

November 2023

Final determination of South East Water's in-period outcome delivery incentives for 2022-23

Ofwat

About this document

This document provides our final determination on the extent to which the price controls included in our PR19 final determinations, are to be adjusted to reflect South East Water's performance for the 2022-23 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 2022-23](#).

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

Background

At the 2019 price review (PR19), companies made pledges to their customers and stakeholders about the service levels they would meet to make progress towards stated outcomes (performance commitments). Companies' performance commitments form a key part of the service package that they are expected to deliver. 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 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 to incentivise them to keep up this outperformance.

South East Water reported its performance against these performance commitments in its annual performance report (APR) in July 2023. We assessed the company's performance against its performance commitments and, in September 2023, consulted on our [draft](#)

¹ We take account of performance commitments as set out in this appendix, adjusted, if relevant, in accordance with Annex 2 of the 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](#).

[determinations](#) for companies' in-period ODIs for 2022-23. We have carefully considered the [responses](#) we received relating to our draft determinations.

Our final determination sets out relevant adjustments to the company's price controls, for one or more future years. The results of our assessment for 2022-23 will affect South East Water's customers' bills in the 2024-25 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 2022-23](#).

In our [Sector overview Final determinations of in-period outcome delivery incentives for 2020-21](#) we deferred our determination of the value of companies' ODI payments for usage of water per person (known as Per Capita Consumption) 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 2022-23, 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 £0.937m and a D-MeX underperformance payment of £0.748m, based on our assessment of 2022-23 company performance; and
- intervention on the following performance commitment:
 - Mains repairs – we are intervening to decrease the underperformance payment by £0.042m. This is a change to our draft determination for this performance commitment and reflects an update to reported mains length that the company reported to us in its draft determination consultation response.

In its draft determination consultation response, South East Water raised a new request, which it did not include in its 2022-23 APR submission. It wanted us to apply a 0% tax rate to its ODI payments. In our draft determination, we applied a tax rate of 19%. In our final determination, we continue to apply a tax rate of 19% because the evidence submitted by the company did not convince us that a different tax rate should be applied at this time.

See section 1 for the results of our assessment.

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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 2022-23 (£m)	Our draft determination after interventions 2022-23 (£m)	Our final determination after interventions 2022-23 (£m)	Difference between company view and our final determination (£m)
Mains Repairs	-0.084	-0.084	-0.042	0.042

In our final determination we are intervening on the following performance commitments:

1.1.1 Mains Repairs

Our draft determination

We did not intervene in our draft determination.

Stakeholders' responses

In its response to our draft determination, which is published on our [website](#), the company explained that during the process of completing the business plan tables, it picked up an increase in the mains length at year end for 2022-23. This was due to a lag of data inputting following the completion of a work order.

This results in an increase to mains length of 116.5km, as a result mains repairs reduces from 170.3 to 169.7 repairs per 1000km of main.

Consideration of responses and final determination

We are decreasing the company's underperformance payment on this performance commitment by £0.042m. This is because the company told us that its initial 2022-23 APR submission was incorrect due to a data processing issue and it has now provided correct data.

We also make comments with respect to the following *matters and* performance commitments:

1.1.2 Tax

Our draft determination

The company did not request an adjustment to the standard marginal tax rate of 19% in its 2022-23 APR submission. We applied a tax rate of 19% on ODI payments in our draft determination.

Stakeholders' responses

In its response to our draft determination the company states that it is not correct to reduce its revenue to account for a tax shield that does not exist. The company states that there is little risk that it will make a taxable profit in the year the penalties are applied (2024-25). It also states that it will have considerable carried forward tax losses from 2022-23 (around £47m), and probably also 2023-24 (not yet known).

It states that the reason that its marginal tax rate is 0%, is due to a number of factors which are mostly beyond its control. The company states that Ofwat is right to ensure that the right level of ODI penalties are paid, including the tax effects. But it states that in South East Water's case, that means that a marginal tax rate of 0% should be applied. It points out that a number of regulatory mechanisms are based on getting this calculation correct, including Return on Regulatory Equity (RoRE) calculations and the willingness to pay work on which the ODI rates were based at PR19. It states that if the incorrect marginal tax rate is used, then it undermines the integrity of those regulatory mechanisms and adds an arbitrary penalty to water companies.

