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By email

Ian McAulay
Chief Executive Officer
Southern Water

17 May 2022

Dear Ian,

Strategic regional water resource solutions: Accelerated gate two final decision 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
- Hampshire Water Transfer and Water Recycling

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 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 17 May 2022.

The solution owners and other interested parties had the opportunity to respond to the draft decision during the representation period, which followed the publication of the decisions on 1 March 2022. We have taken all relevant representations into account in making our final decision.

Solutions funded in PR19 final determination

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

Final decision summary in respect of Southern Water-sponsored solutions

Recommendation item	Desalination	Water Recycling	Hampshire Water Transfer and Water Recycling
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
Is there a need for a remediation action plan?	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.

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

We are changing the funding of the Water Recycling and the Hampshire Water Transfer and Water Recycling solutions to reflect the substantial change in solution design in the Hampshire Transfer and Water Recycling solution proposed at accelerated gate one and the overlap between the two solutions. The revised costs allowance is shown below:

Final decision funding allowances

	Gate one	Gate two	Gate three	Gate four	Total
Hampshire Water Transfer and Water Recycling					
New Allowance Proposed in Draft Decision	£0.00	£1.13m	£9.48m	£10.83m	£21.44m
Water Recycling					
Previous Allowance	£3.58m	£5.36m	£12.52m	£14.30m	£35.76m
Combined Allowance					
New Allowance (Hampshire Water Transfer and Water Recycling and Water Recycling)	N/A	N/A	£21.99m	N/A	N/A

We expect separate accounting and expenditure reporting for each solution and request this to be provided in an interim update by 14 November 2022. We also expect the interim update to propose how solution funding should be split between the Hampshire Transfer and Water Recycling and the Water Recycling solution for the remainder of gate three. We will review the funding of the two solutions for the remainder of gate three at that point.

Southern Water and Portsmouth Water should propose to RAPID any amendment to the financial arrangements for the Hampshire Transfer and Water Recycling solution by 14 November 2022. Whether the cost sharing proportions remain the same or to change, we expect a thorough rationale for the proposed financial arrangements.

Evidence of efficient expenditure

Efficient costs allowance for Desalination is £4.69m (of £5.56million claimed). This includes £1.06m of expenditure which Southern Water had accounted for as early gate three activities but which we consider gate two activities.

For the Water Recycling solution, efficient costs are £4.28m (of £4.90 million claimed).

For the Hampshire Water Transfer and Water Recycling, allowed expenditure is £1.13m (of £2.29 million claimed). The amount allowed is the full accelerated gate two allowance for this solution. We have not allowed the overspend.

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 Desalination, Recycling and Hampshire Water Transfer and Water Recycling at accelerated gate two are satisfactory (falls short of meeting expectations in some areas).

We have decided to apply a delivery incentive penalty of 10% to the Recycling and Hampshire Water Transfer and Water Recycling solutions. 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 gate two allowed efficient expenditure. Southern Water will not be able to mitigate this penalty.

Remediation

A list of remediation issues is provided in the Appendix to each final 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.

Priority actions have been identified for Water Recycling and for Hampshire Water Transfer and Water Recycling. 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 final 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
Chief Executive

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