15 November 2022

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

Ofwat

About this document

This document provides notice of our final determination on the extent to which the price controls set by the PR19 final determination, are 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: Final determinations of in-period outcome delivery incentives for 2021-22.

We also publish models related to our final determinations on our website.

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.[1]

Each performance commitment (PC) 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 performance against these performance commitments in its annual performance report (APR) in July 2022. We assessed the company's performance against its performance commitments and, in October 2022, consulted on our draft determinations for companies' in-period ODIs for 2021-22.

[1] 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.

In our final 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 the company's licence. The results of our assessment for 2021-22 will affect South East Water's customers' bills in the 2023-24 Charging Year.

Further details regarding the responses we received, our final determinations and the adjustments that we have made are presented in sections 1 and 2, and in Sector overview: Final determinations of in-period outcome delivery incentives for 2021-22.

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 the Consultation on changes to per capita consumption performance commitments – our decision on reporting performance and ODI timing 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 have included 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; and
- WINEP PC – we are intervening to reduce the underperformance of £0.325m to £0.000m This is a change from our draft determinations

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 performance commitments. We consider that it is not necessary to intervene to exclude the impacts of the storms from these performance commitments 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 from 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

1.1 Interventions and policy decisions

Table 1.1 below sets out our view of the payments due for performance commitments on which we have intervened compared to the values reported by South East Water.

Table 1.1: Summary of interventions

Performance commitment	Company's reported payments 2021-22 (£m)	Our draft determination after interventions 2021-22 (£m)	Our final determination after interventions 2021-22 (£m)	Difference between company view and our final determination (£m)
Water Industry National Environment Programme	-0.325	-0.325	0.000	0.325

In our final determination we are intervening on the following performance commitment(s):

1.1.1 Water Industry National Environment Programme

Our draft determination

In its APR submission, 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 had 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 performance commitments simply because of WINEP changes. As a result, we did not intervene in our draft determination to change the underperformance payment of £0.325m.

Stakeholders' responses

South East Water's response, which we publish on our website, disagreed with the fact that we had not removed its £0.325m underperformance payment in relation to its WINEP performance commitment. The company referred us to the drafting of its bespoke PC definition which, unlike most of those in the sector, requires that "all elements of its 2020-25 period WINEP obligations are delivered to agreed scopes and to final statutory deadlines".

Consideration of responses and final determination

Having considered stakeholders' responses on this matter, we are decreasing the company's underperformance payment on this performance commitment from £0.325m to £0.000m. This is because we consider it better aligns with the bespoke wording contained in this PC definition, which is not contained in other bespoke WINEP PC definitions.

1.1.2 Unplanned outages

Our draft determination

We intervened 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).

Stakeholders' responses

We did not receive any specific comments on this issue.

Consideration of responses and final determination

Having received no stakeholder responses on this matter, our final determination on the company's performance payment for this performance commitment remains unchanged from our draft determination, above.

1.1.3 Request for interventions for storm events

Water supply interruptions

In this section, we set out:

- our position at draft determination;
- stakeholders' responses to our draft determination;

- our consideration of the points raised in those responses; and
- our final determination.

Our position at draft determination

Background

South East Water reported a total underperformance payment of £3.157m on its water supply interruptions performance commitment. It attributed £1.474m of this to the impact of Storms Eunice, Dudley and Franklin. The company requested that we intervene to exclude the impact of these storms on ODI payments from this performance commitment. The impact for customers of these service interruptions was severe. Around 39,000 South East Water customers were without water for between 1 and 126 hours. The exclusion requested by South East Water would have reduced the company's underperformance payment on its water supply interruptions PC by £1.474m[2]. This means that the company would not have returned any of the £1.474m to customers.

South East Water considered that the storms amounted to an emergency under the Civil Contingencies Act 2004. The company stated 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 stated 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 stated that the succession of storms prevented UKPN from restoring supplies and power failures continued at a large number of its sites for many days.

