure. We discuss this further in section 5. Financeability and in the 'Aligning risk and return technical appendix'.

Opening RCV adjustments

As part of the business plan SES Water proposed allocations of the RCV for the Water Resources price control based on Ofwat guidance. We are allocating the company's RCV from the existing wholesale control to the water resources control in accordance with the proportions proposed by SES Water.

We make reconciliation adjustments ('midnight adjustments') related to the company's performance against incentive mechanisms from previous price reviews and for land sales in order to determine the opening RCV for the period of the PR19 controls. We also adjust the RCV upwards to reflect a change in the accounting treatment of leases, which causes some assets formerly recognised as operating leases to be recognised on the company's Balance sheet. In doing so, we have followed the approach set out in IN 18/09 Guidance for reporting operating leases in PR19 business plans. SES Water did not propose any adjustment.

Table 4.4: Opening RCV, 1 April 2020 (£ million)

	Water resources	Water network plus
RCV – 31 March 2020	260.0	
% of RCV allocated by control	5.23%	94.77%
RCV – 31 March 2020	13.6	246.4
Midnight adjustments to RCV	-0.5	-9.8
Midnight adjustments relating to operating leases	0.0	0.0
Opening RCV – 1 April 2020 (before fast-track reward)	13.1	236.6

Return on capital

Companies are allowed a return on the RCV, equal to the Weighted Average Cost of Capital (WACC).

Our PR19 methodology set out an 'early view' cost of capital for all wholesale controls. SES Water's revised business plan incorporates the early view cost of capital with a company specific uplift on its cost of debt of 25 basis points. Therefore the company's plan incorporates a cost of capital for the wholesale price controls of 3.45% - CPIH deflated (2.45% - RPI deflated compared with our early view cost of capital 3.30% CPIH deflated and 2.30% RPI deflated).

As set out in the PR19 methodology, we apply a three-stage approach to assessing whether to approve the uplift. Detailed commentary on the assessment is set out in the 'Cost of capital technical appendix' that accompanies our draft determinations for slow track and significant scrutiny companies.

In summary, SES Water provides convincing evidence on the level for its proposed uplift as it was within our 25-40 bps plausible range. However, the company does not provide convincing evidence that there are benefits that adequately compensate customers for the additional cost of providing an uplift. In addition, the company does not provide convincing evidence for customer support for the uplift. The proposal passes only one of the stages of the three-stage approach for the cost of debt uplift, and therefore has not passed the assessment.

We have updated our view of the cost of capital for the wholesale price controls to 3.08% – CPIH deflated (2.08% – RPI deflated). We set out the basis for the updated view in the 'Cost of capital technical appendix'. We have used our updated cost of capital in this draft determination.

The PR19 methodology confirmed we will transition to CPIH as the primary inflation rate from 2020. At 1 April 2020, we will index 50% of RCV to RPI; the rest, including totex that is added to the RCV, will be indexed to CPIH. Table 4.5 and Table 4.6 set out the opening and closing balance for each component of RCV.

The PR19 methodology confirmed our protection of the value of the RCV as at 31 March 2020 across each of the wholesale price controls. Totex that is added to the RCV from 1 April 2020 is stated as 'post 2020 investment'.

In determining the 'return on capital' revenue building block, we apply the relevant deflated cost of capital to the average RCV for the year for each component (RPI inflated, CPIH inflated and post 2020 investment). This results in a return on capital for each wholesale control over the period 2015-20 as set out in Table 4.7.

Table 4.5: Opening RCV by wholesale control for each component of RCV, 1 April 2020 (£ million)

	Water resources	Water network plus	Total
RPI inflated RCV	6.5	118.3	124.8
CPIH inflated RCV	6.5	118.3	124.8
Other adjustments	-	-	-
Total RCV	13.1	236.6	249.6

Table 4.6: Closing RCV by wholesale control for each component of RCV, 31 March 2025 (£ million)

	Water resources	Water network plus	Total
RPI inflated RCV	4.8	86.5	91.2
CPIH inflated RCV	4.5	81.6	86.1
Post 2020 investment	3.5	84.5	88.0
Other adjustments	-	-	-
Total RCV	12.8	252.6	265.3

Table 4.7: Return on capital by wholesale control for each component of RCV, 2020-25 (£ million)

	Water resources	Water network plus	Total
RPI inflated RCV	0.6	10.6	11.2
CPIH inflated RCV	0.8	15.2	16.1
Post 2020 investment	0.3	7.4	7.7
Other adjustments	-	-	-
Total return on capital	1.7	33.3	35.0
Company view – total return on capital	2.0	39.7	41.7

Note: Total return on capital is calculated by multiplying the annual average RCV for each element of RCV (RPI inflated, CPIH inflated and post 2020 investment) by the wholesale WACC for each control. The return on capital for each year of the price control for each wholesale control are shown in the 'SES Water - Allowed revenue appendix' in Tables 3.1 to 3.8 and 4.1 to 4.2.

RCV run-off

RCV run-off is the proportion of the RCV which is recovered in the 2020-25 period. Companies are able to propose different run-off rates for RPI inflated and CPIH inflated RCV and also for the water resources control for post 1 April 2020 investment. Table 4.8 sets out the resultant RCV run-off revenue for each component of RCV for each wholesale control.

