

Representations from SES Water Customer Scrutiny Panel regarding Ofwat's Draft Determination on SES Water Business Plan

Following the July publication of Ofwat's Draft Determinations on Water Company Business Plans, the SES Water (SESW) Customer Scrutiny Panel (CSP) has met on 2 occasions with SESW management to discuss the potential implications and next steps.

The focus of the CSP interest has been to understand the possible customer impacts and issues that might arise as a consequence of the determination and how SESW intends responding to them.

Although there is no formal requirement for Customer Challenge Groups (such as the CSP) to respond to the Draft Determinations, there is the option to provide comments as "Representations from other stakeholders" if appropriate. The CSP has taken the view that there are some valid concerns from a potential customer impact perspective that warrant the CSP to share these concerns with Ofwat.

The specific components of the Final Determination that the CSP would want to comment on are;

- Cost efficiency (in terms of impact on customers)
- Resilience
- Leakage and mains replacement
- Softening

1. Cost efficiency

The CSP has consistently maintained the view that it is not the CSP's remit to audit/assure SESW's finances, and thus the CSP does not take any specific view on the ability or not of SESW to achieve Ofwat's draft determination assumptions regarding cost efficiency. As highlighted above, the focus of the CSP interest is to understand the potential impact of the cost efficiency actions on customers and services, particularly in the context of how such actions and outcomes might impact upon the conclusions and preferences of the customer engagement during the PR19 process.

The CSP recognises that there can be both positive and negative implications, e.g. achieved increased efficiencies could improve the ability to fund greater assistance for vulnerable customers and/or the local environment, but equally might constrain the ability to deliver on some key customer benefit programmes such as mains replacement, treatment works upgrades and further digital customer transformation programmes.

The CSP noted that during the PR19 customer engagement, when identifying key customer priorities, issues such as "reliability of supply" and "water quality" were prioritised above "keeping bills down". This was further supported by the Willingness to Pay conclusions, where customers prioritised doing more on leakage and usage reduction rather than bill reductions. The CSP has noted Ofwat's comments in the Draft determination that SESW has not tested bill profiles for the 2025 to 2030 period, although SESW has committed to seek customer views on affordability and priorities in its ongoing engagement. In line with Ofwat's recommendation, the CSP is actively involved in working with SESW on the ongoing customer engagement plan, which will include further bill profile testing.

SESW have shared with the CSP the Company's revised bill impact proposal, following SESW's review of the Draft Determination details, and how SESW contend that this provides an appropriate balance of cost reduction versus enhancement investment.

Thus, while the CSP shares the Ofwat view that water companies should strive to be appropriately cost efficient, it is concerned that SESW believes the draft determination could limit its ability to fully fund and implement some of the key programmes intended to deliver on the commitments such as resilience, leakage and usage. The CSP hopes therefore that Ofwat will agree to strike an appropriate balance between realistic cost efficiency and necessary and justifiable enhancement expenditure to ensure the agreed customer priorities are met.

2. Resilience

Improving resilience, both short and long-term, and continuity of supply was a key priority from the SESW customer engagement. The CSP was supportive, in its PR19 response to Ofwat, of the conclusions and plans from SESW to continue the evolution plan of continuous improvement in the % of customers served by more than one treatment works, as this was a specific measure highly supported by customers.

The CSP's understanding is that Ofwat originally supported the SESW 10 year investment plan adopted in PR14 to move to 100% of dual supply by 2025, but was now "requiring further evidence" to justify the funding, which if not allowed would curtail the programme already significantly completed and negatively impact on the customer expressed priorities and expectations for resilience, and leave 44% of customers without dual supply.

The CSP has been assured by SESW that they believe they can adequately evidence and justify the funding requirement, which hopefully will allow this important programme to be completed.

Given the clear importance that customers (as well as Ofwat) have placed on wanting to see a robust plan for resilience, the CSP (in collaboration with the proposed new Environmental Scrutiny Panel) is committed to continuing to closely monitor the Company's progress in this area.

3. Leakage & mains replacement

The CSP notes that SESW has for some time been a top tier performer on leakage management, and the CSP pressed strongly within the PR19 process for SESW to maximise its plans for further leakage reductions given that this was a top customer priority based on the PR19 customer engagement.

SESW has explained its concerns to the CSP that the Draft Determination disallows a planned enhancement expenditure for leakage reduction programmes including targeted mains replacement on the basis that "the company is not forecasting to go beyond upper quartile performance". SESW shared with the CSP a graph showing the planned leakage performance level of all the water companies (both on a per property and km of mains basis), whereby SESW contend that "upper quartile" would logically refer to 4 companies (i.e. out of 17) but only includes 3, and it appears that SESW are only just outside the determined quartile, and thus would be the 4th company within the the upper quartile if based on 4 companies.

When querying with SESW what the implication may be of continuing to being disallowed the expenditure, the CSP was advised that one consequence would most likely be more focus on short-term leakage reduction activity such as pressure management and finding and fixing leaks, rather than the planned and targeted mains repair programme which provides much a more sustainable leakage reduction solution. The CSP supports SESW's focus on the longer term, given that the willingness-to-pay research concludes customers are supportive of the 15% reduction target and the replacement of 1% of mains per year to do

this. If SESW were to receive no enhancement funding for leakage in its Final Determination the CSP would also be concerned about the impact on customers of SESW having to find an alternative source of funding to carry out the short-term reduction activity to try and meet the stretching target, especially given SESW is already a strong performer in this area.

The CSP accepts that it is for SESW to argue its case with Ofwat, but the CSP is supportive of it doing so on the basis that allowance of enhancement expenditure will support achievement of the highest stated customer priority.

4. Softening

SESW have explained to the CSP that it is accepting of the Ofwat determination to apply an ODI penalty on softening, but has concerns regarding the “binary” nature of the ODI i.e. any measure of hardness above the target of 80 mg/l of calcium would incur a penalty, regardless of whether it is 0.1 mg/l or >5 mg/l. SESW have previously targeted to achieve an “average over time” of 80 mg/l that allows for small fluctuations above and below the level.

SESW have subsequently shared with the CSP the independent report from NERA Economic Consulting, which supports the conclusion that the Ofwat proposed ODI does not “align the penalty with the customer benefit/disbenefit, and thus the ODI does not achieve its stated objective”. The independent report provides an alternative proposal for an ODI which suggests a more graduated and structured ODI to better reflect the reality of the impact of softening. This appears to the CSP to be a sensible and appropriate position from a customer impact perspective.

In conclusion, the CSP is wholly supportive of Ofwat’s close scrutiny of the Water Company Business Plans, and the aims to drive a step change in performance across the industry. As a customer focused group, the CSP has a prime concern to ensure the best outcomes for customers, and it is hoped that Ofwat consider the above points in that context. Meanwhile the CSP will continue to closely monitor the plans, actions and progress of SES Water in terms of the commitments and performance metrics the Company has included in its Business Plan and which have an impact on customers.

Graham Hanson

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