

October 2022

# **Draft determination of Southern Water's in-period outcome delivery incentives for 2021-22**

**Ofwat**

## About this document

This document provides our draft determinations on the extent to which the price controls included in our [PR19 final determinations](#) need to be adjusted to reflect Southern Water's performance for the 2021-22 charging year, under [Part 3A of condition B](#) of the company's licence (Performance Measure Adjustments, referred to in this document as 'in-period' determinations).

The specific adjustments, and our reasons for these, are set out in this document and in our [Sector overview: Draft determinations of in-period outcome delivery incentives for 2021-22](#).

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

We welcome your views by 21 October 2022. We will make our final determinations by 15 November 2022.

## Background

At the 2019 price review (PR19), companies' made performance commitments (PCs), or pledges, to their customers and stakeholders about the service levels they would meet to make progress towards their outcomes. Southern Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Southern Water - Outcomes performance commitment appendix](#).<sup>1</sup>

Each performance commitment has an outcome delivery incentive (ODI) that provides either financial or reputational consequences for companies of outperforming or underperforming their performance commitments. Many of the financial ODIs are paid during the 2020-25 price control-period. The reason for this is to bring payments closer in time to when customers experience a given level of performance. The remaining incentives are paid at the end of the period.

ODIs act as an incentive for companies to deliver their committed levels of performance, returning funding to customers for foregone benefits if they deliver less than is expected. Companies that go beyond and deliver greater benefits than expected to customers and the environment can receive outperformance payments.

Southern Water reported its performance against these performance commitments in its annual performance report (APR) in July 2022. We have considered this information and, where necessary, further information from companies' answers to our queries. In our draft

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<sup>1</sup> We take account of performance commitments as set out in the PR19 definitions adjusted, if relevant, in accordance with Annex 2 of the company's performance commitment appendix. Annex 2 provides for changes and corrections to be made to 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](#).

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 each company's licence.

We will make our final determination by 15 November 2022. These will affect Southern Water's customers' bills from the 2023-24 charging year.

In our [Sector overview Final determinations of in-period outcome delivery incentives for 2020-21](#) we deferred our determination of the value of companies' Per Capita Consumption (PCC) ODI payments for the 2020-21 to 2023-24 charging years to the end of the 2020-25 period. We set out this decision and the reasons for it in this [decision document](#) which we published after having considered stakeholder responses to our July 2021 consultation.

## Executive summary

Having assessed the company's performance against its performance commitments in 2021-22, the ODI payments and performance are as reported by the company with the following exceptions:

- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £4.157m and a D-MeX underperformance payment of £0.936m, based on the assessment of 2021-22 company performance;
- We are making an adjustment of £0.411m to account for restated 2020-21 leakage performance;
- We are making an adjustment on taxation to ensure consistency with PR19. We are changing the tax rate from 19% to 0% for 2021-22 ODI performance and making a bespoke adjustment of £10.789m to remove the tax element of Southern Water's ODI performance in 2020-21;

See section 1 for details of our interventions and policy decisions.

## Contents

1. Results of our assessment	4
1.1 Interventions and policy decisions	4
1.2 C-MeX and D-MeX	6
1.3 Payment deferrals and abatements	6
2. Impact of 2020-21 in-period ODI assessment on price controls	7
2.1 Our draft determination	7
3. Responding to this consultation	11

# 1. Results of our assessment

## 1.1 Interventions and policy decisions

We are not intervening on Southern Water's reported performance for 2021-22 in our draft determination. However, we are applying following amendments to the in-period adjustments model and the ODI performance model:

- An adjustment for restated leakage performance in 2020-21;
- an amendment for tax paid on ODI payments in 2020-21;
- setting a 0% tax rate on 2021-22 ODI payments;
- input of the published value for November 2021 CPIH; and
- an amendment relating to the long term supply demand schemes PC.

### Leakage and per capita consumption (PCC)

In 2020-21 we deferred £0.398m of underperformance payments for Southern Water's leakage performance commitment. This was because the company reported data in the 2021 APR using a revised reporting methodology. We wanted to be clear about the impact of the methodological changes and ensure the company only benefited from real improvements in performance, not from changes in methodology.

This year, in its 2022 APR, Southern Water submitted leakage performance and three-year average baseline data using both the PR19 methodology and its revised methodology. The APR reports the 2021-22 figure and a revised 2020-21 figure using the PR19 methodology. Southern Water is parallel reporting internally using its revised methodology.

