

December 2019

PR19 final determinations

**Southern Water – Accounting for past
delivery final decisions**

PR19 final determinations: Southern Water - Accounting for past delivery final decisions

In our [draft determinations](#), we published the ‘Accounting for past delivery 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. It also set out any further interventions that were not resulting from an action, which we made as part of the draft determination.

This document sets out the decisions on accounting for past delivery we are making for the final determination. Our decisions and interventions set out here are relative to the company’s 15 July 2019 past delivery submission (the ‘15 July 2019 submission’). They also take into account the representations made on all our draft determinations, responses from companies to our queries and additional information provided following further engagement with companies and other stakeholders as part of the final determination process.

Table 1 below sets out all the initial assessment of plans actions, the model the action relates to, a summary of the company’s response to the initial assessment of plans action, our assessment of the company’s response, any further interventions we made as part of the draft determination, a summary of the company’s updated submission and / or representation on the draft determination, our assessment of the company’s updated submission and / or representation and our final interventions for the final determination. Table 1 also sets out any further interventions that are not resulting from an action which we are making as part of the final determination.

Our final determination and the final decisions set out in this document take account of Southern Water’s actual performance in 2018-19 and updated evidence for its forecast performance in 2019-20 (taking into consideration its actual performance in 2018-19) as submitted on 15 July 2019 or in updated information submitted as part of its 30 August 2019 representation.

Each action and further intervention that is not resulting from an action has a unique reference. The prefix ‘SRN’ denotes the company Southern 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 from the initial assessment of plans. Actions whose numbers are preceded with a ‘B’ denote advised actions from the initial assessment of plans. 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.’ Both draft and final interventions are followed by a three digit code for the model the intervention is relevant to and a two digit reference for the interventions in that model. Where a company submits updated information as part of its 30 August 2019 representation and we reflect this in our final determination, we identify this intervention in our final determination models with the reference SRN.PD.REP. The past delivery model codes are set out below.

Model	Code
ODIs	002
Land sales	003
WRFIM	005
Totex	006
Water trading	007
Residential retail	008
Residential retail SIM	009
RCV adjustments feeder model	010
Revenue adjustments feeder model	011
South West Water aggregation model	012
Thames Water / Southern Water revenue profiling model	013
Business retail SIM	014
Southern Water enforcement revenue adjustments	015

For all other documents related to the Southern Water’s final determination, please see the [final determinations webpage](#).

Table 1 – Accounting for past delivery final decisions for Southern Water

Model	Ref.	IAP action	Summary of company response to the IAP action	Our assessment and rationale for the draft determination	Summary of company updated submission and /or representation	Our assessment and rationale for the final determination decision	Decisions for the final determination
All models	SRN.PD.A5	PR14 reconciliations: Further to the actions we have set out to address our concerns over the evidence provided in its business plan for the individual reconciliations, we will require the company to refresh all of its PR14 reconciliations to replace its 2018-19 forecast performance with 2018-19 actual performance and update the evidence for its forecast 2019-20 performance taking into account of the actual 2018-19 performance.	No company action required for the draft determination.	No intervention required. We will review Southern Water's responses to its actions and further information provided for all the PR14 reconciliation models before making any further interventions for the final determination.	In its 15 July 2019 submission, Southern Water updates all of its PR14 reconciliations with actual performance for 2018-19 and provides evidence for its forecast performance in 2019-20.	Our final interventions take account of Southern Water's actual performance in 2018-19 and updated evidence for its forecast performance in 2019-20 (taking into consideration its actual performance in 2018-19) as submitted on 15 July 2019 and in its 30 August 2019 representation.	N/A
All models	SRN.PD.REP	In its 30 August 2019 representation, Southern Water does not submit any updated past delivery business plan tables or reconciliation models.					
Outcomes	SRN.PD.A1	PR14 Outcome delivery incentives: Southern Water is required to use the correct outcome delivery incentive rate for 'Interruptions to supply' and update table App27 accordingly.	Southern Water recalculates the 2017-18 underperformance payment for its 'Interruptions to supply' performance commitment using the correct incentive rate.	No intervention required. Table App27 (PR14 reconciliation - financial outcome delivery incentives summary) includes the corrected 2017-18 underperformance payment for the 'Interruptions to supply' performance commitment.	In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A

