

October 2021

**Draft determination of Southern Water's
in-period outcome delivery incentives
for 2020-21**

Ofwat

About this document

This document provides our draft decision on the extent to which the price controls set by our [PR19 final determinations](#) need to be adjusted to reflect Southern Water's performance for the 2020-21 Charging Year, under [Part 3A of condition B](#) of the company's licence. The specific changes, and our reasons for these, are set out in this document and [Sector overview: Draft determinations of in-period outcome delivery incentives for 2020-21](#), which concerns the impact of our draft determinations across the companies.

We also publish models related to our draft determinations on our [website](#).

Executive summary

This section sets out the results of our 2020-21 in-period outcome delivery incentives (ODI) assessment for Southern Water. ODIs are the financial or reputational consequences for companies of outperformance or underperformance against its performance commitments. Performance commitments are the pledges companies made to their customers and stakeholders at the 2019 price review (PR19) about service levels to make progress towards their outcomes.

'In-period' ODIs bring ODI payments closer in time to when customers experience a given level of performance. We do this through an annual reconciliation process between July and November following the relevant reporting year, in this case 2020-21. The results of our assessment for 2020-21 will affect Southern Water's bills in the 2022-23 charging year.

For 2020-21 Southern Water reported net underperformance payments of £41.305m against its performance commitments with in-period outcome delivery incentives, excluding C-MeX and D-MeX. We have assessed the company's performance against its performance commitments. In our draft determination, we are intervening on the following performance commitments:

- Water quality compliance (CRI, or the compliance risk index) - we are increasing the company's underperformance payment by £0.056m to align with the latest data from the Drinking Water Inspectorate.
- Leakage – we are deferring our determination of the value of the company's ODI payments due to uncertainty that the company's reported leakage is calculated in a way that is consistent with how the leakage targets were set.
- Per capita consumption (PCC) – in line with our July consultation proposals, we are changing the timing of our determination of the value of ODI payments for this performance commitment to end of period.
- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £4.906m and a D-MeX underperformance payment of £1.033m, based on assessment of 2020-21 company performance in our draft determinations.

See sections 2.2, 2.3 and 3.1 for details of our interventions.

In our draft determination we propose that the amount of revenue the company can recover from its customers in 2022-23, as a result of its performance against its performance commitments with in-period ODIs in 2020-21, is reduced by £45.995m. This figure includes C-MeX and D-MeX payments and deferrals but is before adjustments for inflation, tax and other relevant factors.

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1. Introduction

1.1 Background

Southern Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Southern Water - Outcomes performance commitment appendix](#).¹ Most of the company's performance commitments have financial incentives which are paid 'in-period'. This brings ODI payments closer in time to when customers experience a given level of performance. The remaining financial incentives are end of period.

Southern Water reported its performance against these performance commitments in its annual performance report (APR) in July 2021. We have considered this information and, where necessary, further information from companies' answers to our queries. In our draft determination we set out relevant adjustments to the company's price controls, for one or more future years, in accordance with [Part 3A of condition B](#) of its licence (Performance Measure Adjustments, referred to in this document as 'in-period' determinations). Our determination, when finalised, will affect Southern Water's customers' bills from the 2022-23 charging year.

As set out in the PR19 final determinations, outperformance payments above 3% of a company's wastewater or water regulatory equity for that year are shared with customers. This means companies receive 50% of outperformance payments above this threshold. This aggregate sharing mechanism automatically applies to all ODI payments except to the customer measure of experience (C-MeX), developer measure of experience (D-MeX) and those allocated to retail price controls.

1.2 Purpose of this document

This document provides detailed information relating to the extent to which the price controls for the 2020-25 period need to be adjusted to reflect Southern Water's performance for the 2020-21 Charging Year. These changes are the result of the company's performance against its in-period ODIs as set out in the PR19 final determinations). This is our draft decision for consultation. We welcome your views by 21 October 2021 as set out in section 4. We will make our final determinations by 15 November 2021.

¹ We take account of performance commitments as set out in the PR19 definitions adjusted, if relevant, by the annex 2 process. Annex 2 of the company's performance commitment appendix provides for changes and corrections to be made to its performance commitment definitions during the 2020-25 period in certain circumstances. An overview of changes and corrections made to companies' performance commitment appendices can be found at [PR19 Outcomes performance commitments: changes and corrections](#).

2. Results of our assessment

2.1 Reported performance

Southern Water's reported performance for 2020-21 against its performance commitments with in-period ODIs is set out in table 3.1 below. The company's largest individual underperformance payment was £19.4m for its treatment works compliance performance commitment. The company's largest individual outperformance payment was £0.014m on its external sewer flooding performance commitment.