Our draft determination

Having reviewed the company's requests and supporting evidence, we considered 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 was 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. We considered that it was not necessary to intervene to exclude the impacts of these storms from the water supply interruptions PC thereby leading to adjustments to the payments that ordinarily flow under the price control package in the PR19 determination. We said our proposed decision ensured that the company bore the

[2] Since publication of our draft determination, we now understand that our interpretation of the company's exclusion slightly overestimated the reduction in the company's underperformance by £0.071m.

appropriate level of risk and remained incentivised to deliver for customers and the environment.

The effect of our decision was that the company's reported underperformance on its supply interruptions performance commitment remained unchanged at £3.157m in our draft determination.

Stakeholders' responses to our draft determination

We received two responses specifically to South East Water's draft determination. These are available on our website.

South East Water

South East Water disagrees with our decision not to exclude the impact on ODI payments directly attributable to Storms Eunice, Dudley and Franklin from the assessment of its performance against its water supply interruption performance commitment. It provides detailed arguments in response to the draft determination, all of which we have considered. In summary those are:

The approach to civil emergencies

- The company stated that exclusions were identified in the reporting guidance, and they reasonably interpreted this guidance to apply in circumstances where it is not appropriate or indeed fair to penalise companies who have already had to deal with a significant event not caused by the water service.
- The company stated that the interruptions to supply ODI is designed to give an incentive to companies to use good practices to avoid inconveniencing customers by interrupting their supply. They stated that it was not designed to inappropriately penalise companies for the incidence of bad weather, or the resilience of third parties such as electricity distributors.
- South East Water said it was not sure why Ofwat had not seen sufficient evidence and provided an extract of the Civil Contingencies Act 2004, which it says makes the definition of an emergency clear. The company resubmitted some information previously submitted in the APR and minutes of the Sussex Resilience Forum from 21st February 2022, which show the meeting included Category 1 responders. It noted that these minutes also refer to the interruptions to supply to hospitals which resulted from the power outages, which clearly constituted a threat to human welfare as defined in the given extract of the Civil Contingencies Act in its definition of an 'emergency'.
- The company stated that the incidence of storm Eunice and the storms Franklin and Dudley in February 2022 were a highly unusual event and were not something that either the company or UK Power Networks could reasonably be expected to have anticipated or made long-term plans for. It said that if such an incident does not meet the bar for an exclusion from the Interruptions to Supply ODI, then it is hard to imagine any incident that might. It stated that "as such this suggests that this an irrelevant exclusion clause"

and that if the exclusion clause is indeed to be disregarded in this way, that clearly represents a change to the ODI performance commitment.

Retrospective regulation

- South East Water stated that it made a reasonable interpretation of the PR19 FD by assuming that Ofwat would accept its requests for exclusions and that by not doing so Ofwat was effectively rewriting the PR19 FD. It said that by disallowing reasonable exclusions, Ofwat is changing the PC.

The in the round approach

- The company stated it did not see the relevance of the points around ODI collar already providing some protection. It stated that historic performance or the use of collars were not relevant to the exclusion for which it applied. It notes that collars were indeed part of the package as described, and so were exclusions. It also made the point that performance in previous years was also extreme weather related, resulting from events in excess of 1 in 100 years frequency.
- The company stated that the assessment around performance in a reasonable range was concerning. They said it has the potential to imply that it is acceptable to not accept a valid exclusion if overall the total reward/penalty range is within a reasonable expected range and ignore whether the exclusion is relevant or indeed fair in that assessment. It said its perverse if our policy implies that if companies performed worse in other performance commitments, this exclusion would have been allowed.
- The company stated that the cost/service disconnect referred to in its draft determination is mischaracterised, as the costs in question are almost entirely backward looking and therefore did not include the cost of such weather events. It pointed out that this kind of storm return frequency is well in excess of anything which occurred during the period used to create the cost/service package.

The incentives created by Ofwat's approach

- The company stated that if Ofwat persists in penalising companies in this manner (not allow exclusions for extreme events), then incentives around ODIs become really significant, which may have unintended consequences in company behaviour for example, by diverting resources to avert high impact low consequence events. It stated that this could be at the expense of investment that creates long term stability of its service such as asset maintenance where the incentives have different properties. It said it doesn’t believe this is in anyone’s best interest, least of all customers.
- The company said it is concerned about what Ofwat is intending to incentivise. It stated that it isn't in customers' interests for the company to construct sufficient backup generation facilities for it to be able to continue to supply customers without interruption in the case of a total power loss across our region. It said such a response would be disproportionate, not in the customer interest and have a huge carbon footprint.

