

December 2019

PR19 final determinations

South East Water – Aligning risk and return final decisions

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PR19 final determinations: South East Water – Aligning risk and return final decisions

In our [draft determinations](#) we published the ‘Aligning risk and return actions and interventions’, the ‘Securing long-term resilience actions and interventions’ and the ‘Securing confidence and assurance actions and interventions’ document for each company. This set out the required and advised actions in our initial assessment of plans, a summary of the company’s response to the action, our assessment of the company’s response, and any further interventions we made as part of the draft determination.

This document sets out the decisions we are making for the final determination in response to representations received from companies on our draft determinations and changes for the final determination that are not resulting from representations received. We set out our response to thematic representations and representations from other stakeholders within the ‘Aligning risk and return technical appendix’ and the ‘Allowed return on capital technical appendix’. Our ‘Allowed revenue appendix’ for the company is published alongside this document. These documents are intended to be fully consistent. In the event of any inconsistency, the other documents listed above take precedence over this document.

Table 1 below sets out the action/intervention reference, our assessment and rationale for the draft determination, a summary of the company representation, our assessment and rationale for the final determination and our decisions for the final determination.

Table 2 sets out any further decisions that are not resulting from an action and/or representation which we are making as part of the final determination.

Each action has a unique reference. The prefix ‘SEW’ denotes the company South East Water. The central acronym references the test area where the action has been identified, please see the ‘Glossary’ for a key to these acronyms. Actions whose numbers are preceded with an ‘A’ denote required actions and actions whose numbers are preceded with a ‘B’ denote advised actions. Draft determination interventions not resulting from an initial assessment of plans action are preceded with a ‘C’ and new interventions for the final determination not related to a previous action are preceded with a ‘D.’ For all other documents related to the South East Water draft determination, please see the [final determinations webpage](#).

Table 1: South East Water – Representations in response to the draft determination

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
Risk and return	SEW.RR.A1	The company should amend its overall assessment of RoRE outcomes, or provide convincing evidence to explain why it is reasonable to assume totex outcomes should be asymmetrically skewed to the downside within an incentive based regime.	The company should amend its overall assessment of RoRE outcomes, or provide convincing evidence to explain why it is reasonable to assume totex outcomes should be asymmetrically skewed to the downside within an incentive based regime. The company should consider further its assessment of its totex range in response to the draft determination in the context of its reported past performance.	Representation made. In its representation on the draft determination, South East Water points out that its totex out performance in the last two years of 2015-20 is significantly lower than in the first three years referred to by Ofwat, meaning that outperformance for the five years lies within the upside risk range it proposes for PR19.	Change for the final determination.	See SEW.RR.D4 In the ‘Aligning risk and return technical appendix’ we explain that when reviewing past performance we do not observe any clear evidence of skewed returns at a sector level. We note that extreme weather events (e.g. the ‘Beast from the East’ of 2018) have occurred in the periods assessed in this dataset as well as other non-standard events such

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				The company draws attention to asymmetric downside risk factors for totex performance including asset health and weather related incidents. This view is reflected in its downside Totex scenario analysis.		as a cryptosporidium incident in 2017. We consider that companies must be held accountable for their actions in respect of matters over which they have significant management control. This includes matters such as asset health developments and compliance failures which we consider to be company specific issues which may not be relevant for a notionally structured, efficient company.
Risk and return	SEW.RR.A2	The company has targeted a credit rating for its actual corporate structure that is one notch above a minimum investment grade. The company should provide further evidence, with Board assurance, to support its view that this is reasonable for the financeability of the company given the proposed investment and the funding requirement of the company.	<p>Intervention required.</p> <p>South East Water has completed the action. In particular the company has provided evidence of its recent fund raising through a number of tranches at a reasonable cost of debt, as well as the protection provided by the covenanted debt structure, alongside the commitment to provide an equity injection to de-gear to 75 per cent.</p> <p>However, we consider that certain financial ratios provide limited headroom against the target credit rating which in turn provides just one notch headroom to a minimum investment grade rating as set out in 'Aligning risk and return technical appendix'.</p> <p>We are not intervening in respect of the financial ratios achieved under South East Water's actual financial structure in our draft determinations as it is South East Water that is responsible for ensuring it maintains financial resilience and the financeability of its activities over the long term.</p>	<p>Representation made.</p> <p>South East Water states it has reviewed its target credit rating for the actual structure and remains satisfied that Baa2/BBB (Moody's/S&P) is appropriate.</p> <p>In its revised plan, South East Water targets Baa1 (Moody's) for the notional capital structure.</p>	<p>No change for the final determination.</p> <p>We set out our assessment in response to SEW.LR.A5</p>	N/A

