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By email

Ian McAulay
Chief Executive Officer
Southern Water

1 March 2022

Dear Ian,

Strategic regional water resource solutions: Accelerated gate two draft decision for Southern Water

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

- Desalination
- Water recycling
- Havant Thicket Raw Water Transfer

The RAPID partner regulators would like to thank Southern Water for submission timeliness, collaborative approach and positive engagement which has helped drive the quality and speed of progression of this solution.

This letter should be read in conjunction with the draft decision documents for each of these solutions, which are published alongside this letter. Both this letter and the draft decision documents are published on our website on 1 March 2022.

Following the publication of our draft decisions, solution owners and other interested parties have the opportunity to respond to the draft decisions. Representations are invited by email to rapid@ofwat.gov.uk and the representation period will close at 6 pm on 12 April 2022. All representations will be considered before our final decision, which we intend to publish at 10am on 17 May 2022.

Where we have identified issues requiring urgent remediation, we expect the solution owners to resolve them to a suitable quality no later than 30 June 2022.

Solutions funded in PR19 final determination

The table below summarises the elements of our draft decisions in respect of each of the Southern Water-sponsored solutions. Further details are contained in the accompanying draft publication documents.

Draft decision summary in respect of Southern Water-sponsored solutions

Recommendation item	Desalination	Water recycling	Havant Thicket Raw Water Transfer
Solution owners	Southern Water	Southern Water	Southern Water, Portsmouth Water
Should further funding be allowed for the solution to progress to gate three?	No	Yes	Yes
Is there evidence all expenditure is efficient and should be allowed?	No	No	No
Delivery incentive penalty?	N/A	Yes – 10%	Yes – 10%
Is there any change to partner arrangements?	No	No	No
Are there priority actions for urgent completion?	No – the solution has been removed from the gated process.	Yes	Yes

Solution progress and funding

At the request of Southern Water, Fawley desalination has been removed from the RAPID gated process. It has been agreed that both Havant Thicket Raw Water Transfer and Water Recycling solutions are to progress.

Funding is allowed for the Water Recycling and Havant Thicket Raw Water Transfer solutions to continue to be developed to accelerated gate three.

We have changed the funding of the Havant Thicket Raw Water Transfer solution to reflect its revised scope. The revised total allowance is £21.44m.

As at accelerated gate one, we allocate funding in its entirety to Southern Water through gates three and four. Southern Water and Portsmouth Water should, however, agree and propose to RAPID cost sharing proportions before the end of the representation period. These proposals may be for them to remain the same or to change and in either case the rationale for the proposal should be explained.

Evidence of efficient expenditure

Efficient costs allowance for desalination is £4.78m (of £5.25m million claimed). For Water Recycling solution, it is £4.14m (of £4.77m million claimed). For Havant Thicket Raw Water Transfer, it is £0.63m (of £2.73m million claimed).

If Southern Water disagrees with this decision, then improved evidence of cost efficiency must be submitted as part of their representations by 12 April 2022.

Delivery incentive penalty at accelerated gate one

We imposed a delivery incentive penalty of 10% of Southern Water's total gate one allowed efficient expenditure. Southern Water was able to avoid the incentive penalty through provision of a remediation action plan for the desalination and water recycling solutions and delivery of the remediation action plan in full by 26 July 2021. We do not believe these actions were completed in full but have decided not to apply the gate one penalty.

Submission quality and delivery incentive penalty at accelerated gate two

Our overall classification is that submissions for Water Recycling and Havant Thicket Raw Water Transfer at accelerated gate two are satisfactory (falls short of meeting expectations in some areas). There are significant shortfalls in important areas. At accelerated gate two, the solutions should have been of a suitable standard for inclusion in a final WRMP. We are concerned that some areas of the work are not yet at that standard.

We have decided to apply a delivery incentive penalty of 10% to the Water Recycling and Havant Thicket Raw Water Transfer. The largest penalty across a company's suite of solutions is applied to the company's total allowed efficient expenditure at that gate. For Southern Water, this results in a delivery incentive penalty of 10% of its total accelerated gate two allowed efficient expenditure. Southern Water will not be able to mitigate this penalty.

Our overall classification for work completed on Desalination until the point when Southern Water recommended the solution's removed from the programme is that it was satisfactory (falls short of meeting expectations in some areas).

Remediation

A list of remediation issues is provided in the Appendix to each draft decision document divided into priority actions, actions and recommendations. Priority actions are those that should have been completed at gate two and must now be addressed on a short timescale in order to make sure a solution stays on track.

We have also identified actions that should be completed in full in the gate three submission. The response to these actions will influence the assessment of the gate three 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 Water Recycling and Havant Thicket Raw Water Transfer. We expect the solution owners to resolve priority actions to a suitable quality no later than 30 June 2022.

Should you have any questions about this letter or draft decision, please e-mail rapid@ofwat.gov.uk and someone from the team will be in touch.

Once again, Ofwat would like to thank Southern Water for the work that it has carried out over the gate two period.

Yours sincerely

David Black
Interim Chief Executive Officer

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