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Outcomes	SRN.PD.A2	<p>PR14 Outcome delivery incentives: Southern Water is required to update its forecast for 2019-20 performance to take account of the actual 2018-19 performance for all its performance commitments.</p> <p>We expect the company to pay particular focus where we found the evidence provided in its business plan for the 2018-20 forecasts to be insufficient which was for:</p>	No company action required for the draft determination.	<p>No intervention required.</p> <p>We will review Southern Water's updated data before making any interventions for the final determination.</p>	<p>In its 15 July 2019 submission, Southern Water provides evidence for its updated forecast performance for 2019-20 in light of its actual performance in 2018-19 for all of its performance commitments.</p> <p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to the specific actions SRN.PD.A2a to SRN.PD.A2n.</p>	<p>No intervention required.</p> <p>The draft determination intervention is no longer required because the company addresses the issue appropriately in its 15 July 2019 submission. However, we note the following:</p> <p>Performance commitment 1: Wastewater asset health (sewer collapses, WwTW PE compliance, external flooding - other causes)</p> <p>We are not including the £16.80 million penalty in the 2015-16 reporting year relating to wastewater treatment works population equivalent compliance in the ODI model. This is being reconciled in a separate model. Please see intervention SRN.PD.D011.01 below.</p>	N/A
Outcomes	SRN.PD.A2a	8: Per capita consumption (PCC) - five-year average target	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2b	4: Interruptions to supply	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2c	5: Odour complaints' (Portwood and Tonbridge treatment works	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2

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Outcomes	SRN.PD.A2d	5: Mean Zonal Compliance (MZC)	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2f	5a: Drinking water quality - discolouration contacts	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2g	3: Leakage (including customer supply-pipe leakage) - five-year average target	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2h	6: Wastewater treatment works numeric compliance	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2i	8: Bathing waters with 'excellent' water quality (part 1)	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2j	9: Bathing waters with 'excellent' water quality (part 2)	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2k	10: Bathing waters with 'excellent' water quality (part 3)	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2l	13: Thanet sewers	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2

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Outcomes	SRN.PD.A2m	14: Woolston STW	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Outcomes	SRN.PD.A2n	15: Millbrook sludge	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2	As SRN.PD.A2
Residential retail	SRN.PD.A3a	PR14 Residential retail: Southern Water is required to provide further evidence to explain its table R9 forecasts which depart from the trend in the first three years of the control period.	Southern Water provides evidence to support its forecasts by referring to details of its metering programme.	No intervention required. We consider the evidence to be sufficient to explain the forecast.	In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A
Residential retail	SRN.PD.A3b	PR14 Residential retail: Southern Water is required to provide further clarity on the reasons for the difference between reforecast customer numbers and actual customer numbers in 2018-2019.	Southern Water responds to our action by making the reforecast customer numbers equal to the forecast actual customer numbers.	Intervention required. We are intervening in Southern Water's reforecast customer numbers for 2018-19 to reinstate the values provided in September 2018. The reforecast customer numbers are based on the charges that the company set at the end of 2017. They cannot be changed after they are first provided in the July 2018 APR submission. The materiality threshold for financing adjustment is in part based on the company's accuracy in forecasting its customer numbers. Therefore, updating the reforecast customer numbers with more recent forecasts than the ones used for setting charges undermines the purpose of the materiality threshold.	In its 15 July 2019 submission, Southern Water includes reforecast customer numbers based on the charges the company set at the end of 2017. In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.	No intervention required. The draft determination intervention is no longer required because the company addresses the issue appropriately in its 15 July 2019 submission.	N/A