Table 4.8: RCV run-off on the RCV (5 year) (£ million)

	Water resources	Water network plus	Total
CPIH inflated RCV	2.0	36.7	38.7
RPI inflated RCV	2.0	36.7	38.7
Post 2020 investment	0.7	18.0	18.7
Total RCV run-off	4.8	91.4	96.1
Company view – total RCV run-off	4.8	93.1	97.8

Note: Total RCV run-off is calculated by multiplying the opening RCV by the relevant RCV run-off rate for each element of RCV (RPI inflated, CPIH inflated and post 2020 investment) by the RCV run-off rate for each control (50% of run-off is applied to post 2020 investment in the year of additions).

SES Water's approach to setting RCV run-off rates is to recover an amount equivalent to capital maintenance charges. Whilst this produces the highest run-off rates in the sector at 7.1%, this is consistent with the profile at PR14 and the company provides sufficient evidence in support of the rates. We accept SES Water's RCV run-off rates for the draft determination. However, the interventions to allowed totex changes the post-2020 investment added to RCV and therefore the total RCV run-off. Table 4.9 sets out the average RCV run-off rates across 2020-25 for each wholesale control proposed in the company's business plan and for our draft determination.

Table 4.9: RCV run-off rates for each wholesale control (5 year)

	Water resources	Water network plus
Original company plan (%)	7.07%	7.08%
Draft determination (%)	7.07%	7.08%

Note: RCV run-off (%) reflects the average of the rates applied to the CPIH and RPI inflated RCV components across the 5 years 2020-25.

The annual rates for each wholesale control are set out in the 'SES Water - Allowed revenue appendix' in Table 5.1 to Table 5.2.

4.3 PR14 reconciliations

In PR14, we set mechanisms to incentivise companies to do the right thing for their customers. These financial incentives cover cost efficiency, outcomes performance, revenue forecasting (wholesale and retail), customer service (the service incentive mechanism), water trading and land sales. It is important to reconcile the financial impacts of these mechanisms in PR19 to ensure that customers only pay for the service the company delivers.

We are also applying adjustments to reflect performance in the final year of the 2010 to 2015 period, which could not be fully taken into account in PR14. These adjustments apply to the RCV (the 'midnight adjustment') and revenue for the 2020-25 period. These adjustments are made in line with the 'PR14 reconciliation rulebook'.

We are publishing models for each of these reconciliations, and for the overall RCV and revenue adjustments on our website. 'SES Water - Accounting for past delivery actions and interventions' provides a detailed explanation of all policy interventions we are making in the models. Table 4.10 summarises our interventions. Table 4.11 sets out the resulting adjustments to revenue and the RCV. The 'SES Water - Accounting for past delivery appendix' sets out how these adjustments are allocated across controls and how the RCV adjustment feeds into the midnight adjustments to RCV set out in Table 4.4.

We are publishing the results of the reconciliation of the service incentive mechanism for all companies alongside the draft determinations for slow track and significant scrutiny companies in the 'Accounting for past delivery technical appendix.'

For outcome delivery incentives, the information we have used to reflect performance in 2019-20 is based on the company's latest expectations. Final figures for 2019-20 will not be able to be taken into account in PR19. We set out in the 'PR14 reconciliation rulebook' that we planned to complete the reconciliation for 2019-20 outcome delivery incentives at PR24 for 2025-30 so that we use final information.

However, most outcome delivery incentives for the 2020-25 period are in period and will have been reconciled before this date. In light of this we consider it would be more appropriate to complete this reconciliation in the autumn of 2020 and apply any change to bills for 2021-22 as part of the new in-period process. We will designate all of the financial PR14 performance commitments as being in-period for this purpose. Any adjustment between the 2019-20 forecast and actual figures should be modest and we would not expect a significant impact on bills. If, contrary to expectations the bill impact were to be more significant, we would expect companies to take measures to smooth the impact for their customers. The new PR19 mechanism to

share benefits with customers from unexpected high outcome delivery incentive payments in a year will not apply to PR14 outcome delivery incentives. Instead the PR14 protection that caps the impact across the five years 2015-20 will apply.

The above applies equally to the company's 2015-20 in period outcome delivery incentives and we have used forecast information for 2018-19 and 2019-20 to reconcile these outcome delivery incentives. For the avoidance of doubt, no application is required in 2019 for in period determinations.

Table 4.10: Reconciliation of PR14 incentives, interventions (2017-18 prices, unless otherwise stated)

Incentive	Intervention(s)
Outcome delivery incentives	No interventions required.
Residential retail revenue	We are intervening to round the company's modification factor figures to 2 decimal places to ensure consistency with the 'PR14 reconciliation rulebook'. We are including a figure of 3.74% for the 'Materiality threshold for financing adjustment - Discount Rate' in line with the 'PR14 reconciliation rulebook'. Overall, our minor interventions reduce the total residential retail revenue payment at the end of the 2015-20 period from £0.130 million to £0.129 million.
Wholesale revenue forecasting incentive mechanism	No interventions required.
Totex	No interventions required.
Land sales	No interventions required.
Service incentive mechanism	We are intervening to set SES Water's service incentive mechanism adjustment to - 7.94% of household retail revenue to reflect its performance from 2015-16 to 2018-19. This equates to - £2.471 million in total revenue over the period. This decreases revenue relative to the company's estimate of the mechanism's impact.
PR09 blind year adjustments	No interventions required.