Based on the PR19 methodology, Southern Water reported leakage ODI underperformance payments of £0.265m for 2021-22 and stated that its 2020-21 payment would have been an outperformance payment of £0.014m.

Having assessed the information the company submitted, for draft determination we are basing payments for 2020-21 and 2021-22 on the data derived using the PR19 methodology. This ensures that there is no benefit from changes to methodology. We include underperformance of £0.265m for the 2021-22 performance and an outperformance of £0.014m for the 2020-21 performance. This means we include a positive adjustment of £0.411m as one component within the bespoke adjustment to Southern Water's water network plus price control. This is because the company included the deferred value from the 2021 in period determination in its modelling. However, based on the figures derived using the PR19 methodology, the amount included should have been an outperformance of £0.014m instead of an underperformance of £0.398m. As stated beneath table 2.2, we adjust for the time value of money where applicable.

For the remaining years of the control period, for the purposes of calculating the ODI payments we expect Southern Water to report leakage and PCC performance commitment data using the PR19 methodology. However, to ensure transparency and to support other processes such as WRMPs and the PR24 processes the company should provide this data using both the PR19 methodology and the revised methodology.

## **Taxation**

In our PR19 final determination, we did not expect Southern Water to pay tax during the current price control period and so its Final Determination did not include any allowance for tax. On page 58 of the [PR19 Reconciliation Rulebook Guidance](#) we stated that companies should set out their expected marginal tax rate for the following charging year in their requests for an in-period determination, including whether they expect to pay corporation tax and any capital allowances, with appropriate evidence. We said we will take this information into account when making our determination.

This year, Southern Water submitted information to support its view that it does not expect to pay tax within the 2020-25 period, due to its high capital allowances and taxable losses that reduce its future tax liabilities. Based on the information provided, and subject to further clarification from the company ahead of the final determination, we are adjusting the modelled tax rate. Consequently, in modelling its draft determination for 2021-22 performance, we are changing the assumed tax rate from 19% to 0%. We also adjust the tax element of the company's 2020-21 ODI performance, through a bespoke adjustment of £10.789m split between the water network plus, wastewater network plus, bioresources and residential retail price controls. However, subject to our decision for final determination, we will keep the company's position under review and if its circumstances change, for example, if the company were to pay tax in the current period, we may revisit this adjustment.

## **November 2021 CPIH**

We are applying a correction to the company's in-period adjustment model to include the Office of National Statistics (ONS) published value of 114.1 for November 2021 Consumer Price Index (including housing). This replaces the value of 112.6 Southern Water had used in the model.

## **Long term supply demand schemes**

We have made amendments (recorded in the Ofwat IPD22 actions worksheet) to make three corrections to Southern Water's ODI performance model. Only one of these corrections has a financial impact on ODI payments and that is for this performance commitment (PR19SRN\_WN13). The company selected 'true' in row 36 of the PC\_Company\_input worksheet when it should have been false because the ODI for this PC only applies in 2024-25. The financial impact of this correction is to decrease the sum of the underperformance shown in the Initial calculation of end of period revenue adjustment by price control by

£16.199m. This change is visible in cells C19:C25 of worksheet 3H but it makes no financial difference to our 2021-22 in-period ODI draft determinations.

## 1.2 C-MeX and D-MeX

On 21 September we published the relative performance of all companies. Our draft determination includes a C-MeX underperformance payment of £4.157m and a D-MeX underperformance payment of £0.936m based on our assessment of 2021-22 company performance.

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.

## 1.3 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 any payment deferrals or 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 deferrals or abatements in our draft determinations.

In our [Final Determination of Southern Water's in-period outcome delivery incentives for 2020-21](#), we deferred £0.398m of the company's underperformance payment in relation to its leakage performance commitment. Because this deferral was for 2020-21 leakage we have accounted for this in the way described in section 1.1.

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

### 2.1 Our draft determination

In this section we outline the financial impacts of our draft determinations.

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

#### **Table 2.1: Draft determination on adjustment to 2023-24 price controls as a result of performance against ODIs**

This table sets out our draft determinations on the ODI payments to be applied to price controls in the 2023-24 charging year after accounting for:

- the in-period ODI payments for each company based on their performance in 2021-22;
- brought forward deferrals;
- bespoke adjustments, including prior year restatements, where relevant; and
- our draft determination on C-MeX and D-MeX payments.