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Residential retail	SRN.PD.C008.01	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to round Southern Water's modification factor figures to two decimal places to ensure consistency with the 'PR14 reconciliation rulebook'.</p>	<p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention retained.</p>	<p>We are rounding to two decimal places, modification factor figures for 2015-16 to 2019-20 associated with the following lines in business plan table R9:</p> <ul style="list-style-type: none"> • unmetered water-only customer; • unmetered wastewater-only customer; • unmetered water and wastewater customer; • metered water-only customer; • metered wastewater-only customer; and • metered water and wastewater customer. <p>Our interventions increase the total residential retail revenue payment at the end of the 2015-20 period from £2.736 million to £2.737 million (2017-18 FYA CPIH deflated price base).</p>

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Residential retail	SRN.PD.C008.02	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to apply the appointee WACC as the discount rate to be used to provide a financing adjustment for the time value of money of the reward or penalty in line with the 'PR14 reconciliation rulebook'. This may be required if the materiality threshold for financing adjustment is exceeded.</p> <p>Our intervention ensures that there is no mismatch between the discount rate used and the revenue control to which it is applied.</p>	<p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	Intervention retained.	<p>For Southern Water we are including a figure of 3.74% for the 'Materiality threshold for financing adjustment - Discount Rate.' This replaces the figure of 3.6% contained in Southern Water's 15 July 2019 submission.</p> <p>Our interventions do not result in any changes to the total residential retail revenue payment at the end of the 2015-20 period because the materiality threshold is not exceeded.</p>
Residential retail service incentive mechanism (SIM)	SRN.PD.C009.01	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to adjust Southern Water's household retail revenue as a result of its SIM performance from 2015-16 to 2018-19.</p>	<p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention retained.</p> <p>We are updating our analysis to take account of companies' finalised scores for 2018-19.</p>	<p>We are intervening to set the residential retail service incentive mechanism adjustment to -10.79% of residential retail revenue, which is - £33.022 million (2017-18 FYA CPIH deflated price base) in total over the period. We further explain how we calculate this in the 'Accounting for past delivery technical appendix'.</p>
Totex	SRN.PD.A4a	PR14 Totex: Southern Water is required to amend the value it has reported for transitional expenditure to match actual spend in tables WS15/WWS15 and model.	Southern Water misunderstood the action and provides the forecast transitional expenditure figure rather than the outturn transitional expenditure figure.	<p>Intervention required</p> <p>Southern Water does not update the transitional expenditure in tables WS15/WWS15 to match actual spend.</p>	<p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	Intervention retained.	See SRN.PD.C006.01 and SRN.PD.C006.02 below.

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Totex	SRN.PD.A4b	PR14 Totex: Southern Water is required to ensure it has reported the correct values for third party costs in the tables and model.	Southern Water responds to the action and reports third party values consistent with those reported in the annual performance reports.	No intervention required. Southern Water provides a satisfactory response to this action.	In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A
Totex	SRN.PD.A4c	PR14 Totex: Southern Water is required to provide a detailed and numerically supported explanation to accompany its forecasted performance for years 2018-19 and 2019-20.	Southern Water responds to the action and provides evidence in its 'Technical Annex 8 - accounting for past delivery' document (P.15) to explain its forecast performance. For water this is mainly driven by increased investment in tackling leakage. For wastewater, the increased expenditure is mainly due to increased investment in asset maintenance which is partly driven by weather conditions and related asset failures.	No intervention required. Southern Water provides a satisfactory response to this action.	In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific action.	N/A	N/A

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Totex	SRN.PD.C006.01	N/A	N/A	<p>Intervention required.</p> <p>Southern Water populates 2014-15 with its forecast water transitional costs figure of £10.2 million rather than the actual figure of £1.498 million.</p>	<p>In its 15 July 2019 submission, Southern Water populates 2014-15 with its forecast water transitional costs figure rather than the actual reported outturn figure of £1.498 million.</p> <p>Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	Intervention retained.	<p>We are replacing Southern Water's water transitional costs figure in 2014-15 of £10.200 million with the actual water transitional costs figure of £1.498 million in 2012-13 prices as shown in Table 4.1 Actual transition expenditure of 'Updated 2010-15 reconciliation'.</p> <p>Along with SRN.PD.D006.01 below, our interventions do not change the water totex menu revenue adjustment which remains at - £4.056 million (2017-18 FYA CPIH deflated price base) and increases the water totex menu RCV adjustment from £31.654 million to £31.822 million (2017-18 FYA CPIH deflated price base).</p>