Table 4.11: Reconciliation of PR14 incentives, 2020-25 (£ million, 2017-18 prices)

Incentive	RCV adjustments		Revenue adjustments	
	Company view	Ofwat view	Company view	Ofwat view
Outcome delivery incentives	0.0	0.0	0.9	0.9
Residential retail revenue	N/A	N/A	0.1	0.1
Wholesale revenue forecasting incentive mechanism	N/A	N/A	0.0	0.0
Totex	-3.0	-3.0	-1.1	-1.1
Land sales	-0.9	-0.9	N/A	N/A
Service incentive mechanism	N/A	N/A	-0.9	-2.5
PR09 blind year adjustments	-6.4	-6.4	0.3	0.3
Water trading	N/A	N/A	0.0	0.0
Total	-10.3	-10.3	-0.6	-2.2
Total post profiling	N/A	N/A	-0.7	-2.3

Total post profiling is the total revenue over the period, taking account of the time value of money and the company's choices of how it wishes to apply revenue adjustments either in the first year or spread over a number of years.

These reconciliations are based on data from the 1 April company submissions. We will update these reconciliations to reflect the July data submissions for the final determinations.

4.4 Other allowed revenue

Other components of allowed revenue are:

- Corporation tax allowance – this is estimated from projected corporation tax rates, profit forecasts and assumed levels of tax relief contained in our financial model for the draft determination.
- Grants and contributions – this represents revenue that we expect to be received from developers in respect of work undertaken by companies to service new developments. It will include income from connection charges and infrastructure charges.

- Non-price control income – this forecast income is deducted from the total allowed revenues, as this revenue is not recovered from the charges covered by the price control – but is expected to cover some of the costs included in the calculation of the price control.

Table 4.12: Calculation of other allowed revenue (£ million)

	Water resources	Water network plus	Total	Company view - total
Tax	0.3	5.1	5.5	2.5
Grants and contributions (price control)	0.0	8.7	8.7	14.3
Deduct other income (non-price control)	-0.2	-4.5	-4.8	-4.8

Taxation

We calculate a tax allowance reflecting the corporation tax that the company expects to pay in 2020-25. We calculate the tax allowance using our financial model based on the projected taxable profits of the appointed business and the current UK corporation tax rates and associated reliefs and allowances.

SES Water provided information in data tables relevant to the calculation of the expected tax charge. The information has been updated as part of the resubmission of various data tables to take account of the recent changes to capital allowances. We have accepted the information provided by the company and applied this to the draft determination.

Our financial model calculates a higher level of taxable profits than the company view, so the resulting tax allowance is higher. The company's view is based on its actual interest costs, which are higher than our assumed cost of debt used for the draft determination.

Our interventions in other areas may impact on forecast levels of capital expenditure and in the area of new connections our assumed recovery rates may differ from what SES Water assumes in the business plan. The resulting impact on allowances used for the calculation of taxation has not been reflected. Where these changes result in significantly different inputs for capital allowances or tax deductions, we expect SES Water to identify this as part of its representations on the draft determination.

Table 4.13: Calculation of other allowed revenue (£ million) - Tax

	Water resources	Water network plus	Total	Company view - total
Tax	0.3	5.1	5.5	2.5

Grants and contributions (price control)

Companies receive grants and contributions from developers towards the costs of 'new developments', expenditure to reinforce the network, and 'new connections', expenditure to connect a property, for example the meter and connection pipe. We calculate the grants and contributions receivable by applying a recovery rate to our view of new developments and new connections expenditure. This ensures that developers pay a fair share towards costs to connect new properties. We use this calculation of grants and contributions receivable from developers to ensure that the amounts billed to water customers correctly reflect only that share of any new development spend which should be borne by them.

The recovery rates are calculated as follows:

- For water new developments we use the rate implied by the SES Water business plan which is 51.4%; and
- For water new connections we use a rate of 100%, based on historical practice in the industry. This is broadly supported by company business plans.

Table 4.14 shows our assumed amounts of grants and contributions. Our view of new developments and new connections expenditure is lower than SES Water's forecast. The reasons behind the differences in our view of 'Base expenditure' are set out above in the 'Cost allowances' section. This gives a lower view of grants and contributions than the company forecast.

For diversions activities, where companies move their assets to make way for new infrastructure, we use the company view of the associated income and assume that this represents 100% of the costs. In modelling our draft determinations we assume that all diversions income is inside the price control. For the final determinations we consider that we should make a distinction between diversions that are inside or outside the scope of section 185 of the Water Industry Act 1991. Works that are outside the scope of section 185 are, for example, works under the New Roads and Street Works Act 1991 or those associated with High Speed 2. We are yet to have sufficient data to be able to distinguish section 185 diversions from non-section 185 diversions. For the final determination we will assume diversions expenditure is inside the price control unless it relates to non-section 185 diversions. Where

companies forecast diversions works outside of section 185 then they should provide details of the income relating to this, on an annual basis, in the data request that accompanies the draft determination. This should be returned with the representations to the draft determination.