For further details on the interventions, deferrals, abatements and bespoke adjustments, see section 1.

This draft determination on the ODI payments to be applied for Southern Water is also set out in the in-period adjustments model published on our website.

Price control	Company's reported ODI payments (£m)	Interventions (£m)	ODI payments deferred from 2020-21 (£m)	Ofwat DD deferrals (£m)	Ofwat DD abatements (£m)	Bespoke adjustments (£m)	C-MeX payments (£m)	D-MeX payments (£m)	Total ODI payments to be applied to customer bills in 2023-24 (£m)
Water resources	0.511	0.000	0.000	0.000	0.000	0.000	0.000	0.000	<b>0.511</b>
Water network plus	-3.715	0.000	-0.409	0.000	0.000	1.889	0.000	-0.268	<b>-2.503</b>
Wastewater network plus (WaSCs only)	-29.610	0.000	0.000	0.000	0.000	8.064	0.000	-0.669	<b>-22.214</b>
Bioresources (WaSCs only)	-1.286	0.000	0.000	0.000	0.000	0.311	0.000	0.000	<b>-0.976</b>
Residential retail	-0.600	0.000	0.000	0.000	0.000	1.642	-4.157	0.000	<b>-3.115</b>
<b>Total</b>	<b>-34.700</b>	<b>0.000</b>	<b>-0.409</b>	<b>0.000</b>	<b>0.000</b>	<b>11.905</b>	<b>-4.157</b>	<b>-0.936</b>	<b>-28.297</b>

**Table 2.2: Breakdown of bespoke adjustments**

This table provides a breakdown of the bespoke adjustments included in our draft determinations.

Price control	Prior year restatements (£m)	Prior year C-Mex indexation (£m)	Prior year D-Mex indexation (£m)	Prior year total (£m)	Time value of money adjustment (£m)	Green recovery	Total bespoke adjustments to be applied to customer bills in 2023-24 (£m)
Water resources	0.000	0.000	0.000	0.000	0.000	0.000	<b>0.000</b>
Water network plus	1.805	0.000	0.031	1.835	0.054	0.000	<b>1.889</b>
Wastewater network plus (WaSCs only)	7.802	0.000	0.033	7.835	0.229	0.000	<b>8.064</b>
Bioresources (WaSCs only)	0.302	0.000	0.000	0.302	0.009	0.000	<b>0.311</b>
Residential retail	1.292	0.303	0.000	1.595	0.047	0.000	<b>1.642</b>
<b>Total</b>	<b>11.200</b>	<b>0.303</b>	<b>0.064</b>	<b>11.567</b>	<b>0.338</b>	<b>0.000</b>	<b>11.905</b>

The prior year C-Mex and prior year D-Mex values correct an error in how the C-Mex and D-Mex models applied indexation in 2020-21. Where applicable we adjust for the time value of money.

**Table 2.3: Changes to price controls (draft determinations)**

This table sets out the impact of our draft determinations 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 2021-22](#) for how we are applying 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	1.54	-3.45
Water network plus (K factors)	Previous determination	0.83	-4.00	2.29	-1.55
	Revised	0.83	-4.00	0.69	-0.10
Wastewater network plus (WaSCs only)	Previous determination	0.99	-9.29	8.93	-1.05
	Revised	0.99	-9.29	2.90	4.29
Bioresources (WaSCs only)	Previous determination	46.880	45.628	47.664	48.187
	Revised	46.880	45.628	46.688	48.187
Residential retail (total revenue, TRt – £m, nominal prices)	Previous determination	50.921	44.094	52.257	52.911
	Revised	50.921	44.094	48.451	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.

### 3. Responding to this consultation

We would welcome any comments on this document. Please email them to [in-periodODIs@ofwat.gov.uk](mailto:in-periodODIs@ofwat.gov.uk) or post them to:

IPD2022 Consultation response  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

[Or Ofwat, 11 Westferry Circus, Canary Wharf, London, E14 4HD if that is more appropriate.]

The closing date for this consultation is **21 October 2022**. If you wish to discuss any aspect of this consultation, please contact the In-period ODI team by post or by email at [in-periodODIs@ofwat.gov.uk](mailto:in-periodODIs@ofwat.gov.uk)

We intend to publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk). Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our [privacy policy](#) explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this draft determination, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for

disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

We will publish our final determinations by **15 November 2022**, after considering representations from all stakeholders.

**Ofwat (The Water Services Regulation Authority)  
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