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Totex	SRN.PD.C006.02	N/A	N/A	<p>Intervention required.</p> <p>Southern Water populates 2014-15 with its forecast sewerage transitional costs figure of £13.768 million rather than the actual figure of £14.255 million.</p>	<p>In its 15 July 2019 submission, Southern Water populates 2014-15 with its forecast sewerage transitional costs figure rather than the actual reported outturn figure of £14.255 million.</p> <p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	Intervention retained.	<p>We are replacing Southern Water's sewerage transitional costs figure in 2014-15 of £13.768 million with the actual sewerage transitional costs figure of £14.255 million in 2012-13 prices as shown in Table 4.1 Actual transition expenditure of 'Updated 2010-15 reconciliation'.</p> <p>Along with SRN.PD.C006.03 and SRN.PD.C006.04 below, our intervention increases the wastewater totex menu revenue adjustment from £0.567 million to £0.607 million (2017-18 FYA CPIH deflated price base) and increases the wastewater totex menu RCV adjustment from - £93.613 million to - £94.357 million (2017-18 FYA CPIH deflated price base).</p>

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Totex	SRN.PD.C006.03	N/A	N/A	<p>Intervention required.</p> <p>Southern Water incorrectly includes the value of sewer adoptions within its sewerage actual totex figures for 2016-17 and 2017-18.</p>	<p>In its 15 July 2019 submission, Southern Water incorrectly includes the value of sewer adoptions within its sewerage actual totex figures for 2016-17 and 2017-18.</p> <p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention retained.</p> <p>As the value of sewer adoptions are not costs the company has incurred, they should not be included within total expenditure (totex).</p>	<p>We are intervening to deduct £17.067 million (2016-17) and £23.702 million (2017-18) (outturn prices) from Southern Water's reported sewerage actual totex figures.</p>
Totex	SRN.PD.C006.04	N/A	N/A	<p>Intervention required.</p> <p>Southern Water incorrectly reports the value of sewer adoptions within its sewerage disallowances line for 2016-17 and 2017-18 to cancel out the figures reported within sewerage actual totex.</p>	<p>In its 15 July 2019 submission, Southern Water reports the value of sewer adoptions within its sewerage disallowances line for 2016-17 and 2017-18 to cancel out the figures which were incorrectly reported within sewerage actual totex.</p> <p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention retained.</p> <p>We are intervening to remove these figures from actual totex and in the disallowances figures to ensure these costs are removed from the reconciliation.</p>	<p>We are deducting £17.067 million (2016-17) and £23.702 million (2017-18) (outturn prices) from Southern Water's reported sewerage disallowances figures.</p>

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Totex	SRN.PD.D006.01	N/A	N/A	N/A	In its 15 July 2019 submission, Southern Water input its 'Water: Final menu choice' figure rounded to 1 decimal place.	Intervention required. Where companies did not change their position on the menu from that used in the PR14 final determination, we are ensuring the water and sewerage final menu choices reflect the full accuracy of these figures as calculated in the PR14 populated final determination models (see 'Calculations' tab cell D68).	We are intervening to change the 'Water: Final menu choice' figure from 106.300 to 106.254.
WRFIM	SRN.PD.C005.02	N/A	N/A	Intervention required. We note small rounding differences on the recovered revenues in the Southern Water's model compared to tables WS13/WWS13 line 23 and the RPI indices in the model are not the same as the updated table App23 RPI indices.	In Southern Water's 15 July 2019 submission, the WRFIM model and tables WS13 / WWS13 are consistent. In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.	No intervention required. The draft determination intervention is no longer required because the company addresses the issue appropriately in its 15 July 2019 submission.	N/A