Table 4.14: Calculation of other allowed revenue (£ million) – Grants and contributions

	Water resources	Water network plus	Total	Company view - total
Grants and contributions	0.0	8.7	8.7	14.3

Non-price control income

Non-price control income is income from the excluded charges defined in licence condition B. For example, it includes bulk supplies, standpipes, unmeasured cattle troughs, and other services. This is deducted from the total allowed revenues, as this revenue is not recovered from the charges covered by the price control – but is expected to cover some of the costs included in the calculation of the price control.

We have reviewed the company forecast of 'non-price control income' and use this in the draft determination.

Table 4.15: Calculation of other allowed revenue (£ million) – Non-price control income

	Water resources	Water network plus	Total	Company view - total
Non-price control income	-0.2	-4.5	-4.8	-4.8

Note: negative numbers represent a deduction from the allowed revenue.

Uncertainty mechanisms

The PR19 methodology makes limited provision for companies to propose bespoke uncertainty mechanisms. In response to our initial assessment of plans, SES Water withdrew proposed uncertainty mechanisms in respect of lead standards and business rates. It has not proposed any other uncertainty mechanisms in its revised business plan.

5 Assurance, returns and financeability

This section sets out the accountability the company's Board has demonstrated for delivering its plan, the accuracy and consistency of the information within the plan and company proposals for aligning the interests of company management and investors with its customers. We summarise SES Water's response to our actions on securing confidence and assurance, including SES Water's proposals in response to our 'Putting the sector in balance' position statement. We comment on the possible range of returns for the notional financial structure. We comment also on the financeability of the draft determination and any adjustments that we have made to the bill profile.

5.1 Assurance

The PR19 methodology set out that stakeholders should have confidence in the information presented in business plans. We set expectations that:

- the data and information presented in the plan must be subject to good assurance processes to ensure it is consistent and accurate; and
- a company's full Board should own, be accountable for and provide assurance of the business plan.

In the initial assessment of plans, we identified four actions in relation to SES Water's data tables and financial model. SES Water has satisfactorily responded to three of these actions as set out in its response to our actions on securing confidence and assurance. For the remaining required action, we are requiring the company to provide further evidence to explain the assurance process it has taken to develop its tax forecasts.

If the company does not provide sufficient evidence in advance of the final determination, we will consider whether it is appropriate to make an adjustment to the tax allowance in the final determination.

We also had concerns with six of SES Water's forward-looking Board assurance statements and included actions for the Board to provide restated assurance statements covering the areas of large investments, risk identification, risk mitigation, financeability, its governance and assurance processes for delivering resilience and monitoring delivery of its outcomes.

SES Water has since provided compliant Board assurance statements on all of these topics.

5.2 Putting the sector in balance

In July 2018 we published our 'Putting the sector in balance: position statement'. The position statement set out the steps we expect companies to take to demonstrate they strike the right balance between the interests of customers and their investors. In summary, we expect that:

- company dividend policies for their actual financial structures and performance related executive pay policies show appropriate alignment between returns to owners and executives and what is delivered for customers[2];
- companies with high levels of gearing will share financing gains from high gearing with customers; and
- companies provide assurance and supporting evidence to demonstrate their long-term financial resilience and management of financial risks for the actual financial structure.

We also encouraged companies to adopt voluntary sharing mechanisms, particularly where, for example, companies outperform our cost of debt assumptions.

Our assessment of SES Water's proposals is in Table 5.1.

Table 5.1: Our assessment of SES Water's proposals to balance the interests of customers

Issue	Our assessment
Gearing outperformance benefit sharing	The company has confirmed it has reduced its gearing level from c.77% at March 2018 to c.61% at March 2019 and is committed to maintaining gearing below 70% for 2020-25. SES Water accepts the default benefit sharing mechanism set out in our 'Putting the sector in balance' position statement and commits to share benefits if it triggers the mechanism.
Voluntary sharing mechanisms	SES Water has not proposed any voluntary sharing mechanism. The company commits to making contributions to a payment matching scheme - ClearStart – but it does not commit to making company contributions to a social tariff or hardship fund over 2020-25. SES Water states that shareholders will make good any funding gap caused by entrolment in social tariffs exceeding the company's target of 19,000 by 2025.
Dividend policy for 2020-25	SES Water confirms that it is committed to meet the expectations on dividend policy as set out in our 'Putting the sector in balance' position statement. In doing so its September business plan indicated a base dividend yield of 3.8% for 2020-25. It has confirmed that its dividend policy directly links to whether customer pledges and other obligations have been met before dividends are declared, considering actual performance against regulatory and other commitments. The company has committed to reporting on its dividend policy annually, and confirms that changes to the dividend policy over 2020-25 will be

[2] We explain more fully our expectations in the 'Aligning risk and return technical appendix' that accompanies this draft determination.

