

December 2019

PR19 final determinations

SES Water – Delivering outcomes for customers additional information appendix

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Water softening

1 Introduction

SES Water is the only company with a statutory obligation to soften water, due to the 1862 Caterham Spring Water Company Act and then the 1903 Sutton District Waterworks Act (amended in 1983). For the 2015-20 period, it has a performance commitment and associated outcome delivery incentive related to the delivery of a water softening programme, with a total maximum underperformance payment of £15 million. This performance commitment is not being continued into the 2020-25 period, as the programme has now been delivered. However, at final determination we include a new performance commitment in relation to the company's ongoing water softening requirements.

2 Our draft determinations

At draft determination we set a performance commitment level at 80 milligrams per litre of calcium (mg l/Ca), which is equivalent to the company's average historical performance. The company has agreed an equivalent water softening target with the local authority, London Borough of Sutton, and the Drinking Water Inspectorate (DWI). At draft determination we accepted (almost in its entirety) a £12 million cost adjustment claim to continue to provide softened water at this level for the 2020-25 period.

As a result of the cost allowance and agreed water softening targets, at draft determination we intervened to include an annual in-period performance commitment with financial (underperformance) incentives to protect customers from poor company performance in relation to water softening.

We set the annual performance commitment level as 260 (Unit: Number of weeks above the target). This is derived by multiplying 5 sites (where the 80 mg l/Ca target is applicable) by 52 weeks.

We set an underperformance rate at £21,150 for every week a single site produces an average weekly hardness of above 80mg l/Ca. This was intended to recover up to the amount of the cost allowance for extended failures (after the application of cost-sharing). The outcome delivery incentive has no additional collars or deadbands to limit the company's financial exposure.

Additionally, as part of the performance commitment, the company had an obligation to provide written confirmation from the local authority that it accepts the 80mg l/Ca hardness limit.

3 Stakeholder representations

In SES Water's 30 August 2019 draft determination response, the company accepts the introduction of a water softening performance commitment and an associated outcome delivery incentive. However, it proposes an alternative approach to that at draft determination which it considers reflects the nature of its softening activities and what it considers as the effective impact that failing the performance commitment level has on its customers.

It states that softening below (better than) the draft determination performance commitment level may result in additional costs to it and its customers which are not currently in the funding allowance and may also lead to increased carbon emissions. The company proposes that performance should be measured as a quarterly average, as opposed to definition which tracks how many weeks in a calendar year it misses its softening performance commitment level (defined as 'the number of times that water treatment works meet the weekly target to partially soften water'). The company provides a statistical analysis of historical data on variance in hardness of abstracted water and its softening performance to support its representation on quarterly averaging. The analysis is assured by an independent third party.

It sets performance commitment levels at zero in all years (Unit: mg/l above target per site per quarter).

The company proposes underperformance payments that are scaled according to the amount by which the performance commitment level has been missed and are normalised, per megalitre supplied, to reflect the number of customers served.

In its response to the draft determination, the Consumer Council for Water (CCWater) states that setting the water softening performance commitment level as a running average rather than an absolute figure would allow the company the flexibility to strike the right balance between delivering customers' priorities on both water hardness and water quality.

The local authority provides written confirmation that it accepts SES Water's proposal to maintain an average quarterly level of 80mg l/Ca at the Woodman Sterne plant (and any other treatment works governed by the Sutton District Waterworks Act

1903). It sets out a number of conditions on the company regarding annual compliance reporting.

4 Our assessment and reasons

We consider that the company has provided sufficient and convincing evidence for us to update the measurement units in the performance commitment definition and consequently the performance commitment levels.

However, the company does not sufficiently justify why a quarter of a year is a more appropriate period to measure the performance as opposed to a more frequent measurement interval. Its proposals result in significantly lower incentives to deliver and we also consider that reporting performance quarterly does not result in improved benefits for customers. Whilst we agree that a running average and scaled underperformance payments are more appropriate, we consider that a quarterly averaged reporting period is too long as customers could experience prolonged periods of low water softness within the quarter. We consider that it is not unduly onerous on the company to have stricter reporting obligations and that a fortnightly reporting period is appropriate. We also consider that the definition should specify that the timing of the company's water hardness tests should represent a uniform regime over time and that this should be verified by an appropriate third party.

The company's proposed incentive rates are weighted by the average throughput in a year of each of the five works. We consider that the company has provided sufficient and convincing evidence for a change. We have revised the performance commitment to reflect the extent to which the company misses the 80mg l/Ca limit and the throughput of the site where the failure occurs. We implement this in a way that takes account of the company's concerns, but retain a single set of performance commitment levels and ODI rates which we consider simpler for reporting and therefore more transparent to customers.

5 Our final decision

We maintain an annual in-period water softening performance commitment with financial underperformance incentives only in our final determination.

We revise the performance commitment definition to state that performance will be measured by the extent by which the water hardness limit of 80 mg l/Ca is exceeded

and scaled according the throughput of the site (as opposed to the number of sites and elapsed time of failure in the performance commitment at draft determination).

We set the performance commitment level to 0 in all years (unit: the average number of mg l/Ca by which the water treatment works fail to meet the average fortnightly target reported to zero decimal places).

We set the outcome delivery incentive underperformance rate to -£0.0282m per mg l/Ca by which water treatment works fail to meet the average fortnightly target reported. This is intended to provide a similar overall level of financial exposure for the company as with the draft determination incentive.

If the local authority which enforces the Sutton District Waterworks Act 1903 (as amended) notifies the company to adjust the target level of water softening that it requires the company to meet, the company must notify us of the adjusted target and we will consider whether this performance commitment should be changed.

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