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
			Pursuant with action SEW.LR.A5 on financial resilience we expect the company to provide further assurance that the targeted gearing level and credit rating for its actual financial structure are consistent with maintaining financial resilience in the long term.			
Risk and return	SEW.RR.A3	There is an inconsistency between the business plan and the business plan tables; the company should clarify the target credit rating for the notional company.	No intervention required. South East Water has completed the action.	No representation made.	No change for the final determination.	N/A
Risk and return	SEW.RR.A4	The company should provide further evidence to support the calculation of RCV run-off rates and demonstrate that the rates are consistent with the approach set out in the business plan. The company should reconsider or reduce the scope of the PAYG adjustment in the context that: <ul style="list-style-type: none"> The adjustment should clearly address only a notional financeability constraint. <p>Evidence that underpins the cost of capital for the 2025-30 bill profile should be compelling, to ensure the company's conclusion that its' chosen bill profile reflects customers' preferences is robust. The company should consider revising the bill profile for 2020-30 if appropriate to maintain customer preferences for stable bills.</p>	No intervention required. South East Water has completed the action. The company has adjusted the increase to PAYG rates to be in line with the level required to address the assessed financeability constraint for the notional company. South East Water has provided sufficient evidence to support the level of the adjustment. We note that South East Water has reduced the weighted average cost of capital it has used to calculate bills for 2025-30. This is at the high end of the range set out in our early view cost of capital, and is above the upper end of the range in our updated view. However we accept the rationale for the pull forward of revenue in 2020-25 on the basis of the financeability assessment.	Representation made. South East Water states it would require an additional adjustment to the PAYG rates in the draft determination of 1.4% to achieve notional financeability.	Change from the draft determination. Following our assessment of financeability, we accept the company proposal to increase PAYG rates however we reduce the level of the adjustment. The increase in PAYG rates has a beneficial impact on the adjusted interest cover ratio.	Following our assessment of financeability we are advancing revenue through the use of PAYG rates to align the financial ratios targeted by the company on a notional basis. We increase PAYG rates by 2.12% to bring forward £18.8m and increase RCV run-off rates by 0.72% to bring forward £24.5m of allowed revenue from future periods. We discuss our adjustments to advance revenue through PAYG and RCV run-off rates further in the 'South East Water final determination'. We set out our approach to assessing notional financeability and for addressing financeability constraints for the notional company for final determinations in the 'Aligning risk and return technical appendix'.
Risk and return	SEW.RR.C1	South East Water's approach to setting PAYG rates is to recover operating expenditure and capitalised infrastructure renewal expenditure.	We are making a technical intervention to align PAYG rates to South East Water's stated approach of recovering operating expenditure	Representation made.	Change for the final determination.	A number of companies and stakeholders have made similar representations in relation to inconsistent treatment of