Issue	Our assessment
	clearly signalled to stakeholders using a range of channels, including Annual Performance Reports. We expect the company to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and other stakeholders, including performance in delivery against the final determination. We expect the company to be transparent in this area, to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our position statement. We expect the company to respond to these issues in its response to our draft determination.
Performance related executive pay policy for 2020-25	SES Water states that its Board fully agrees with Ofwat's expectations with regard to transparency about executive pay and in particular any performance related element that is linked to performance for customers as set out in our 'Putting the sector in balance' position statement. It states that there are a number of details to be finalised for its policy for 2020-25, but the company has indicated the following: • Metrics will be more closely aligned to delivery of service to customers and be more heavily weighted than currently. The measures will move away from generic financial performance, to more detailed customer pledges for example C-Mex, complaints, supply interruptions and other factors that it knows make a real difference to the improvement of its customer service. • The process for setting stretching targets will include consideration of both historical results, and where required, external benchmarking. In addition the remuneration committee will perform an annual review of the policy to ensure it remains appropriately stretching. Any out performance will only be payable if the company is earning a net reward for the delivery of the customer pledges in any one year. • The remuneration committee will have full powers to determine and recommend to the Board the final awards, including discretionary powers to vary or veto performance awards. • A commitment to publishing the executive pay policy for 2020-25 in its annual reports, together with performance results and associated pay awarded through the policy. • The policy will be finalised and published in advance of April 2020. We understand that there remain a number of details to be finalised, for example the exact structure and weightings of the measures and how the company will demonstrate a linkage to substantial service delivery for customers. The company's stated intentions on how it is proposing to design its policy, if applied, demonstrate the company's commitment to move in the direction of the expectations set out in 'Putting the sector in balance'. We expect SES Water to provide an update on this in response to its draft determination. We expect SES Water to demonstrate that its policy on performance related executive pay demonstrates a substantial link to stretching performance delivery for customers through 2020-25. We expect the company and its remuneration committee to ensure executives have stretching targets linked to performance delivery for customers and that any further updates to the policy for 2020-25 are transparently reported to stakeholders in its annual performance report.

Issue	Our assessment
Financial resilience of the company's actual financial structure	SES Water has confirmed that it has reduced its gearing level from about 77% at March 2018 to about 61% at March 2019, and is committed to maintaining gearing below 70% for 2020-25. SES Water considers that its revised plan is consistent with the financial ratios required for its target credit ratings of Baa1 with Moody's and BBB+ with Standard & Poor's. Following our initial assessment of plans we asked SES Water to explain the steps it is taking to maintain long-term financial resilience in the context of a company specific adjustment to the cost of capital not being guaranteed, and to set out the risk management and risk /mitigation approaches it has identified. The company's Board has confirmed that it will take the practical steps required to ensure that the company remains financially resilient in the context of the cost of capital determined for the company. It says that the company has: • obtained an undertaking of financial support from its two main shareholders; • strengthened its equity position by adjusting gearing; • reduced its net debt and high cost embedded debt and instigated an ongoing review of financing options; and • taken action on operational resilience to manage the risk of impacts on its business. SES Water's assessment does not take account of our interventions to the business plan, which includes, for example, our updated view of the cost of capital, our assessment of efficient costs, and our assessment of outcome delivery incentives. Each company is responsible for ensuring its capital and financial structure allows it to maintain financial resilience over the short and the long term and so we expect SES Water to take account of these issues in its commentary on its long-term financial resilience in response to our draft determination, taking account of the reasonably foreseeable range of plausible outcomes of the final determination including evidence of further downward pressure on the cost of capital in very recent market data as we discuss in the 'Cost of capital technical appendix'. We also note that the undertaking of financial support referenced by the company is in the form of a 'non-binding expression of intent'. We seek further assurance that this provides the necessary support the company may require to maintain its financial resilience in extreme downside scenarios. In its future reporting, we expect SES Water to apply suitably robust stress tests in its long-term viability statements in 2020-25.

5.3 Return on regulatory equity

The PR19 methodology sets out that we expect companies to demonstrate a clear understanding of risk to the delivery of their business plans and to explain and demonstrate how they manage and mitigate risk. We expect companies to use Return on Regulatory Equity (RoRE) analysis to assess the impact of upside and

downside risk on the basis of their notional capital structures based on a prescribed suite of scenarios using P10/P90 confidence limit values[3].

RoRE is calculated as the return on equity for the equity portion of the RCV based on our notional gearing assumption. A company's base RoRE is aligned with our allowed real post-tax cost of equity, but can differ between companies because the blended real cost of equity will vary according to the proportion of the RCV (and notional regulatory equity) that is indexed to RPI or CPIH[4]. The proportion of RCV (and notional regulatory equity) that is linked to RPI or CPIH will vary between companies according to factors that include the size of the investment programme, the proportion of totex that is capitalised and RCV run-off rates.

Table 5.2 sets out the annual average RoRE ranges in SES Water's updated PR19 business plan submission, and the values in our draft determination. The base RoRE in our draft determination reflects our updated cost of equity. The RoRE ranges reflect our interventions outlined below, and other interventions we are making as part of our draft determination.