Consideration of responses and final determination

Having considered stakeholder responses on this matter, our final determination on the company's tax rate on its ODI payments is as stated in our draft determination, above.

We funded an allowance for tax in the PR19 final determination that exceeds the adjustment amount claimed by the company for its in-period ODI determination. It would therefore not be appropriate to limit the tax adjustment in its in-period ODI decision for any of the years 2020-21 to 2022-23.

This is because South East Water has not submitted sufficient evidence to support its assertion that it will not pay tax for the remainder of the 2020-25 period. Such evidence would include tax computations for 2022-23 and forecast tax computations for 2023-24 and 2024-25 with supporting narrative and information on the assurance processes undertaken, including any third party assurance if relevant.

1.1.3 Water Industry National Environment Programme (WINEP)

Our draft determination

We said in our draft determination that the bespoke wording for this performance commitment requires that "all elements of its 2020-25 period WINEP obligations are delivered to agreed scopes and to final statutory deadlines". We stated that this wording is not contained in other companies' bespoke WINEP performance commitment definitions. We said that in our [Final determination of South East Water's in period outcome delivery incentives for 2021-22](#), we accepted that the performance commitment levels for this performance commitment need to be adjusted for revised targets, approved by the Environment Agency.

We stated that in its response to our query SEW-APR-IP-003, South East Water had provided confirmation from the Environment Agency of extended deadlines for some of its WINEP schemes and updated cumulative targets for the remainder of the 2020-25 period.

We said that the updated cumulative targets did not affect the company's reported performance or payments for 2022-23, as the targets for 2022-23 remained the same (38 schemes delivered). However, we noted that they did affect the cumulative target for 2023-24, which had changed from 44 schemes delivered to 38 schemes delivered. We noted that the cumulative target of 65 schemes delivered for 2024-45 remained unchanged. We said we will update the performance commitment level for this performance commitment for 2023-24 via the Annex 2 process.

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 is as stated in our draft determination, above.

1.1.4 Unplanned outage

Our draft determination

We did not intervene or comment on this matter in our draft determination; nor did we receive any stakeholder comments on it.

Our final determination

In our [Sector overview: Final determinations of in-period outcome delivery incentives for 2022-23](#), we highlight matters identified by our review of company submissions for the unplanned outage performance commitment. In light of these matters, companies should review their approach to peak week production capacity (PWPC) against the common methodology in the PR19 reporting guidance to ensure that they are acting in compliance. Should South East Water's unplanned outage performance information be revised or restated

in future, we expect the company to clearly identify any reasons for the restatement and quantify the impact of any changes to data and/or assumptions on reported unplanned outage. We will take account of adjustments we have made to the relevant price control relating to the company's unplanned outage performance in making future determinations.

1.1.5 Leakage and per capita consumption

Our draft determination

We did not intervene in our draft determination.

Stakeholders' responses

In its consultation response South East Water told us that it has identified a change to its per capita consumption (PCC) baseline figures (2017-18, 2018-19, 2019-20) and therefore the impact of its three year average performance in 2020-21 and 2021-22. The company stated that this does not affect the in-period ODIs because the PCC ODI is not applied in the 2024-25 billing year, but that it thought it appropriate to bring our attention to it here.

South East Water provided the revised annual values for 2017-18, 2018-19 and 2019-20 and its recalculated performance against its PR19 performance commitment levels for PCC. The company stated that it estimates that this would change its forecasted underperformance payment from around £9.8m to around £8.3m, for the 2020-25 period should Ofwat not intervene at PR24.

Consideration of responses and final determination

We queried the company to evidence how it has satisfied itself that PCC restatement has not impacted on its reported leakage and to confirm why this does not affect the PCC figures South East Water has reported for 2020-21 and 2021-22. We also asked South East Water to provide a copy of external assurance showing that the assurer agrees that the restatement does not affect reported leakage and in-period ODI payments resulting from performance against the leakage performance commitment.