- The company disputed Ofwat's suggestion that allowing exclusions would encourage companies to concentrate either on convincing Ofwat of the need for a change rather than delivering what matters to customers. It said that this is at best a misguided interpretation of the application of the exclusion. It said its focus on dealing with these events doesn't even consider the ODI and that its focus is entirely on customers, domestic, business and most importantly customers in vulnerable situations. It stated that any consideration of an exclusion comes much later, and only after all customers are back on supply.
- The company stated it is not correct to suggest the size of the ODI penalty has any influence on its desire to maintain supplies. It said its issue is not to challenge the importance of interruptions but merely to have a regulatory mechanism that is fairly and consistently applied.
- As part our consultation process for developing the PR24 methodology, Northumbrian Water submitted a report by Frontier Economics (commissioned by Northumbrian Water, Yorkshire Water and South East Water) on managing extreme weather risk within regulatory frameworks[3]. While this report focused on the development of our PR24 methodology, which we will conclude next month, and our in-period determination process must focus on the PR19 framework, we have considered the points to the extent they are relevant to this process.

CCW

The Consumer Council for Water (CCW) responded to our consultation. It agreed with our decision "not to make exceptions for Northumbrian Water, South West Water, South East Water and Yorkshire Water where a combination of extreme weather events and third-party damage to company infrastructure contributed to failure. CCW supports this view by saying companies should carry this risk, as they can also gain benefits if they experience a period of good weather leading to reduced pressure on their water and wastewater networks."

Consideration of stakeholders' responses to our draft determination

In addressing the points made by respondents to our draft determination, we consider it helpful to start by setting out the overall framework within which we make our in-period determinations. As such, in this section we set out:

- the overall regulatory framework within which we make our in-period determinations;
- the approach to civil emergencies; and
- assessing whether an intervention is required.

[3] Frontier Economics (commissioned by Northumbrian Water, South East Water and Yorkshire Water), 'Managing extreme weather event risk in the regulatory framework', October 2022.

The overall framework

Our price reviews specify the costs that we allow companies to recover from their customers, and the service that we expect them to deliver for that. Our policy objectives under our price reviews are set by reference to our statutory duties[4] and the UK and Welsh governments' strategic priorities and objectives statements which we have to act in accordance with.

The outcomes framework

Within our price control regime, the outcomes framework holds companies to account for the level of service they provide. While this includes broad measures of customer satisfaction (C-Mex for households and D-Mex for developers), other performance commitments focus on more specific features of the underlying service, such as supply interruptions, and asset health measures to measure the operational resilience of companies' networks.

The determinations specify performance commitment measures and performance commitment levels that we expect companies to attain for several areas of service, based on the business plans that companies put forward. Performance commitments are linked to outcome delivery incentives (ODIs). If companies fall short of their performance commitment levels, they incur underperformance payments which are calculated using the specified ODI rate. This incentivises them to deliver the service levels expected of them. We also encourage companies to push themselves to provide even better service by providing outperformance payments where they go beyond the performance commitment level.

Where a company does not deliver the expected level of service this means customers are affected. A company's customers bear the impact of a reduction of service, in this case an interruption to supply, no matter what the cause or reason for that service failure.

Companies have a significant level of control over the delivery of the outcomes that we specify when defining performance commitments. However, in some cases external factors can also have an effect on the ability of companies to meet their performance commitment levels. Where appropriate, we maintain incentives on companies to mitigate the impact of external factors on customers through how they prepare and respond to such events. For example, in dry weather, mains may be more likely to burst and cut off supply to customers, but companies can reduce the likelihood of this happening through the way they monitor and maintain their assets, and if supply is cut off, they can mitigate the impact on customers by repairing the fault quickly.

