

December 2019

# PR19 final determinations

**SES Water – Cost efficiency  
final determination appendix**

## **PR19 final determinations: SES Water – Cost efficiency final determination appendix**

## About this document

This document is a cost efficiency appendix to 'PR19 final determinations: SES Water final determination'. This document provides further details of the company specific issues related to cost allowances and is structured as follows:

- Section 1 provides a summary of our decisions on the company's cost adjustment claims;
- Section 2 provides a summary of our decisions on the company's enhancement proposals, by enhancement area;
- Section 3 provides our decision on costs proposed by the company under the transition programme;
- Section 4 provides our decision on unit cost adjustments related to the WINEP uncertainty mechanism.

Further information on our assessment and our approach can be found in the 'Securing cost efficiency technical appendix' and the various excel feeder models that we have published.

## 1. Cost adjustment claims

Table 1 summarises our consideration and allowances for the cost adjustment claims submitted by the company. For completion we include all claims that were part of our draft determination decisions, as well as additional or revised claims the company submitted in its representation to the draft determination. We give further details in our published cost adjustment claim feeder model for SES Water.

**Table 1: Cost adjustment claims and our allowed totex adjustments, 2020-25 (£ million of 2017-18)**

Description of Claim	Value of company claim	Our allowed adjustment	Rationale for decision
Water softening statutory requirements	11.5	11.5	SES Water has a unique statutory obligation to partially soften water. It claims for the additional costs to maintain and operate the treatment processes associated with softening. In its August 2019 representation the company accepts the allowance we made at draft determination. Therefore the allowance we make at final determination is unchanged from the draft determination. See 'SES Water final determination' for further information.
Mains replacement for leakage reduction	13.1	0.0	The company claims additional expenditure for mains replacement in order to deliver its leakage reduction proposal. We partially accept the claim because the company receives a leakage reduction enhancement allowance under our revised approach to leakage for final determination. We use the unit cost rate in the supply demand balance enhancement feeder model to determine a leakage reduction allowance, and therefore no allowance is made within the cost adjustment claim model. See 'SES Water final determination' for further information.
Wholesale electricity usage – water network plus	6.9	6.9	The company claims that it has a high average pumping head which leads to higher energy costs beyond that are not captured within our base econometric models. We consider the company provides sufficient and convincing evidence to demonstrate the need for adjustment and the company therefore receives the claim in full. See 'SES Water final determination' for further information.
Wholesale electricity usage – water resources	3.5	3.5	

## 2. Enhancement assessments

Our approach to assessing enhancement expenditure is detailed in our publication ‘Securing cost efficiency technical appendix’. We generally assess enhancement expenditure separately for each enhancement category, as defined by the individual enhancement cost lines in company business plan tables. We assess multiple lines together where there is a potential for costs to be apportioned differently by companies and where there is some synergy between programmes.

Our preferred method of assessment is benchmarking analysis. Where the investment area does not lend itself to statistical modelling we rely more on the evidence provided by companies in their business plans. We follow a risk-based process of having a lighter touch (‘shallow dive’) assessment for low materiality costs and a more thorough assessment of the evidence (‘deep dive’) of high materiality costs.

Table 2 summarises our consideration and allowances for the enhancement expenditure cost lines submitted by the company. We give further details in our published enhancement feeder models for SES Water.

**Table 2: Assessments of water enhancement expenditure, 2020-25 (£ million of 2017-18)**

Enhancement cost	Company view in August 2019 business plan (after reallocations)	Our final determination allowance	Rationale for decision
Meeting lead standards	1.7	1.7	We use a benchmark model to make allowances for these costs. SES Water’s costs for this enhancement expenditure are more efficient than our benchmarks and we allow the full amount requested.
Supply and demand side enhancements: Total	20.0	11.2	We partially allow enhancement costs for leakage reduction because the company’s performance levels are forecast to pass beyond the quartile threshold during the 2020-25 period, but we apply an efficiency challenge to the company’s unit cost based on our deep

			<p>dive assessment of the company's related cost adjustment claim for mains replacement. See 'SES Water final determination' for further information.</p> <p>We allow the remaining request within the 2020-25 supply-demand balance enhancement component in full because the unit cost is lower than the efficient industry benchmark.</p>
Metering (excluding new connections) for meters requested by optants, customers and businesses	21.1	19.1	As at draft determination we make an allowance for metering based on our unit cost model. At final determination we apply the frontier shift to the model output which results in a minor reduction in the allowance.
Resilience	8.9	6.4	We use our deep dive approach and challenge the need, cost efficiency and optioneering of the proposed investments. See 'SES Water final determination' for further information.
Total clean water WINEP	1.0	1.0	We use our shallow dive approach to set allowances, applying the company shallow dive efficiency factor only, for invasive non-native species and drinking water protected areas programmes. The company shallow dive efficiency factor is zero for SES Water and therefore we allow the requested cost in full.
Aggregated free form lines	0.4	0.4	SES Water requests £0.4 million for expenditure related to WINEP catchment management activities. We correct our assessment for final determination and apply a shallow dive efficiency challenge which, because SES Water's shallow dive efficiency factor is zero, results in the full requested expenditure being allowed.
<b>Total water enhancement</b>	<b>53.1</b>	<b>39.8</b>	

### **3. Transition expenditure**

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

## 4. WINEP uncertainty mechanism

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

SES Water has a single scheme in WINEP that is classified as ‘amber’: restoration of the Upper Darent waterbody. In its response to our query SES-IAP-CE-003 the company confirmed that it does not include any expenditure for this scheme in its business plan in the belief that investigation work yet to be completed will show that there will be no need to carry out any enhancement work. Furthermore, SES Water states that should this assumption prove incorrect, it will carry out the work required sourcing the expenditure from shareholders without recourse to customers. Accordingly, we set no cost adjustment rate for this single scheme, as shown in Table 3 below.

**Table 3: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP schemes excluded from our final determination (£ million in 2017-18 prices)**

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

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500  
Fax: 0121 644 7533  
Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)  
Email: [mailbox@ofwat.gov.uk](mailto:mailbox@ofwat.gov.uk)

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