In its response to our query the company confirmed that the total annual leakage figures used to generate its baseline align with the figures submitted on 15 August 2022 in response to our water balance data request. South East Water reconfirmed that its original PCC baseline does not align with this data request, therefore when completing the business plan tables it identified that it should be aligning its PCC baseline with the water balance calculations. South East Water provided a third party assurance letter for its August 2022 data submission.

The company stated that it did not recognise the need to update its PCC baseline at that time and that this only became clear when it used the data request information to update its Water Resources Management Plan (WRMP) and business plan tables.

South East Water also told us that when calculating its 2020-21 and 2021-22 performance it used the correct PR19 methodology and therefore the recalculation carried out does not affect these years and that the only change in reporting is that of the 3 year average baseline.

Having considered South East Water's response on this matter, our final determination on the company's performance payment for its leakage performance commitment is as stated in our draft determination. We are making no changes to the company's ODI model and we will continue to apply the calculated underperformance payment.

Should any leakage or per capita consumption information be revised or restated in future, our subsequent determinations will take account of the company's relevant performance and the adjustments we have made to the relevant price control in relation to the leakage performance commitment.

1.2 C-Mex and D-Mex

Our draft determination

On 26 September 2023 we published the relative performance of all companies. Our final determination includes a C-MeX underperformance payment of £0.937m and a D-MeX underperformance payment of £0.748m, based on our assessment of 2022-23 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

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 payments for these performance commitments is as stated in our draft determination, above.

1.3 Payment deferrals and abatements

As set out in the [PR19 Reconciliation Rulebook: Guidance Document](#), companies can ask us to defer outperformance or underperformance payments, or abate outperformance payments. 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 2022-23 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 below sets out the change between our draft and final determinations.

Table 2.1: Change between draft and final determination on total ODI payments to be applied to customer bills in 2024-25

Price control	Draft determination on total ODI payments to be applied to customer bills in 2024-25 (£m)	Change between draft and final determination on total ODI payments to be applied to customer bills in 2024-25 (£m)	Final determination on total ODI payments to be applied to customer bills in 2024-25 (£m)
Water resources	-0.139	0.000	-0.139
Water network plus	-4.409	0.042	-4.367
Residential retail	-0.682	0.000	-0.682
Total	-5.230	0.042	-5.188

Table 2.2: Final determination on adjustment to 2024-25 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 2024-25 charging year after accounting for:

- the in-period ODI payments for each company based on their performance in 2022-23;
- our final determination on these payments after any interventions; and
- our final determination on C-MeX and D-MeX payments.

For further details, 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.

Final determination of South East Water's in-period outcome delivery incentives for 2022-23

Price control	Company's reported ODI payments (£m)	Ofwat FD ODI payments (£m)	ODI payments deferred from 2021-22 (£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 2024-25 (£m)
Water resources	-0.139	-0.139	0.000	0.000	0.000	0.000	0.000	0.000	-0.139
Water network plus	-3.661	-3.619	0.000	0.000	0.000	0.000	0.000	-0.748	-4.367
Residential retail	0.255	0.255	0.000	0.000	0.000	0.000	-0.937	0.000	-0.682
Total	-3.544	-3.502	0.000	0.000	0.000	0.000	-0.937	-0.748	-5.188

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)	Time value of money adjustment on prior year total (£m)	Green economic recovery (£m)	Total bespoke adjustments to be applied to customer bills in 2024-25 (£m)
Water resources	0.000	0.000	0.000	0.000
Water network plus	0.000	0.000	0.000	0.000
Residential retail	0.000	0.000	0.000	0.000
Total	0.000	0.000	0.000	0.000

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 2022-23](#) 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	2.46	2.58
	Revised	3.37	2.35	2.46	1.63
Water network plus (K factors)	Previous determination	-0.03	-3.01	0.55	1.21
	Revised	-0.03	-3.01	0.55	-1.92
Residential retail (total revenue, TRt – £m, nominal prices)	Previous determination	19.331	18.758	18.840	19.997
	Revised	19.331	18.758	18.840	18.832

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, we may take account of this, and previous price control adjustments relating to company performance, when making future determinations.

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Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA
Phone: 0121 644 7500

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Any enquiries regarding this publication should be sent to mailbox@ofwat.gov.uk.

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