

October 2022

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

**Ofwat**

## About this document

This document provides our draft determination on the extent to which the price controls included in our [PR19 final determinations](#) need to be adjusted to reflect South East 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, or pledges, to their customers and stakeholders about the service levels they would meet to make progress towards their outcomes. South East Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: South East 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.

South East Water reported its 2021-22 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

---

<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](#).

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 each company's licence.

We will make our final determination by 15 November 2022. These will affect South East 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 South East Water'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 £0.718m and a D-MeX underperformance payment of £0.196m, based on the assessment of 2021-22 company performance;

We are not intervening in line with the company's request, to exclude the impact of Storms Eunice, Dudley and Franklin from its supply interruptions and unplanned outage PCs. We consider that it is not necessary to intervene to exclude the impacts of the storms from these PCs thereby leading to adjustments to the payments that ordinarily flow under the price control package in the PR19 determination. Our decision means that the company's reported performance on its water supply interruptions PC remains unchanged in our draft determination.

However, we are intervening to add the unplanned outages the company has excluded back into the company's performance. This is because South East Water incorrectly excluded incidents caused by third-party impacts. Our intervention increases the company's unplanned outage for the year from 3.44% to 3.51%. This does not have a financial impact as the company only incurs a payment if it underperforms.

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	8
1.3 Payment deferrals and abatements	8
2. Impact of 2020-21 in-period ODI assessment on price controls	9
2.1 Our draft determination	9
3. Responding to this consultation	12

# 1. Results of our assessment

## 1.1 Interventions and policy decisions

### Request for interventions for storm events and third-party events

#### Background

South East Water requested that we intervene to exclude the impact of Storms Eunice, Dudley and Franklin from its common water supply interruptions and its common unplanned outage PCs. The exclusion requested by South East Water would reduce the company's underperformance payment on its water supply interruptions PC by £1.545m and would have no financial impact on its unplanned outage PC.

With regard to its water supply interruptions PC, South East Water considers that the storms amounted to an emergency under the Civil Contingencies Act 2004. The company states that customers' supply was impacted due to the loss of power and the impact of this on the company's water treatment and distribution systems. It states that the storms had a severe impact on the assets of UKPN (UK Power Networks) and that the extent of the loss of power to over 100 South East Water sites overwhelmed the company's back up facilities. It states that the succession of storms prevented UKPN from restoring supplies and power failures continued at a large number of its sites for many days.

In relation to the unplanned outage PC, the company has excluded unplanned outage which was solely due to the failure of power supplies as a result of Storms Eunice and Franklin.

#### Our assessment

We consider that the PCs and ODIs consulted on and set at PR19 were reasonable. As regards the treatment of events raised by the company, our PR19 methodology, confirmed in the PR19 final determinations, was to include the impact of events such as extreme weather in reported performance. In general, PR19 performance commitments provide few exclusions because for adverse events, such as weather events, we want companies to be incentivised to minimise the impact on customers. These are precisely the events we want the sector to be resilient to.

At PR19, we also stated the importance of companies having confidence that performance commitments will not change during the price control period. We said that if there is a potential for such change, this could lead to a disconnect between the cost/service package specified at the start of the period and what is delivered; potentially incentivise companies to focus on convincing Ofwat of the need for a change as opposed to focusing on delivering what matters to customers; and add complexity. The same concerns apply to the potential for creating exceptions during the period by excluding events.

Nevertheless, we have considered South East Water's performance in relation to each relevant PC and whether, in light of our duties and policy objectives, we should exercise our discretion to depart from the outcomes that would ordinarily flow from operation of the ODIs to make changes to payments. Our assessment focused on whether interventions beyond those protections already built into the PR19 final determinations are necessary to ensure that the company bears the appropriate level of risk and remains incentivised to deliver for customers. Our consideration included the following:

- We reviewed the two PC definitions to understand the expectations in place for each PC.
  - The water supply interruptions PC, which incorporates the [reporting guidance for PR19 – Supply Interruptions, published on 27 March 2018](#), states that "the default position is that the water company manages the risk of supply interruptions and there are no exclusions. This measure covers planned and unplanned interruptions. The cause of the interruption is not relevant to the calculation of the reported figure. That is, asset failure caused by third parties would be treated the same as the failure of the company's assets and planned or unplanned interruptions are the same". However, the PC definition also states that companies may make a representation to Ofwat for an exception to be granted on the basis of a civil emergency under the Civil Contingencies Act 2004, where the supply interruption is not the cause of the emergency. We consider that the company provided insufficient evidence that relevant Category 1 responders treated Storms Eunice, Dudley and Franklin as emergencies. In Sussex, an Emergency Strategic Command Group and an Emergency Tactical Coordinating Group were established, led by Sussex Police with UKPN and South East Water as Tier 2 responders. A regular meeting and update structure was established to help co-ordinate a response, but there is insufficient evidence that multi-agency response arrangements were activated beyond this. No major incidents were declared. Nevertheless, we went on to consider whether we should intervene to make changes to the company's ODI payments.
  - The unplanned outage PC definition allows for some exclusions related to outages caused by changes in raw water. The definition goes on to provide examples of where extreme weather may cause site operability issues (such as site access due to heavy snowfall), it states that these types of exclusions may be allowed if well evidenced. South East Water has excluded a small number of outages that were caused by third party related power outages (as a result of storm impact). However, the definition does not provide for exclusions relating to outages caused by third party impacts or power outages, nor do we consider that manageable asset-related issues such as power supply should be treated as excludable events. While external power supplies are run by third party providers, companies decide for themselves the level of risk to take in ensuring that they can provide water treatment assets in the event of a power outage. Therefore, we are intervening to add the excluded outages back into the company's performance.
- We considered South East Water's performance on the water supply interruption PC. South East Water's performance this year is the worst in the sector at 1 hour 12 minutes

and 33 seconds, but it is not evident that the company faced worse conditions compared to other companies in the region. Further, its performance on its water supply interruptions PC in 2020-21 was also poor. We note that, both this year and last, this poor performance meant that the company went beyond the underperformance collar. This means the company has already benefited from the protection provided by the PR19 package (avoiding around £11.115m in underperformance payments as a result). For the unplanned outage PC, the company reported no performance payments in 2021-22 and no performance payments in 2020-21.

- We considered South East Water's overall performance against all its performance commitments for 2021-22 (including C-MeX and D-MeX). The company reported a net underperformance of £2.279m and including C-MeX and D-MeX underperformance payments, this increased to £3.193m. We note that this is not out of step with the range, calculated at PR19, of out/underperformance payments that the company might reasonably be expected to incur during 2020-25 and the broad potential RoRE five year average range for ODIs set out in PR19 methodology of +/- 1 to +/- 3%. This is also the case, when we consider South East Water's overall performance across 2020-21 and 2021-22.
- We consider that loss of supply is perhaps the most serious water service failure, especially for vulnerable customers. The impact for customers of these service interruptions were severe. Around 39,000 South East Water customers were without water for between 1 and 126 hours. This is why the PCs are designed to apply strong incentives to companies to minimise any impact or lack of supply and to protect the environment. This includes low probability high impact events, with resilience being a key part of the PR19 process. We consider that excluding the impact of these events may weaken the company's incentives in relation to such events in the future and managing the impact on customers.
- We considered whether not intervening was likely to create unwanted incentives to invest so as to minimise risk in an inefficient way, which would not be in customers' interests. Companies are subject to both upside and downside risk from ODIs. And companies need to manage resilience through base expenditure and, where appropriate, can request enhancement expenditure to reduce risk. We set out our criteria for resilience enhancement expenditure in the PR24 draft methodology. As part of this, companies will need to undertake a systematic assessment of risks to identify potential schemes. For each scheme, they will then need to quantify the impact on risk of the proposed expenditure. Proposed options will need to be cost beneficial, best value and have customer support.

## Our decision

Having reviewed the company's requests and supporting evidence, in light of the assessment described above, we consider that it is not necessary to intervene to exclude the impacts of

these storms from the water supply interruption PC thereby leading to adjustments to the payments that ordinarily flow under the price control package in the PR19 determination. Our decision ensures that the company bears the appropriate level of risk and remains incentivised to deliver for customers and the environment. The effect of our decision is that the company's reported underperformance on its supply interruptions performance commitments remains unchanged at £3.157m in our draft determination.