Our 'base' expenditure allowance for maintaining the network allows for a level of resilience and has been sufficient for companies to maintain and improve performance and asset health metrics.[5,6] If overall industry costs are higher than forecast then this will impact on

[4] The general statutory duties for most of our work as an economic regulator are set out in the Water Industry Act 1991: https://www.legislation.gov.uk/ukpga/1991/56/contents
[5] Ofwat, PR24 draft methodology: Appendix 9: Setting expenditure allowances, chapter 3.
[6] Ofwat, Assessing base costs at PR24, chapter 5.

the base allowances for the next period which are based in part on historical efficient expenditure. Good management is critical to delivering resilient services. Companies can also put in enhancement claims to improve resilience or service quality further, although they will have to demonstrate this is in customers' interests, and they will be held to account for higher service standards if it is allowed.

Our regime does not, therefore, aim or profess to insure companies against all risks outside of their control. Just like in a competitive market, there will be some risks that regulated companies bear the consequences of, even if the cause was not their fault. However, the flip side of the regime is that there are instances where companies benefit from improved performance when the circumstances are more favourable and may gain outperformance payments as a result. For example, if there is a wet summer, per capita consumption, one of the performance commitments we measure, will be lower than normal, even without any company action, as people tend to water their garden less.

Our price review determinations recognise that companies bear risk, including some external risk, and so have a degree of variability in their returns that is outside of their control. What is important is that the upside and downside risks for an efficient company are broadly balanced so that it anticipates a "fair bet" on a forward-looking basis.

Although we consider companies should bear some risk, we limit the extent of this through a range of protection mechanisms.[7] This includes cost sharing, which means that customers bear a portion of any company overspend (generally 50%). It also includes collars on ODI payments to protect companies against large underperformance payments on specific performance commitments, as well as caps to protect customers against unexpectedly high payments.[8] Companies were able to propose caps and collars in their business plans at PR19, including on bespoke performance commitments[9].

Companies were able to refer their final determinations to the Competition and Markets Authority (CMA) for redetermination. Once the determination has been set, we consider companies should bear the consequences of their price review packages to avoid later unbalancing the package in companies' favour and that they should not seek to reset that balance by seeking exclusions from individual aspects of it in a manner which was expressly not envisaged. We do not rule out the possibility of a circumstance arising where intervention is required in light of our statutory duties and policy objectives. Nevertheless, in light of this approach (which we consider to be consistent with the principles of best

[7] These include reconciliation mechanisms (such as inflation indexation of the cost of new debt, changes to tax rates and changes in customer numbers) protecting for circumstances that arise outside of management control; protections for changes in business rates, abstraction charges and wages; interim determination provision which allow price controls to be reopened in specific circumstances; along with the linked substantial effect provision which provide protection to both companies and customers where circumstances have a material adverse (or favourable) effect on a company.
[8] At PR19, we set caps and collars on performance commitments which we considered were financially material and uncertain. If the performance commitments proposed by companies did not meet these criteria, we generally did not add caps or collars.
[9] We set a cap and collar on South East Water's common water supply interruptions performance commitments, because we considered it to be financially material.

regulatory practice, in particular those of consistency and targeting intervention at cases where it is needed), we see this as being, in practice, a high bar for intervention in the application of the PC and ODI regime.

Impact on wider framework

We also consider how the ODI regime interacts with the wider regime, including investor returns and incentives to invest.

For example, in considering the package as a whole, we consider whether our outcomes regime may create unwanted incentives to invest so as to minimise risk in an inefficient way, which would not be in customers' interests. This applies both to the package as set and to our judgement about any interventions put forward by companies in period, as reflected in our draft determinations. In our draft determinations, we said we did not think our proposed decision would give rise to issues in this respect and we remain of that view.

In relation to supply interruptions, the package set at PR19 reflects the possibility of an intervention only in relation to the impact of a qualifying emergency. Even in cases where a company evidences that there has been a qualifying emergency (our approach to which is discussed below), a decision on whether to intervene has to be taken in light of what the PC definition says, and consistently with our stated policy objectives and statutory duties. Our decision in this final determination on whether or not to intervene reflects that.

Accordingly, by reference to the position we set out at PR19, we do not consider that the approach we have taken leads to companies bearing any more risk than assumed at PR19 or creates any broader consequences which distort the wider regime. Therefore investors will not require a higher allowed return at PR24 with respect to this.