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		The application of efficient totex in our draft determination has resulted in a change to the mix of opex and capex in totex to the extent that PAYG rates are no longer aligned with South East Water's stated approach.	plus capitalised infrastructure renewal expenditure for each year for each wholesale control.	<p>The company provides representations to explain the calculation of the 'natural' PAYG rate as operating costs per the statutory accounts plus all IRE (including the portion of IRE capitalised).</p> <p>The company has reassessed the split of opex and capex that it required necessary to ensure critical operating expenditure is funded.</p>	In presenting the ratios for our final determinations we exclude the effect of differing accounting treatment of infrastructure renewal expenditure from the numerator of the adjusted interest cover ratio to improve comparability of the financial ratios between companies. We set out the revised calculation in table 5.2 of the company final determination document for those companies affected.	infrastructure renewals expenditure and comparability across the industry. We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.
Risk and return	SEW.RR.C2	We are intervening to adjust South East Water's risk range for the cost of new debt to 100 bps on the upside and 25 bps on the downside. This is consistent with historical data on bond issuance costs in the sector compared to our benchmark index for the cost of new debt.	We are intervening to adjust South East Water's risk range for the cost of new debt to 100 bps on the upside and 25 bps on the downside. This intervention is consistent with the PR19 methodology. 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. 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.	<p>Representation made.</p> <p>In its representation, South East Water provides further information on its analysis of RoRE risk ranges for financing cost risk. In particular, it says it has considered the risk of outturn inflation being different to our assumption on inflation (for calculating the real WACC), in relation to the cost of embedded fixed-coupon nominal debt. South East Water says that it retains its approach for risk relating to the cost of embedded nominal fixed-coupon debt pending confirmation by Ofwat of its approach for embedded debt cost risks.</p>	Change for the final determination.	See SEW.RR.D4.
Risk and return	SEW.RR.C3	We are intervening to align the RoRE risk ranges for outcome delivery incentives in our risk and return assessment with the ranges determined under our Outcomes framework. This approach seeks to take account of covariance in performance on individual outcome delivery incentives.	We are intervening to align the RoRE risk ranges for outcome delivery incentives in our risk and return assessment with the ranges determined under our Outcomes framework.	<p>Representation made.</p> <p>See SEW.RR.C4.</p>	Change for the final determination.	See SEW.RR.D4.
Risk and return	SEW.RR.C4	We expect companies to update their RoRE risk range analysis in response to the draft determinations.	We expect companies to update their overall RoRE risk range analysis in updated App26 submissions as part of their response to the draft determination. This should take	<p>Representation made.</p> <p>South East Water says that it has reviewed its App26 submission, having regard to the updated guidance, and</p>	Change for the final determination.	See SEW.RR.D4. Our approach to the risk ranges for a company with a notional structure are set out in the

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			<p>account of the guidance we have provided in the 'Aligning risk and return technical appendix' that accompanies our draft determination and 'Technical appendix 3: aligning risk and return' published with the IAP, and the context that achieved cost and outcomes performance has been positively skewed at a sector level in previous price review periods. Companies are strongly incentivised to achieve and outperform regulatory benchmarks. Therefore where companies consider there to be a potential downward skew in forecast risk ranges for returns, we expect companies to provide compelling evidence that this is expected to be in the context of expected performance delivery of the company, taking account of the company's reported level of actual performance delivered in 2015-19 and taking account of the steps it is already taking or plans to take to deliver against regulatory benchmarks and mitigate downside risk.</p>	<p>taking account of incentive effects and risk management requirements.</p> <p>South East Water considers there remains a material downward skew in its RoRE risk range primarily reflecting the terms of performance commitments and associated ODIs, as well as stretching cost allowance benchmarking. South East Water disagrees that performance commitments have been set at 'P50' levels and says that some have been set at upper quartile performance levels. The company expresses a view that it is not realistic to assume a notionally efficient company can perform relatively well on all outcomes, as well as being an upper-quartile company on costs. We present our assessment of the RoRE risk range provided by the company in its representation in the 'South East Water company specific appendix' which presents a downward skew to the overall risk range relating to totex risk and outcome delivery incentives.</p>		'Aligning risk and return technical appendix'. We comment on the overall level of stretch in our determinations in an annex to the 'Securing cost efficiency technical appendix'
Risk and return	N/A	N/A	N/A	<p>Representation made.</p> <p>The company provides representations that Ofwat's own analysis of financeability is flawed because it incorrectly excludes pension costs in the calculation of ratios and fails to assess ratios in line with rating agencies' approaches.</p> <p>The company sets out failure to ensure the DD meets the financeability test is inconsistent with Ofwat's overarching objective for PR19 to promote financial resilience and also inconsistent with Ofwat's statutory duty to ensure that</p>	<p>Change for the final determination.</p> <p>We consider the reparation of pension deficits over and above the allowance is a matter for companies and their shareholders. Our approach is to exclude these costs from our assessment of financeability to protect customers from the potential impact of this.</p> <p>For the final determination, we are not changing the principle of the adjustment however we note our approach for the draft determination also removed costs which are funded through allowed revenue. For the final</p>	A number of companies and stakeholders have made similar representations in relation to the inclusion of revenue from the pension deficit recovery charges. We set out our response to thematic representations in the 'Aligning risk and return technical appendix'.