2.2 Key interventions

In our draft determination we are intervening to increase Southern Water's underperformance payment in relation to its water quality compliance (CRI) performance commitment to align with the latest Drinking Water Inspectorate (DWI) data, which was not available at the time that Southern Water submitted its data. Southern Water reported a CRI of 4.53 (which resulted in an underperformance payment of £1.589m). The latest DWI data shows that Southern Water's CRI was 4.62 (which resulted in an underperformance payment of £1.645m). Our intervention increases the company's underperformance payment for this performance commitment by £0.056m.

2.3 Payment deferrals and abatements

As set out in our [PR19 final determinations](#) and the [PR19 Reconciliation Rulebook: Guidance Document](#), companies can ask us to defer outperformance or underperformance payments, or abate outperformance payments on individual performance commitments. A deferral results in us delaying when the adjustment will be made to companies' revenue. An abatement results in no adjustment to the company's revenues in relation to the relevant performance commitment in the subsequent charging year.

Southern Water did not request a payment deferral for its reported underperformance payment of £0.908m for per capita consumption performance commitment for 2020-21. In our [July 2021 consultation](#) on changing the timing of our determination of the value of ODI payments for per capita consumption performance commitments, we proposed that this should be end of period for all companies. Prior to our July 2021 consultation, we had asked relevant companies to include ODI payments arising from their per capita consumption performance commitments in the deferrals function of the in-period adjustments model. We now consider it would be more appropriate to reflect this proposed treatment through the ODI performance model, ensuring consistency with our policy proposals and ensuring that all ODI payments accrued during the 2020-25 period can be applied at PR24, when we will make our final decisions.

Southern Water contacted us prior to submitting its APR data to inform us of:

- some changes in water consumption as a result of Covid-19; and
- that, as part of its continuous improvement work, it has been undertaking Pulse Interval Timing (PIT) logging in parallel to its historic methods of recording household night use.

The amount of water that customers use at night is an important set of data when estimating leakage rates. Although Southern Water's independent assurer has told them that PIT logging is a "significant data improvement" we need to have confidence that the reported leakage is calculated in a way that is consistent with how the leakage targets were set. Because this engagement process is ongoing and Southern Water has agreed to supply some further information from its third-party assurance provider we are proposing to defer our decision and the associated ODI payment until 2022. This will give us sufficient time to consider the further information and we will have a clearer understanding of the data and the methodology when we make our determinations in 2022. This involves the deferral of an underperformance payment of £0.398m.

Southern Water did not request any payment abatements. Based on our assessment of the company's performance, we do not consider any are required. As such, we do not apply any payment abatements in our draft decisions.

3. Impact of 2020-21 in-period ODI assessment on price controls

3.1 Our draft determination

In this section we outline the financial impacts of our draft decisions. First, we set out our view compared to the company's requested ODI payments in table 3.1.

Table 3.2 sets out the C-MeX and D-MeX payments included in our draft determination.

Table 3.3 summarises the overall ODI payments, after other payments and relevant adjustments, that the company is due based on its performance in 2020-21.

Table 3.4 sets out our draft decisions on deferrals and abatements and how we propose that these payments should be applied in 2022-23.

Table 3.5 sets out the impact of our draft decisions on the company's relevant price controls.

Unless otherwise stated all values are £m in 2017-18 FYA CPIH prices.

Table 3.1: In-period ODI payments for 2020-21 by price control (excluding C-MeX and D-MeX)

This table sets out the in-period ODI payments requested by Southern Water for 2020-21, by price control, and our draft determination on these payments after any interventions.

Further detail on how these overall numbers have been derived is set out in the ODI performance model, which we have published on our website as part of the draft determinations. Where we have applied interventions, this is set out in "Ofwat_PC_Interventions" in the ODI performance model for this company.

Price control	Company's reported payments (£m)	Our draft decisions after interventions (£m)	Difference (£m)
Water resources	-0.908	0.000	0.908
Water network plus	-5.786	-5.843	-0.057
Wastewater network plus	-32.725	-32.725	0.000
Bioresources	-1.286	-1.286	0.000
Residential retail	-0.600	-0.600	0.000
Total payments	-41.305	-40.453	0.851

See section 2.2 for details of our interventions on the company's performance commitments.