Further, we do not consider that our decision in this final determination on whether or not to intervene will otherwise affect companies' incentives to invest at PR24. As now, companies will be funded to meet a level of resilience through base expenditure.

We will also consider companies' requests for additional expenditure to enhance resilience during our price review process. We set out our proposed approach to assessing these requests as part of the PR24 draft methodology.[10] Our criteria include a clear and systematic risk assessment process that shows the investment is a priority. Investments must address specific relevant hazards, and investments should be cost beneficial, and represent 'best value'. We would not expect to make enhancement allowances to be resilient to very rare events. Enhancement investments that prevent very rare occurrences are only likely to be value for money where customers place a very high value on the service.

Companies will therefore not be 100% resilient and may not meet their performance commitment levels in all cases. However, that does not necessarily imply customers should

[10] Ofwat, PR24 draft methodology: Appendix 9: Setting expenditure allowances, p62-63.

bear the risks of such events occurring under our outcome incentive package, although this package should be balanced in the round. Companies may incur underperformance payments due to events outside of their control, as under PR19 final determinations and reporting guidance. We link ODI incentives to customer valuations at a price review – so companies will only be incentivised to invest efficiently, i.e. where the likely change in ODI payments, which reflects customers' valuations of improving service, outweigh any associated incremental costs of the investment.

The approach to civil emergencies

In our PR19 methodology and subsequent PR19 final determinations we said that in relation to adverse events, such as weather events, we wanted companies to be incentivised to minimise the impact on customers. We said these are precisely the events we want the sector to be resilient to. That having been said, the water supply interruptions performance commitment incorporates the Reporting guidance for PR19 – Supply Interruptions . The reporting guidance states:

> *"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.*
>
> *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*."[11]

As can be seen from the text set out above, there is no automatic or unqualified exclusion from the supply interruptions ODI underperformance payments in the reporting guidance. On the contrary, the sentence concerning a civil emergency explains that companies "may make a representation to Ofwat for an exception to be granted"; in other words, that Ofwat will consider making an exception in the event of a qualifying emergency, should the company make a representation to us to do so.

That is not to say that the sentence concerning a qualifying emergency in the reporting guidance is irrelevant or pointless: it sets out that if such an event has occurred Ofwat should (upon receipt of a representation from the company) consider the matter further. However, the reporting guidance is not mandating the outcome of that consideration: Ofwat may consider that, despite suffering an impact on its performance as a result of a qualifying emergency, the company should nevertheless incur an underperformance payment. Nor does

[11] In this determination, we refer to a civil emergency under the Civil Contingencies Act 2004 where the supply interruption is not the cause of the emergency as a "qualifying emergency".

the reporting guidance specify any particular criteria which Ofwat should consider in deciding whether to make an exception.

We have considered South East Water's comments about its expectation as to the application of the reporting guidance. Our view, as explained above, is that the language is not that of an automatic exclusion. We do not consider, particularly in the light of the overall regulatory framework described in the subsections above and the clear intention of the PC and ODI regime as regards risk transfer and limited exclusions, that companies would reasonably have expected at PR19 that in the event of a qualifying emergency, any supply interruption would be excluded automatically and in its entirety from the ODIs, irrespective of any other considerations or circumstances.

We have considered the company's comment that the performance commitment was not designed to inappropriately penalise companies for the incidence of bad weather, or the resilience of third parties such as electricity distributors. The reporting guidance for the water supply interruptions PC states that "The cause of the interruption is not relevant to the calculation of the reported figure." As we say in the overall framework section, above, our regime does not aim or profess to insure companies against all risks outside of their control. We also note that, as mentioned below, the company has received significant protection through the application of the underperformance collar.

We have considered the information provided by the company and remain of the view that the company has provided insufficient evidence to demonstrate that an emergency occurred in line with the PC definition. The additional evidence provided by the company demonstrates that the Local Resilience Forum, which included Category 1 responders, convened but not that an emergency occurred. For example, the Local Resilience Forum decided that there was no need to declare a major incident.