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Revenue adjustments	SRN.PD.C011.01	N/A	N/A	<p>Intervention required.</p> <p>We are standardising the discount factor used to profile revenue adjustments.</p> <p>Companies can choose to apply revenue adjustments either in the first year, or, spread over a number of years in the 2020-25 period to minimise the impact on bills or to generate a bill profile that is appropriate for its customers.</p> <p>We consider the wholesale WACC is an appropriate discount factor as this is a measure of the time value of money that is consistent with the price control framework. We are not intervening in Southern Water's choices for profiling revenue adjustments in 2020-25.</p>	<p>In its representation, Southern Water does not raise substantive reasons to change our draft determination in relation to this specific intervention.</p>	<p>Intervention required.</p> <p>We are intervening to reflect our updated view of the wholesale WACC.</p> <p>We are not intervening in Southern Water's choices for profiling revenue adjustments in 2020-25.</p> <p>Where profiling selections have been made for controls with no revenue (Dummy control and/or Business retail) we have set these selections to '0'. This has no impact on the modelling outputs.</p>	<p>We are using our view of the wholesale WACC (2.92%) as the discount factor to preserve the net present value of the outperformance or underperformance payments due when spreading adjustments over the period.</p>

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Revenue adjustments	SRN.PD.D011.01	N/A	N/A	<p>We have separately issued 'Notice of Ofwat's proposal to impose a penalty on Southern Water Services Limited', a penalty notice inviting comments on our proposal to issue an enforcement penalty against Southern Water.</p> <p>We have not included interventions in the draft determination as the consultation on the penalty notice is currently open. The outcome delivery incentive and PR09 blind year reconciliations included in this draft determination do not reflect the restated performance data covered by the penalty notice. We will reflect that restated data in the final determination.</p>	<p>In its representation, Southern Water does not raise substantive reasons to change the approach set out in our draft determination in relation to this specific intervention.</p>	<p>Intervention required.</p> <p>In 'Ofwat's final decision to impose a financial penalty on Southern Water Services Limited' we published our decision to impose an enforcement penalty against Southern Water for misreporting performance of its wastewater treatment sites. Ofwat's decision is that a penalty of about £37.7 million is appropriate. This has been reduced to £3 million in the light of undertakings provided by Southern Water, including providing redress, valued at £34.7 million, to customers in lieu of a penalty.</p> <p>Southern Water's undertakings require it to make reparations to customers and former customers of about £123 million in total over the next five years. The undertakings from Southern Water have three elements. The first element is to address the price review underperformance payments that Southern Water avoided paying as a consequence of its misreporting performance of its wastewater treatment sites and which it is now incurring based on restated performance data. This amounts to £91.2 million and will be returned to customers via bill rebates over the next five years. The second element is a payment to customers, in lieu of a penalty, for the company's failure to meet its legal obligations. This amounts to £31.7 million and will also be paid to customers via bill rebates over the next five year period.</p>	<p>We are intervening to reduce net wastewater revenue by £126 million (2017-18 FYA CPIH deflated price base) associated with the enforcement penalty notice imposed on Southern Water for misreporting performance of its wastewater treatment sites set out in 'Ofwat's final decision to impose a financial penalty on Southern Water Services Limited.'</p> <p>The penalty notice required Southern Water to pay the £3 million penalty to Ofwat by 22 November 2019 (for onward payment to the Consolidated Fund held by HM Treasury as required by the Water Industry Act 1991). The company paid the penalty on 15 November 2019 which we repaid to the Consolidated Fund held by HM Treasury on 21 November 2019. This penalty is therefore not considered in the reconciliations.</p>

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						<p>The third element to the company's undertakings is a package of measures that Southern Water has and is putting in place. This includes investment in treatment works, and new operational and governance arrangements. The company will report to us regularly to demonstrate that the corrective actions it is taking are working and the company's reports to us will be independently assured.</p> <p>We have implemented the penalties as other wastewater revenue adjustments in the final determination. The restated performance data covered by the penalty notice is included in this final determination within the outcome delivery incentive reconciliation and the other revenue adjustment.</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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