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				water companies are able to finance the proper carrying out of their functions.	determination, we match the pension deficit recovery costs to the revenue allowance in our assessment of notional financeability.	
Securing confidence and assurance	SEW.CA.A1	<p>On dividend policy the company is required to confirm that it is committed to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance: position statement' to include:</p> <ul style="list-style-type: none"> clear Board commitment to publish detail on dividend policies in the APR. <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance: position statement.</p>	<p>No intervention but further action needed by South East Water.</p> <p>We expect South East Water to be transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers and to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our putting the sector in balance: position statement. We expect the company to respond to this issue in its response to our draft determination.</p> <p>We expect South East Water 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. In doing so, the company should refer to the examples of best practice we have identified among companies.</p>	<p>Representation made.</p> <p>The company provides some additional information in response to our action.</p> <p>The company confirms that when setting dividend payments, it will take into account its performance against pre-set stretching ODI targets and its performance outside of the ODI framework, including other commitments made to customers but provides insufficient detail on the specific obligations and commitments to customers that will be considered. The company confirms that the level of performance delivery considered will be determined with reference to the final determination.</p> <p>The company hasn't indicated that dividends may be both increased or lowered from the base depending on the actual performance of the company and provides insufficient detail on how performance delivery will impact on dividends paid.</p>	<p>Change for the final determination.</p> <p>We have updated our assessment of the reasonable base dividend for water companies in 2020-25 as set out in the 'Aligning risk and return technical appendix'.</p> <p>Under our current assessment the company falls short in a number of areas set out below. We expect South East Water to be transparent when explaining its dividend policy and reporting on dividends paid over 2020-25 and demonstrate how it has taken account of obligations and commitments to customers and other stakeholders, including;</p> <ul style="list-style-type: none"> the specific obligations and commitments considered under the policy, and how performance delivery has impacted on the dividends paid. 	We expect South East Water to be transparent when explaining its dividend policy and reporting on dividends paid over 2020-25, to demonstrate how it has delivered on the commitments in relation to its dividend policy and to ensure it meets the expectations we set out in 'Putting the sector in balance' as updated in 'Aligning risk and return technical appendix'.
Securing confidence and assurance	SEW.CA.A2	<p>On executive pay the company is required to confirm that it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance: position statement' to include:</p> <ul style="list-style-type: none"> providing full details and commitment to publish, including all performance metrics, the executive pay policy for 2020-25; visibility and evidence of substantial linkage of executive 	<p>No intervention but further action needed by South East Water.</p> <p>There remain a number of details to be finalised, for example the finalisation and approval of the policy including the details of the underlying metrics and associated weightings for both the annual and long term bonus schemes. Once finalised, we expect South East Water to provide an update in its response to the draft determination to demonstrate that it is committed to meet the expectations</p>	<p>Representation made.</p> <p>In its response the company has provided some additional information to that previously provided. It states that the design of its scheme covers the key corporate governance principles, such as board leadership, transparency, governance and licence obligations.</p> <p>Target metrics will be stretching and reference the final determination, and for each metric there will be a threshold</p>	<p>Change for the final determination.</p> <p>South East Water states that it is committed to meet the expectations set out in our 'Putting the sector in balance: position statement'. Based on our calculations, the overall percentage of alignment of incentives to customers is in line with the 60% we highlighted as evidence of good practice amongst the companies we regulate in our document, 'PR19 draft determinations: Aligning risk and</p>	We expect South East Water to be transparent when explaining and reporting the application of its performance related executive pay policy over 2020-25, to demonstrate how it exhibits a substantial alignment to the delivery of service for customers and meets the expectations we set out in 'Putting the sector in balance' as updated in 'Aligning