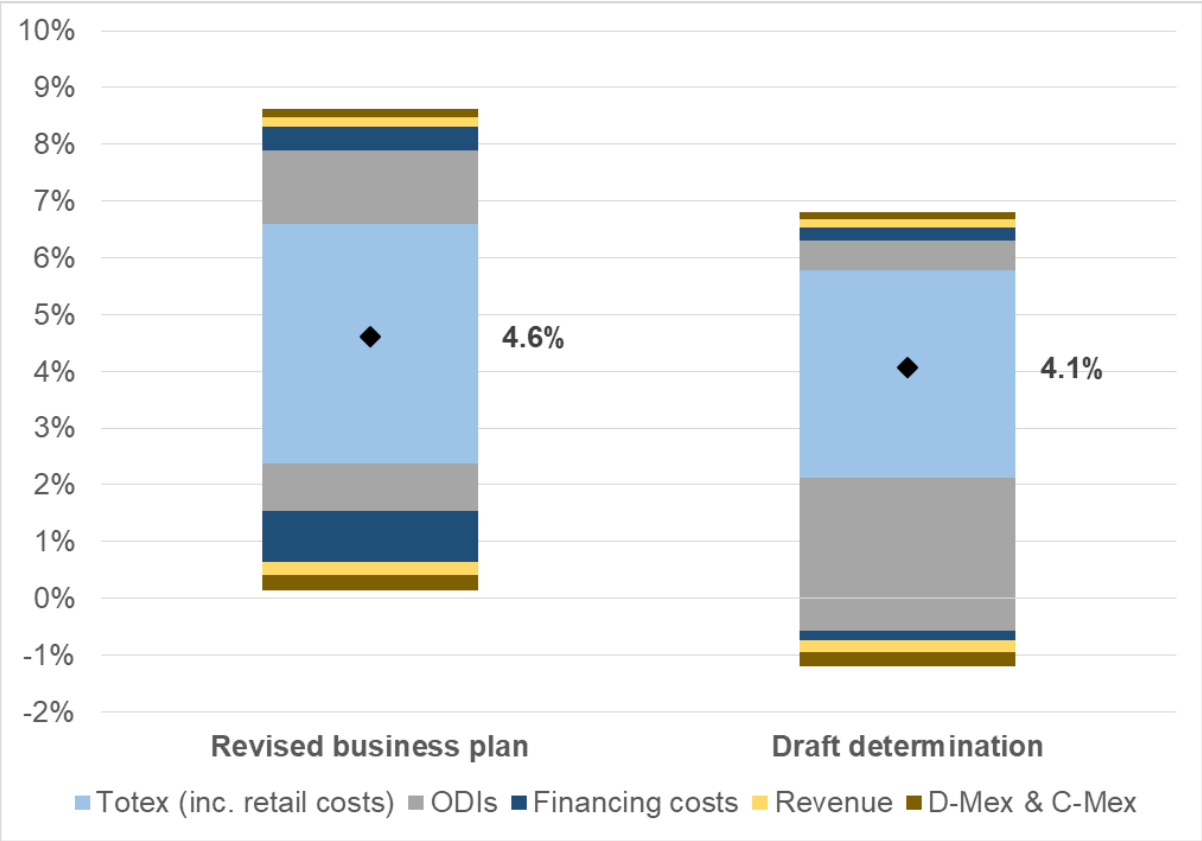
[3] P90 is the performance threshold at which there is only a 10% chance of outturn performance being better and P10 is the performance threshold at which there is only a 10% chance of outturn performance being worse.

[4] RPI is the retail price index; CPIH is the consumer price index including owner-occupiers' housing costs; both are published by the Office for National Statistics.

Table 5.2: SES Water RoRE ranges

	Updated Business plan (Apr 19)		Draft determination ranges reflecting our interventions	
Base RoRE	4.6%		4.1%	
Risk ranges	**Lower bound**	**Upper bound**	**Lower bound**	**Upper bound**
Totex	-1.80%	0.86%	-1.56%	1.34%
Outcome delivery incentives	-0.82%	1.29%	-2.70%	0.52%
Financing costs	-0.90%	0.43%	-0.16%	0.24%
Retail costs	-0.44%	0.44%	-0.38%	0.38%
D-Mex & C-Mex	-0.29%	0.14%	-0.25%	0.13%
Revenues (includes Retail)	-0.23%	0.15%	-0.20%	0.13%
Total	**-4.48%**	**3.31%**	**-5.25%**	**2.74%**

Figure 5.1: RoRE ranges



The draft determination risk ranges shown in Table 5.2 and Figure 5.1 reflect two interventions we are making for our draft determination with respect to values in SES Water's revised business plan:

- For the draft determination we are intervening to reduce SES Water's financing risk range associated with the cost of new debt to 75 bps on the upside and 50 bps on the downside. This intervention is consistent with the PR19 methodology and takes account of our decision not to allow SES Water's proposal for a company specific adjustment to its cost of capital for 2020 to 2025. It is also consistent with historical data on bond issuance costs in the sector compared to our benchmark index for the cost of new debt, and the company has not provided convincing evidence for a higher risk range. However, as set out in the 'Aligning risk and return technical appendix', we are considering the assessment of debt cost risk further for the final determination.