Our approach to assessing whether an intervention is required

Although not necessarily determinative in this case, wider factors we take into account when considering our duties include the factors set out above concerning how the overall outcomes framework is intended to operate. They also include the fact that the PR19 final determination comprised a package over a five-year period and that some events over that period will in any given year benefit companies while others will not. We are also mindful of the natural information asymmetry between companies and regulators that favour companies in identifying circumstances that have a negative financial impact on them but makes it harder to identify circumstances which provide fortuitous benefits. These benefits can arise for example in the event of favourable weather conditions making it easier to achieve outperformance against the performance commitment levels as set at the previous price control. If we did not take such possibilities into account, it could lead to one-off adjustments that asymmetrically favour companies.

This is why we consider it appropriate to assess overall risk in the PR19 package, as well as the severity and the impact on ODI payments of individual events[12]. This is in line with our PR19 determinations which set out the overall level of risk we would expect a company to face over the 2020-25 period. For example, if an efficient company, with notional levels of gearing, faced an individual event outside its control that risked its ability to finance its functions, that might well, depending on all the relevant circumstances, be a situation in which it we considered it appropriate to intervene.

South East Water also said that it did not see the relevance of the points around the ODI collar already providing some protection. It stated that the use of collars was not relevant to the exclusion for which it applied. As noted in our draft determination, the company's performance was significantly beyond its underperformance collar. This is relevant because it means that the company has already benefited from the protection provided by the PR19 package, as the underperformance collars means that the impact of the storms on the company's ODI payments for 2021-22 is reduced from £10.937m (without the collar) to £1.474m (with the collar). This is a relevant consideration when, as a factor in our decision, we consider the financial impact of the storm events on the company.

Our final determination

Having reviewed the company's requests and supporting evidence we consider it is clear that the sentence concerning a qualifying emergency in the reporting guidance does not confer an automatic exclusion of the impact of Storms Eunice, Dudley and Franklin on South East Water's water supply interruptions performance commitment. We also explain that, in light of the additional information it provided, the company has still not demonstrated that there was a qualifying emergency. But we have, nevertheless, considered whether we should intervene by reference to our statutory duties and policy objectives and reviewed evidence from the company that showed its efforts to mitigate the impact on customers.

In its response, South East Water argued that looking at historic performance is not relevant to the exclusion for which it applied. Having considered the company's arguments and those of other respondents. while we consider that historic performance may be relevant in considering when to intervene in a particular case, having considered the company's arguments and those of other respondents, we agree that, in these particular circumstances, we should consider carefully the specific financial impact of this event on the performance commitments in question.

Our price review set out the range of ODI payments that we expect companies to experience over the 2020-25 period, taking account of caps, collars and other relevant factors. In the PR19 methodology, we expected returns from ODIs[13] would generally be between ±1% and

[12] When we made our draft determinations, we compared the size of the requested reduction in the underperformance payment against the size of the company's regulatory equity. Comparisons of this sort are normal practice in the water sector and in other regulated sectors.
[13] The expected returns for ODIs excludes expected returns for C-MeX and D-MeX.

±3% return on regulatory equity (RoRE).[14] [15] At the time of setting the PR19 package, we estimated companies' ODI risk range, and checked it fell within this range. For South East Water, we estimated a range of -1.80% to +0.47%.[16]

South East Water requests a change of £1.474m of underperformance payments to the impact of the Storms Eunice, Dudley and Franklin on its water supply interruptions performance commitment, after taking into account the protection already provided by the collar on this performance commitment. This is equivalent to -0.28% return on notional regulatory equity (of £532m in 2021-22 in 2017-18 prices) at an appointee level for a single year. Even this would be well within the estimated range for the five year period. In any event, though, because we assess and allocate risk over a five-year period, this would lead to an impact on the company's return on notional regulatory equity of -0.06%, before accounting for any other performance across the period.

Overall, we considered whether there was anything else by reference to our statutory duties and wider policy objectives, in particular the financial impact of the ODI payments, that required us to intervene. However, the financial impact of the ODI payments does not appear sufficiently significant as to require us to intervene and we have concluded in all the circumstances that we do not need to do so. Consequently, we have decided not to exclude the financial impact of the storm events from the ODI payments.

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

Our draft determination

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.

Stakeholders' responses

We did not receive any specific comments on this issue.