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		<p>remuneration to delivery to customers;</p> <ul style="list-style-type: none"> clear explanation of stretching targets and how they will be applied; clearer explanation of how the policy will be rigorously applied and monitored; and commitment to report how changes, including the underlying reasons, are signalled to customers. <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.</p>	<p>we have set out in 'Putting the sector in balance: position statement'.</p> <p>We expect the company and its remuneration committee to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers through 2020-25 and is underpinned by targets that are stretching. Trust and confidence can best be maintained where stretching performance is set by reference to the final determination and taking account of stretching regulatory benchmarks (for example delivery of upper quartile performance) and should include a commitment that it will continually assess performance targets to ensure targets will continue to be stretching throughout 2020-25.</p> <p>We expect the company to report transparently, in its annual performance report, about further updates to the development of its policy that will apply in 2020-25.</p>	<p>(minimum), base and stretch level of performance. Threshold, base and stretch will be set relative to:</p> <ul style="list-style-type: none"> AMP6 level of performance the final determination target, and the P10 and P90 levels of performance The threshold level will be defined to ensure that improvement from AMP6 performance is incentivised i.e. set at a level greater than the actual AMP6 performance <p>Reflecting best practice it states that at least 60% of the award in the scheme(s) will be linked to delivery for customers. The incentive scheme(s) will be finalised using some or all of the metrics from the following:</p> <ul style="list-style-type: none"> 'common' PC's as identified by Ofwat 'customer facing' commitments as identified by Ofwat metrics with financial rewards and penalties metrics that incentivise the management of the main ODI risks for AMP7 <p>The company states that it will finalise and approve the final incentive scheme(s) following the final determination.</p>	<p>return technical appendix'. However we consider that there is scope for the company to improve this position.</p>	<p>risk and return technical appendix'.</p>
Securing long-term resilience	SEW.LR.A5	<p>South East Water considers its targeted credit rating of Baa2/BBB is consistent with ongoing financial resilience. We note that this is one notch lower than the current credit rating. It is also one notch lower than the credit rating for the notional structure that the company has targeted and based its Board assurance statement for the notional company structure upon</p> <p>In its response to our draft determination South East Water</p>	N/A	<p>Representation made</p> <p>In its representation South East Water reiterates its view that a Baa2/BBB credit rating remains appropriate and financial resilience over time. The company refers to its recent successful debt refinancing exercise.</p> <p>The company says that it remains committed to de-levering and its shareholders plan to inject £54m in the</p>	<p>No change for the final determination</p> <p>We consider that our determinations are financeable for an efficient company with a notional capital structure. However, there is also a need for companies to ensure that they are financially resilient under their actual structures. We have not accepted all of the company's representations and the allowed return is lower in the final</p>	<p>We will closely monitor changes in levels of the company's gearing, credit ratings and other key financial metrics during 2020-25 to test that adequate steps are being taken by management and that financial resilience is being maintained.</p> <p>In its future reporting, we expect the company to explain clearly in its long term viability statement how the Board has identified and assessed the potential risks to its</p>

Test area	Actions/ intervention reference	Action	Our intervention for the draft determination	Summary of company representation	Our assessment and rationale for the final determination	Final interventions in the final determination
		<p>should provide further Board assurance about how its relatively high ongoing gearing level, and targeting of a Baa2/BBB credit (that is only one notch above the lowest investment grade rating and lower than the target credit rating the company says it targets on a notional basis) is consistent with long term financial resilience. In doing so it should take account of the issues referenced in action SEW.LR.C1.</p> <p>In its future reporting South East Water should undertake suitably robust stress tests to support its long term viability statements.</p>		<p>current year which will allow it to de-lever to 75.4% by the end of AMP7. The company sets out that it recently completed the re-financing of its maturing debt ahead of the start of the 2020 to 2025 period</p> <p>South East Water also says that its relatively simple covenanted debt structure provides protection to customers in the event of financial stress. The company also says that its covenant lock-up is set at 85% gearing and has provided sufficient mitigation for lenders to support its business. It also notes that it has substantial undrawn facilities which can be used to fund debt servicing to prevent a downgrade to its credit rating.</p> <p>South East Water has committed to assess its financial resilience beyond 2025 in its next long term viability statement.</p>	<p>determination reflecting market expectations on the cost of finance. Therefore, on account of South East Water's high level of gearing, the cost of capital in our final determinations that is lower than the draft determinations and limited headroom in its credit ratings, the company may need to take steps to improve its financial resilience in 2020-25.</p>	<p>financial resilience and the mitigating actions it is taking to address those risks.</p>
Securing long-term resilience	SEW.LR.C1	The Board assurance on actual and notional financeability and financial resilience in the revised business plan was provided on the basis of the assumptions made in the business plan, prior to any interventions we have made in the draft determination and our updated view of the cost of capital. There is evidence of further downward pressure on the cost of capital in very recent market data which will be considered for our final determination.	We expect companies to provide further Board assurance, in their responses to the draft determination, 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 'Allowed return on capital technical appendix'.	See SEW.LR.A5.	See SEW.LR.A5.	See SEW.LR.A5.