- We are intervening to align the RoRE risk ranges for outcome delivery incentives shown in Table 5.2, Figure 5.1, and in the PR19 financial model with the RoRE risk range values for outcome delivery incentives set out in section 2 (Outcomes). The revised values reflect our interventions on outcome

delivery incentives under the Outcomes Framework which seek to take account of covariance of performance on individual outcome delivery incentives in the presentation of the overall outcome delivery incentive range.

In all other areas we have retained SES Water's proposed RoRE range, which produces a negative skew overall, driven primarily by costs and outcome delivery incentives. Our view is that an efficient company should be able to achieve the base equity return on the notional structure. We expect SES Water to consider necessary revisions to its overall RoRE range in response to the draft determination.

5.4 Financeability

We interpret our financing duty as a duty to secure that an efficient company can finance the proper carrying out of its functions, in particular by securing reasonable returns on its capital. In coming to our determinations we assess whether allowed revenues, relative to efficient costs, are sufficient for a company to finance its investment on reasonable terms and to deliver activities in the long term, while protecting the interests of current and future customers.

Our PR19 methodology requires companies to provide Board assurance that the business plan is financeable on both the notional and their actual capital structures. Our methodology requires companies to provide evidence to support these statements, including evidence supporting the target credit rating and that this is supported by the financial ratios that underpin the plan. SES Water's Board has provided assurance that its business plan, on both the notional and actual capital structures, remains financeable in the long term, and that the plan protects customers' interests in the short and long term.

We consider that companies and their shareholders should bear the risk of their capital structure and financing choices, not customers. Therefore, we have focused on whether our draft determination is financeable based on the notional capital structure that underpins our cost of capital using our own financial model.

Our financeability assessment uses a suite of financial metrics based on those used in the financial markets and by the credit rating agencies. We base our assessment of financeability for the notional company structure using our updated view of the cost of capital excluding any proposed company specific adjustment. Our initial assessment of financeability, prior to intervening, is that financial ratios in the round do not provide sufficient headroom to a minimum investment grade credit rating. We are intervening to increase PAYG rates by on average 0.5%, advancing PAYG revenue from future customers by £1 million. Following our intervention, based on the financial ratios from the financial model alongside evidence in the business plan, we consider that SES Water's draft determination is financeable for the notional structure.

The results for key financial ratios are set out below. Following our intervention, key financial ratios for the notional company structure in our draft determination are broadly in line with the level of the ratios set out by SES Water in its business plan. We discuss this further in the 'Aligning risk and return technical appendix'.

Table 5.3: Financial ratios – notional structure before reconciliation adjustments (5 year average)

	Business plan	Draft determinations
Gearing	60.87%	62.16%
Interest cover	4.56	5.00
Adjusted cash interest cover ratio (ACICR)	1.46	1.46
Funds from operations (FFO)/Net debt	13.37%	13.29%
Dividend cover	2.23	2.35
Retained cash flow (RCF)/Net debt	11.13%	11.34%
Return on capital employed (RoCE)	5.76%	5.53%

The basis of the calculation of the ratios is set out in the PR19 methodology

Net debt represents borrowings less cash and excludes any pension deficit liabilities.

FFO is cash flow from operational activities and excludes movements in working capital.

Cash interest excludes the indexation of index-linked debt.

SES Water submitted financial ratios in the business plan tables for the notional company after taking account of reconciliation adjustments. We set out in the table the ratios excluding these adjustments consistent with our assessment of notional financeability. We have agreed the recalculation of the ratios with the company.

As set out in section 4 and above we have amended PAYG rates to reflect our view of efficient totex and the mix of operating and capital expenditure, and to advance revenue to address a financeability constraint on the basis of the notional company structure. We are not intervening to amend RCV run-off rates. The reduction in expenditure means that the RCV will now increase by a smaller amount than set out in the original business plan as shown in Table 5.4.

Table 5.4: PAYG rates, RCV run-off and RCV growth

	PAYG	RCV run-off	RCV growth
Company plan	49.9%	7.08%	13.81%
Draft determinations	50.6%	7.08%	6.29%

SES Water is responsible for the financeability of the company and the maintenance of long-term financial resilience under its actual structure. The company has confirmed it has reduced its gearing level from c.77% at March 2018 to c.60% in March 2019 and is committed to maintaining gearing around that level for 2020-25. We comment further on the financial resilience of the company's actual structure in Table 5.1.

We expect companies to provide further Board assurance that they will remain financeable on a notional and actual basis, and that they can maintain the financial resilience of their actual structure, taking account of the reasonably foreseeable range of plausible outcomes of their final determination including evidence of further downward pressure on the cost of capital in very recent market data as we discuss in the 'Cost of capital technical appendix'.

6 Affordability and bill profile

6.1 Bill profile

SES Water undertook bill acceptability testing to inform its September 2018 business plan submission. Acceptability for its bill is 59% and acceptability for the overall plan is 76%. The company undertook 847 interviews, this included online surveys and in-house interviews, sampling to get views from a representative cross-section of customers. However, SES Water does not test nominal bills, which is how customers will experience bill changes and therefore a significant limitation in demonstrating acceptability of the plan. In addition, the information on bills included in the company's testing did not make it clear where bills have been derived from, making it difficult to understand. The customer challenge group notes the following in relation to its acceptability testing 'The customer engagement and research employed by the company was appropriate and was conducted by specialist accredited market research providers; it was subject to CSP and third party review and followed good industry practice. SESW's engagement provided a genuine understanding of customer priorities, and presented an appropriate range of service options which were effectively tested for acceptability and affordability.'

