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By email

Ian McAulay
Chief Executive Officer
Southern Water

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OFFICIAL

Dear Ian,

Strategic regional water resource solutions: Accelerated gate one final decisions for Southern Water

I am writing to inform you of our final decisions in respect of the following strategic regional water resource solutions:

- desalination;
- water recycling;
- West Country North Sources; and
- the additional solution, raw water transfer from Havant Thicket.

This letter should be read in conjunction with the final decision documents for each of these solutions, which are published alongside this letter. Both this letter and the final decision documents are published on our website on 28 January 2021.

We have received six representations relevant to Southern Water's strategic regional water resource solutions including the joint representation from Portsmouth Water and Southern Water in respect of the additional solution, and the separate representation from Southern Water. Except for Southern Water's representation, all were in support of our draft decisions. We have summarised and responded to the key points relevant to each solution in section 5 of the final decision documents.

Where we have identified issues requiring urgent remediation we expect the solution sponsors to provide us with a remediation action plan by 31 March 2021. This must set out how the

priority actions identified will be resolved to a suitable quality no later than two months before the next gate submission deadline, Monday 26 July 2021.

Additional solution – raw water transfer from Havant Thicket

Our decisions remain unchanged except for the allocation of funds, where we have accepted the proposal put forward in the joint representation from Southern Water and Portsmouth Water. This is subject to review at each gate. Table 1 below summarises our conclusions.

Table 1: Final decision summary in respect of additional solution, raw water transfer from Havant Thicket

Criteria applied	Assessment summary
Is there value in accelerating the solution's development to be 'construction ready' for the 2025-2030 period?	Yes
Does the solution need additional enhancement funding for investigations and development?	Yes, as part of a collaborative solution with Portsmouth Water
Does the solution need the additional regulatory support and oversight provided by the Ofwat gated process and RAPID?	Yes
Does the solution provide a similar or better cost / water resource benefit ratio compared to current solutions?	Yes
<p>Overall conclusion: should the solution be added to the programme?</p> <p>Yes, funding will be allowed at PR24 for the solution to join the accelerated gate two programme. In their joint representation, Southern Water and Portsmouth Water confirmed:</p> <ul style="list-style-type: none"> that the solution will be progressed in collaboration; that it will include an investigation of alternative mitigation options for the section 20 commitments – for example, whether the pipeline infrastructure can provide an interim option to deliver for 2027 until Havant Thicket reservoir can be used as the source; and that Option B4 (61 Ml/d Recycled water sent to Otterbourne via Havant Thicket Reservoir) will be closely aligned and considered in combination with this solution. <p>Additional ring-fenced funding is allowed for progressing this solution through to gate four with a total allowed development allowance of £5.110 million (for gate two to four activities). The allocation of funds is 100% in favour of Southern Water up to gate two. We expect both companies to review this allocation at gate two and each subsequent gate (taking into account activities that need to be completed in order to comply with timescales) and provide a recommendation to RAPID. The final decision on allocation for subsequent stages will be Ofwat's taking into account RAPID's recommendation at each gate. This funding is allowed in accordance with the conditions and requirements as outlined in the PR19 final determinations: Strategic regional water resources solution appendix. The companies will jointly agree a contractual mechanism that compensates Portsmouth Water for any costs arising. Southern Water should show Portsmouth Water costs separately in its submitted costs. Remediation issues are listed in the Appendix to help improve the submission for gate two.</p>	

Solutions funded in PR19 final determination

Table 2 below summarises the elements of our final decisions in respect of each of the Southern Water-sponsored solutions. Our decisions remain unchanged. Further details are contained in the accompanying final publication documents.

Table 2: Final decision summary in respect of Southern Water-sponsored solutions

Recommendation item	Desalination	Water recycling	West Country North Sources
Solution sponsors	Southern Water	Southern Water	Bristol Water Southern Water Wessex Water
Should further funding be allowed for the solution to progress to gate two?	Yes	Yes	Yes, but on the standard track
Is there evidence all expenditure is efficient and should be allowed?	No, some expenditure has been disallowed.	No, some expenditure has been disallowed.	Yes
Delivery incentive penalty?	10%	10%	No
Is there any change to partner arrangements?	NA	NA	No
Is there a need for a remediation action plan?	Yes	Yes	Yes

Solutions' progress and funding

Funding is allowed for the desalination and water recycling solutions to remain on the accelerated track. In the case of water recycling, this is subject to eliminating option B.1 (61 Ml/d discharge to Lower Itchen) and considering option B.4 (61 Ml/d via Havant Thicket) in concert with the additional solution, raw water transfer from Havant Thicket.

For West Country North Sources, funding is allowed for the solution to continue to be developed on the standard track of the programme, with the following options to continue to be investigated:

- Option 1: 16 Ml/d treated water, Cheddar Two to Testwood;
- Option 2: 65 Ml/d raw water, Cheddar Two to Testwood; and
- at least one "cascade" option through the existing companies' networks with network reinforcement where necessary

Evidence of efficient expenditure

Efficient costs allowance for desalination is £1.937 million (of £2.72 million claimed). For water recycling solution, it is £2.347 million (of £3.13 million claimed). For West Country North

Sources we determine that all expenditure of £0.499 million (in 2020–21 prices) is efficient and appropriate, and we allow it in full.

Submission quality and delivery incentives

For our assessment, we used the five criteria outlined in ‘Accelerated gate one assessment – summary of process and criteria, as well as assessing the completeness and sufficiency of work. Our overall classification is that submissions for all four solutions ‘Fall short in some areas’.

For desalination and water recycling solution, this results in a potential delivery incentive penalty of 10% applied to efficient and appropriate expenditure. There is no penalty for West Country North Sources solution.

Application of penalty to total efficient gate spend

The largest penalty across a company’s suite of solutions is applied to the company’s total gate one allowed efficient expenditure. For Southern Water, this results in a potential delivery incentive penalty of 10% of its efficient expenditure. Southern Water can avoid the incentive penalty through provision of a remediation action plan for the desalination and water recycling solutions by 31 March 2021 and delivery of the action plan in full by 26 July 2021.

Remediation

We have categorised the remediation issues into priority actions, actions and recommendations.

Priority actions are those that should have been completed at gate one and must now be addressed on a short timescale in order to make sure the solutions stay on track. They require remediation in full and directly relate to the application of delivery incentives.

We have also identified actions that should be completed in full in the gate two submission. The response to these actions will influence the assessment of the gate two submission.

Recommendations relate to issues where additional information or clarification could improve the quality of future submissions.

We conclude that there are issues for remediation for all Southern Water-sponsored solutions. Priority actions have been identified for desalination and water recycling, and therefore Southern Water should submit a remediation action plan for these solutions by 31 March 2021, with all priority actions to be satisfactorily addressed by 26 July 2021. If all priority actions are satisfactorily completed for both solutions then the penalty will not be imposed. If one or more of priority actions are not satisfactorily completed then the whole of the penalty will be imposed.

A full list of remediation issues is provided in the Appendix to each publication document listing priority actions, actions and recommendations.

Yours sincerely

David Black
Chief Regulation Officer

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