Table 2: South East Water – Changes to the draft determination that are not in response to an action or representation

Test area	Actions/ intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
Allowed return on capital	SEW.RR.D1	<p>We have revised our assessment of the allowed return drawing on market data up at 30 September 2019 and taking account of revisions to our approach following our assessment of representations.</p> <p>We have revised our assessment of the required retail margin deduction down from 0.11% to 0.04%, reflecting our view that the double-counted component of return in the household retail margin has reduced since PR14.</p> <p>We set out the basis for the allowed return on capital in our 'Allowed return on capital technical appendix'.</p>	<p>The sector allowed return on capital for the appointee price controls in our final determinations is 2.96% – CPIH deflated (1.96% – RPI deflated), 23 basis points lower than in the draft determination.</p> <p>The sector allowed return on capital for the wholesale price controls in our final determinations is 2.92% – CPIH deflated (1.92% – RPI deflated), 16 basis points lower than in the draft determination.</p>
Gearing outperformance sharing mechanism	SEW.RR.D2	<p>In our final determinations, we have amended our gearing outperformance sharing mechanism to contain a glidepath.</p> <p>We explain this in the final determination 'Aligning risk and return technical appendix'.</p>	<p>We have changed the trigger from a fixed trigger of 70% in the draft determination to a glide path which will start at 74% for the year 2020-21 and will reduce by 1% each year, ending at 70% for the year 2024-25 in the final determination.</p>
Financeability	SEW.RR.D3	<p>We consider that South East Water's final determination is financeable based on the allowed revenues which include a reasonable allowed return on capital. The final determination is sufficient to ensure it will be in a position to deliver its obligations and commitments to customers.</p>	<p>We discuss our assessment of financeability in the 'South East Water final determination' and the basis on which we consider South East Water's final determination to be financeable on the basis of the notional capital structure.</p>
Return on Regulatory Equity (RoRE) - Financial Risk Assessment	SEW.RR.D4	<p>We have revised our approach to assessing RoRE risk ranges for five of the risk areas set out in the PR19 methodology to take account of changes we have made in our final determinations to address concerns raised by companies on the overall level of stretch in our draft determinations, and evidence on past performance that we have observed in the sector.</p> <p>Our approaches are set out in the 'Aligning risk and return technical appendix' and the risk ranges for South East Water are set out in the 'South East Water final determination'.</p> <p>Taking account of changes in our final determination, the RoRE risk ranges at P10 and P90 confidence limits in our final determinations are, in most cases, more symmetrical than the risk ranges represented by companies. Our view of risk ranges also indicates more scope for outperforming companies to earn higher returns, but also for underperforming companies to receive lower returns.</p>	<p>The final determination risk range reflects the following interventions that we make for all companies:</p> <ul style="list-style-type: none"> • The totex range is our assessment of the plausible range based on evidence of the historic sector performance and taking account of the company's cost sharing rates that apply in its final determination. • The financing cost risk range is based on our assessment of the range for a notional water company including both embedded and new debt. • The ODI risk range has been determined under our Outcomes Framework. • The C-MeX risk range is calculated as 12% upside and 12% downside of residential retail revenue, reflecting the cap and collar limits for this incentive. • The D-Mex risk range is calculated as 6% upside and 12% downside of developer services revenue, reflecting the cap and collar limits for this incentive.

Test area	Actions/ intervention reference	Our assessment and rationale for the final determination decision	Decisions for the final determination
Financial Risk Assessment – Uncertainty Mechanisms	SEW.RR.D5	<p>We are including a PR24 reconciliation mechanism for business rates in our final determination for South East Water along with all other companies because:</p> <ul style="list-style-type: none"> • There is uncertainty about business rates costs because the Valuation Office Agency (VOA) will be carrying out revaluation exercises during 2020-25, and increases (or decreases) in cost levels could be material. • Companies can only exercise limited control over cost levels by engaging with the VOA and, possibly, by considering the business rate implications of asset development choices. <p>We are also including a PR24 reconciliation mechanism for Environment Agency abstraction licence costs in our final determination for South East Water along with all other companies serving England because:</p> <ul style="list-style-type: none"> • The Environment Agency expects to consult on changes to its basis for setting abstraction licence fees during 2020 meaning that there is material uncertainty about company cost levels in 2020-25. • Companies can only exercise limited control over cost levels by engaging with the consultation process and providing accurate information when required for licence fee setting purposes. 	<p>In each case, the cost variance to the company's PR19 cost allowance will be subject to a 75 (customer share):25 (company share) symmetrical sharing rate in the totex reconciliation at PR24. This means that the company will still be incentivised to manage costs efficiently, whilst receiving appropriate protection against material cost increases. Conversely, customers will receive a benefit if outturn costs are lower than the allowance levels we have set. Details will be set out in the PR19 Reconciliation Rulebook.</p>

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

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