[14] RoRE represents the return to shareholders as a proportion of the equity component of the regulatory capital value (RCV), calculated by reference to the notional capital structure. It is a well-established regulatory tool to provide insight on a normalised basis of the return that companies can earn.
[15] The lower limit of the company-level range reflected levels above which we would expect companies to be 90% of the time (the package P10) and the upper limit reflected where we expected companies to perform below 90% of the time (the package P90).
[16] 'PR19 final determinations: South East Water final determination', Ofwat, December 2019, page 65.

Consideration of responses and final determination

Having received no stakeholder responses on this matter, our final determination on the company's performance payment for this performance commitment remains unchanged from our draft determination, above.

1.2 C-Mex and D-Mex

Our draft determination

On 21 September we published the relative performance of all companies. Our draft determination included 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.

Stakeholders' responses

South East Water did not comment on this issue. However, another company identified a minor technical inconsistency between the reporting of C-MeX scores in the reconciliation model and the expectation in the RAG 4.10 guidance, which states that scores should be rounded to 2 decimal places.

Consideration of responses and final determination

To ensure the C-MeX reconciliation model operates consistently with RAG 4.10 and the PR19 Reconciliation rulebook guidance, we have updated the model to round the input scores to 2 decimal places. This has no impact on the payment values calculated by the model for South East Water and our draft determination remains unchanged for this PC.

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 final determination.

2. Impact of 2021-22 in-period ODI assessment on price controls

2.1 Our final determination

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

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

Table 2.1: Change between draft and final determination on total ODI payments to be applied to customer bills in 2023-24 (£m)

This table sets out the change between our draft and final determinations.

Price control	Draft determination on total ODI payments to be applied to customer bills in 2023-24 (£m)	Change between draft and final determination (£m)	Final determination on total ODI payments to be applied to customer bills in 2023-24 (£m)
Water resources	-0.472	0.325	-0.147
Water network plus	-2.099	0.000	-2.099
Residential retail	-0.581	-0.001	-0.582
Total	**-3.152**	**0.324**	**-2.828**

Table 2.2: Final determination on adjustment to 2023-24 price controls as a result of performance against ODIs

This table sets out our final 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 final determination on these payments after any interventions;
- bespoke adjustments, including prior year restatements, where relevant; and
- our final determination on C-MeX and D-MeX payments.

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

This final 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)	Ofwat FD interventions (£m)	ODI payments deferred from 2020-21 (£m)	Ofwat FD deferrals (£m)	Ofwat FD abatements (£m)	Bespoke FD adjustments (£m)	C-MeX FD payments (£m)	D-MeX FD payments (£m)	Final determination on total ODI payments to be applied to customer bills in 2023-24 (£m)
Water resources	-0.472	0.325	0.000	0.000	0.000	0.000	0.000	0.000	**-0.147**
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	**-0.582**
Total	**-2.279**	**0.325**	**0.000**	**0.000**	**0.000**	**0.041**	**-0.718**	**-0.196**	**-2.828**

Table 2.3: Breakdown of bespoke adjustments

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

Price control	Prior year restatements (£m)	Prior year C-Mex indexation (£m)	Prior year D-Mex indexation (£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)
Water resources	0.000	0.000	0.000	0.000	0.000	**0.000**
Water network plus	0.000	0.000	0.015	0.000	0.000	**0.015**
Residential retail	0.000	0.025	0.000	0.001	0.000	**0.026**
Total	**0.000**	**0.025**	**0.015**	**0.001**	**0.000**	**0.041**

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 2.4: Changes to price controls (final determinations)

This table sets out the impact of our final determination on the company's price controls, as set out in the in-period adjustments model published on our website. See Sector overview: Final 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
Water resources (K factors)	Previous determination	3.37	2.35	3.53	1.60
	Revised	3.37	2.35	2.46	2.58
Water network plus (K factors)	Previous determination	-0.03	-3.01	2.12	-0.23
	Revised	-0.03	-3.01	0.55	1.21
Residential retail (total revenue, TRt – £m, nominal prices)	Previous determination	19.331	18.758	19.788	19.997
	Revised	19.331	18.758	18.840	19.997

We have based South East Water's final 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.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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