Table 3.2: C-MeX and D-MeX payments

Our draft determinations include the following C-MeX and D-MeX payments for this company:

Price control	C-MeX payments (£m)	D-MeX payments (£m)
Residential retail	-4.906	n/a
Water network plus	n/a	-0.495
Wastewater network plus	n/a	-0.538
Total payments	-4.906	-1.033

We have taken the data from the APR submissions and compared this against the recorded data from our survey agent, Accent.

Further details on C-MeX and D-MeX can be found on the [Customer and Developer Services experience](#) pages of the Ofwat website and in the published C-MeX and D-MeX models.

Table 3.3: ODI payments including C-MeX, D-MeX, bespoke adjustments and deferrals from 2019-20 (before 2020-21 deferrals and abatements)

This table sets out the composition of total ODI payments, including C-MeX and D-MeX, brought forward deferrals and bespoke adjustments where relevant, but before our draft decisions on 2020-21 deferrals and abatements.

Price control	Ofwat view of in-period ODI payments (£m)	C-MeX and D-MeX payments (£m)	ODI payments deferred from 2019-20 (£m)	Bespoke adjustments (£m)	Total ODI payments (£m, before 2020-21 abatements and deferrals)
Water resources	0.000	0.000	0.000	0.000	0.000
Water network plus	-5.843	-0.495	0.000	0.000	-6.338
Wastewater network plus	-32.725	-0.538	0.000	0.000	-33.262
Bioresources	-1.286	0.000	0.000	0.000	-1.286
Residential retail	-0.600	-4.906	0.000	0.000	-5.506
Total	-40.453	-5.939	0.000	0.000	-46.393

Table 3.4: 2020-21 ODI payments after deferrals and abatements

This table sets out our draft decisions on the ODI payments to be applied, after deferrals and abatements, as set out in the in-period adjustments model published on our website.

Price control	Total ODI payments (£m, before 2020-21 deferrals and abatements)	Ofwat proposed deferrals (£m)	Ofwat proposed abatements (£m)	Total ODI payments to be applied in 2022-23 (£m)
Water resources	0.000	0.000	0.000	0.000
Water network plus	-6.338	-0.398	0.000	-5.940
Wastewater network plus	-33.262	0.000	0.000	-33.262
Bioresources	-1.286	0.000	0.000	-1.286
Residential retail	-5.506	0.000	0.000	-5.506
Total	-46.393	-0.398	0.000	-45.995

See section 2.3 for our decisions relating to deferrals and abatements for this company.

Table 3.5: Changes to price controls (draft determinations)

This table sets out the impact of our draft decision on the company's price controls, as set out in the in-period adjustments model published on our website. See [Sector overview: Draft determinations of in-period outcome delivery incentives for 2020-21](#) for how we propose to apply adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
Water resources (K factors)	Previous determination	-2.04	2.55	-0.51	-1.63
	Revised	-2.04	2.55	-0.51	-1.63
Water network plus (K factors)	Previous determination	0.83	0.29	-1.95	-1.55
	Revised	0.83	-3.99	2.29	-1.55
Wastewater network plus (K factors)	Previous determination	0.99	0.32	-1.19	-1.05
	Revised	0.99	-9.27	8.93	-1.05
Bioresources (unadjusted revenue, UR_t – £m, 2017-18 Nov CPIH prices)	Previous determination	46.880	47.216	47.664	48.187
	Revised	46.880	45.628	47.664	48.187
Residential retail (total revenue, TR_t – £m, nominal prices)	Previous determination	50.921	51.613	52.257	52.911
	Revised	50.921	44.114	52.257	52.911

We have based Southern Water's draft determination on the data and commentary provided to us by Southern Water. Should any of this information be revised or restated in future years, we will take account of adjustments we have made to the relevant price control in relation to the performance commitment(s) in question in making future in-period determinations.

4. Next steps

We welcome any written comments or representations on our draft determinations by **21 October 2021**. Representations can be made by all stakeholders. Representations can be sent to our inbox OfwatPandO@ofwat.gov.uk.

To ensure transparency, we expect companies to publish their representations in full. We also intend to publish all the written representations we receive on our website once we set out our final decisions.

In view of this, if respondents consider that some of the information in their representations should not be disclosed (for example, because they consider it is commercially sensitive information) they should identify that information and explain why. We would expect strong, robust reasons that are specific to the information concerned. We will take such explanations into account, but we cannot give an assurance that information included in representations will not be disclosed.

Information provided in response to this document, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the General Data Protection Regulation 2016, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our [privacy policy](#).

Where companies are making representations, they should consider what further evidence may be necessary to submit with their representations.

We will publish our final decisions by 15 November 2021, after considering representations from all stakeholders.

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