Taking account of its acceptability results, the lack of testing for nominal bills or bill profiles and the complicated nature of the information given to customers, in the round we consider that SES Water provides insufficient evidence on the acceptability of its bills. We note our interventions to SES Water results in a significantly lower bill, with 15.3% reduction in draft determination and so we do not require further evidence of acceptability from SES Water.

SES Water does not test the acceptability of its bill profile for the 2020 to 2025 period with customers. They are asked to comment instead on the bill impact in 2025. The company does test two bill profiles with its customer challenge group: one that is flat in nominal terms, and the other rising throughout 2020-25. The customer challenge group indicates a preference for the rising profile as, in the company's words, 'customers expect bills to increase with inflation'. This is the profile the company applies over the period.

The average bill profile put forward by SES Water provides a bill that falls in the 2020 to 2025 period, with a total reduction of 4.9%. Our amended profile increases this to a reduction of 15.3%.The table below sets out the difference in bills between the company's submission and our amended draft determination figures. Our draft determination follows the same profile as the company plan, with a larger decrease in the 2020-21 and then flat in real terms.

Table 6.1: Bills in real terms

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Company plan	£190	£182	£182	£182	£182	£180
Bill profile – before re-profiling	£190	£163	£163	£161	£159	£157
Draft determinations	£190	£161	£161	£161	£161	£161

In its business plan, the company sets out its intention to reduce bills by 6% in the 2025-30 period. SES Water does not test bill profiles for the 2025 to 2030 period, despite our giving it an action to do so in January. The company claims that it does not need to test profiles as it is using the 'natural rate' for recovering costs. The customer challenge group supports the company's view that there was not enough time to undertake robust research. We consider there to be significant benefits in testing future bill profiles, both in terms of gaining customer views on any large shifts in expenditure and in planning appropriately and note that SES Water pledges to seek customer views on affordability and priorities in its ongoing engagement. We encourage the company to do this and to discuss the results with its customer challenge group.

Table 6.2: Long-term bills

	2020-25	2025-30
Company view of plan	£182	N/A[5]

6.2 Help for customers who are struggling to pay

Our draft determinations for SES Water will deliver a real terms reduction to the average bill between 2020 and 2025.

In addition, SES Water commits to:

- increase the capacity of its social tariff so that it can support 25,000 customers per year by 2024-25;

[5] This figure is not available as the company does not indicate through its financial model what its bill will be in 2025-30. Therefore, the indicative figures included in this section for the bill in this period are based on the company's business plan narrative.

- increase its social tariff cross subsidy to £6, as supported by customers and self-fund part of the extension to its social tariff;
- increase the percentage of customers in debt but making payments from 20% in 2020 to at least 35% by 2025; and
- Re-design and update the eligibility criteria for Clear Start, its payment matching scheme, to help more customers.

SES Water has three bespoke performance commitments on affordability and vulnerability, which will require it to:

- help 25,000 customers through its social tariff schemes;
- increase the awareness of its vulnerability support schemes; and
- maintain 80% customer approval for the notion that its vulnerability support schemes are useful.

Companies will be reporting their performance against the Priority Services Register (PSR) common performance commitment and their bespoke affordability and vulnerability performance commitments to us and their customers on an annual basis during the price control period. In addition, companies put forward in their business plans further measures for addressing affordability and vulnerability issues. We expect companies to report periodically to their customers on their progress in addressing affordability and vulnerability concerns. We will also be considering how we will scrutinise and report on companies' progress in this important area, including working with other stakeholders in the water sector and beyond.

6.3 Total revenue allowances and k factors

Table 6.3 summarises the allowed revenue for each control. This is expressed in a 2017-18 CPIH price base so that this can be compared with the rest of this document.

Table 6.3: Allowed revenue by year (£ million, 2017-18 prices)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Water resources	5.1	5.1	5.1	5.0	5.0	25.3
Water network plus	43.5	44.3	44.9	45.8	46.5	225.1
Residential retail	5.0	4.9	4.8	4.7	4.6	24.1
Total	53.7	54.3	54.9	55.5	56.1	274.5

The water resources and water network plus controls are in the form of a percentage limit (inflation plus or minus a number that we determine for each year of the control (the 'K' factor)) on the change in allowed revenue (R) from the previous charging year (t-1). This is based broadly on the formula:

$$R_t = R_{t-1} \times \left[1 + \frac{CPIH_t + K_t}{100}\right]$$

Table 6.4 sets out the K factors in each year for each of these two controls. For the first year, we have set a 'base' revenue which will be used as the starting revenue for calculating 2020-21 allowed revenues.

Table 6.4: Base Revenue and K factors by charging year (2017-18 prices)

	Base (£ million)	2020-21	2021-22	2022-23	2023-24	2024-25
Water resources	5.1	0.00%	-0.58%	0.27%	-2.66%	-0.78%
Water network plus	43.5	0.00%	1.80%	1.55%	1.99%	1.57%

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.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

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Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gov.uk.

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