However, we are intervening to add the unplanned outages the company has excluded back into the company's performance. This is because South East Water incorrectly excluded incidents caused by third-party impacts. Our intervention increases the company's unplanned outage for the year from 3.44% to 3.51%. Our intervention does not have a financial impact as the company only incurs a payment if it underperforms (it has outperformed).

### **Engaging and working with landowners and land managers to improve catchment resilience related to raw water quality deterioration**

We have made amendments to South East Water's ODI performance model and recorded these in the Ofwat\_IPD22\_actions worksheet. We have made corrections to three performance commitments. Only one of these corrections (for the Engaging and working with landowners and land managers to improve catchment resilience related to raw water quality deterioration PC) affects ODI payments. 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 increase the sum of the underperformance shown in the Initial calculation of end of period revenue adjustment by price control by £0.131m. 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.

### **Water Industry National Environment Programme (WINEP)**

South East Water asked us to intervene to decrease its £0.325m underperformance payment in relation to its WINEP performance commitment. The company presented evidence that it has received extensions to the deadlines for six WINEP schemes from Natural England and the Environment Agency, which it states allow more data to be collected. Whilst the in-period delivery of WINEP is a matter for the company to agree with the environmental regulators, the definition of the company's WINEP PC, PR19SEW\_H.3, states that it is "limited to the 59 schemes classified by the Environment Agency as having 'Green' status as at 1 April 2019 and the Bewl-Darwell Transfer scheme with reference 7SE200012. The company referred us to the fact that its PC definition required that "all elements of its 2020-25 period WINEP obligations are delivered to agreed scopes and to final statutory deadlines." At PR19 we addressed this issue with South East Water and on page 17 of [PR19-final-determinations-South-East-Water---Delivering-outcomes-for-customers-final-decisions.pdf \(ofwat.gov.uk\)](#) we stated that we do not allow the company to retain flexibility in its WINEP to make changes in-period.

As we subsequently clarified in section 1.5 of [IN2201](#) our policy is that we would not expect to make changes to financial PCs simply because of WINEP changes. As a result, we are not intervening to change the underperformance payment of £0.325m.

## 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 £0.718m m and a D-MeX underperformance payment of £0.196m, 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.

South East 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 determination.

## 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 determination.

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 determination 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;
- our draft determination on these payments after any interventions;
- 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 South East 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	-0.472	0.000	0.000	0.000	0.000	0.000	0.000	0.000	-0.472
Water network plus	-1.918	0.000	0.000	0.000	0.000	0.015	0.000	-0.196	-2.099
Residential retail	0.111	0.000	0.000	0.000	0.000	0.026	-0.718	0.000	-0.581
<b>Total</b>	<b>-2.279</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.041</b>	<b>-0.718</b>	<b>-0.196</b>	<b>-3.152</b>

**Table 2.2: Breakdown of bespoke adjustments**

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

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 on prior year total (£m)	Green recovery (£m)	Total bespoke adjustments to be applied to customer bills in 2023-24 (£m)
<b>Water resources</b>	0.000	0.000	0.000	0.000	0.000	0.000	<b>0.000</b>
<b>Water network plus</b>	0.000	0.000	0.015	0.015	0.000	0.000	<b>0.015</b>
<b>Residential retail</b>	0.000	0.025	0.000	0.025	0.001	0.000	<b>0.026</b>
<b>Total</b>	<b>0.000</b>	<b>0.025</b>	<b>0.015</b>	<b>0.040</b>	<b>0.001</b>	<b>0.000</b>	<b>0.041</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 determination 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 apply adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
<b>Water resources (K factors)</b>	Previous determination	3.37	2.35	3.53	1.60
	Revised	3.37	2.35	0.34	4.57
<b>Water network plus (K factors)</b>	Previous determination	-0.03	-3.01	2.12	-0.23
	Revised	-0.03	-3.01	0.66	1.10
<b>Residential retail (total revenue, TRt – £m, nominal prices)</b>	Previous determination	19.331	18.758	19.788	19.997
	Revised	19.331	18.758	18.911	19.997

We have based South East Water's draft determination on the data and commentary provided to us by South East 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.