

November 2023

Final determination of Southern 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 Southern 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. Southern Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Southern 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.

Southern 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 Southern 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 Southern 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 £3.657m and a D-MeX underperformance payment of £1.817m, based on our assessment of 2022-23 company performance.

In its [response](#) to our draft determination consultation, the company requested to defer £21.451m of its 2022-23 underperformance payments to the 2025-26 charging year. Under the normal operation of the ODI mechanism, these payments would have been applied to the 2024-25 charging year. We have considered the company's request in light of the requirements for deferrals set out in the [PR19 Reconciliation Rulebook](#). The company meets these requirements and, having considered the company's request, we have intervened to defer £21.451m of underperformance payments to 2025-26.

See section 1 for the results of our assessment.

Contents

1.	Results of our assessment	4
1.1	Interventions and policy decisions	4
1.2	C-Mex and D-Mex	7
1.3	Payment deferrals and abatements	7
2.	Impact of 2022-23 in-period ODI assessment on price controls	10
2.1	Our final determination	10

1. Results of our assessment

1.1 Interventions and policy decisions

In its APR submission, the company did not request any interventions to its reported performance and ODI payments. Based on our assessment of the company's performance, we did not consider any were required in our draft determination.

However, in its draft determination consultation response, the company requested that we intervene to defer £21.451m of its 2022-23 underperformance payments to the 2025-26 charging year.

We make comments with respect to this along with the company's leakage, pollution incidents and unplanned outage performance commitments below.

1.1.1 Leakage

Our draft determination

In our draft determination, we noted that Southern Water reported a 0.2% reduction against its leakage performance commitment level of 9.0% for 2022-23. We applied the reported underperformance payment of £2.332m in line with the operation of this performance commitment.

In its 2022-23 APR submission, the company stated that it had maintained reporting in line with the baseline methodology in accordance with the expectation set out in our [Final determination of Southern Water in-period outcome delivery incentives for 2021-22](#), and that all water balance data submitted in the APR had been produced in a way that was entirely consistent with the three-year rolling average baseline. Southern Water confirmed that there had been no change to the RAG compliance checklist submitted in 2020-21 and 2021-22. We noted that this means that the company had still not achieved full compliance with the [PR19 common performance commitment definitions](#) and the [leakage reporting guidance](#).

Southern Water also stated that it continues to run parallel reporting internally with amendments being made to address the remaining amber elements and whilst it was yet to be fully compliant, it said that further changes were being introduced to this shadow reporting with the aim of being fully compliant by the start of the 2025-2030 period.

We said we expected all companies to be reporting full compliance with the leakage and per capita consumption (PCC) methodology. We said should any leakage 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.

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.

1.1.2 Tax

Our draft determination

In its 2021-22 APR, Southern Water submitted information to support its view that it does not expect to pay corporation tax within the 2020-25 period. Based on the information provided, we adjusted the modelled tax rate to 0% for 2021-22 and the remainder of the 2020-25 period in our [Final determination of Southern Water's in-period outcome delivery incentives for 2021-22](#).

In its 2022-23 APR, the company submitted updated information to support its view that it does not expect to pay corporation tax within the 2020-25 period, due to its high capital allowances and taxable losses that reduce its future tax liabilities. Based on the information provided this year, we said in our draft determination that we considered that a tax rate of 0% for 2022-23 remains appropriate.

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.

1.1.3 Pollution incidents

Our draft determination

In its 2022-23 APR, Southern Water stated that it was reporting pollution incidents identified retrospectively and that other companies may not have reported these incidents in the same way. It questioned whether the total number of pollution incidents reported in the Environmental Performance Assessment (EPA) is comparable across companies. The Environment Agency undertook a review to ensure that guidance was being followed and that

there was a level playing field between companies. The review concluded that guidance was being followed in the vast majority of cases but did identify a small number of Southern Water incidents which were being reported differently to other companies. These remained classified by the Environment Agency as incidents and/or permit breaches but were not included in the EPA to ensure fair comparison across companies. This did not affect the company's pollution incident or overall EPA rating. Consequently, for the purpose of calculating the company's performance, we used the number of pollution incidents for which the company is responsible, as determined by the Environment Agency.

We said that if in the future additional pollution incidents are identified that should have been reported, we may adjust performance payments accordingly.

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 Southern 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.

1.2 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 £3.657m and a D-MeX underperformance payment of £1.817m, 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 payment 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.

Our draft determination

Southern Water did not request any payment deferrals or abatements in its 2022-23 APR. Based on our assessment of the company's performance, we did not consider any were required. As such, we did not apply any payment deferrals or abatements in our draft determination.

Stakeholders' responses

In its [consultation response](#), the company stated that it would like to defer a proportion of its £42.903m underperformance payments for 2022-23 to the 2025-30 period. The company subsequently confirmed that it wished to defer £21.451m of its underperformance payments for 2022-23, and that it wished to defer these payments to the 2025-26 charging year. The company has provided details of how this deferral would be split across its water resources,

water network plus, wastewater network plus, bioresources and residential retail price controls.

The company sets out the following reasons for its deferral request:

- Cashflow – it states that a shortfall in revenues for 2023-24, due to lower than forecast consumption by residential customers which will not be recovered until 2025-26, means that the company will have lower than expected revenues and cashflow for the remainder of the 2020-25 period. It points out that this will put pressure on financial covenant ratios which will hamper the company's ability to deliver its investment and turnaround programme.
- Bill volatility – it states that the recovery of the shortfall in revenue for 2023-24 will increase customers' bills in 2025-26 by a further 4%, on top of an already significant bill increase due to proposed PR24 investment. It notes that 2025-26 already has the highest proposed bill increase of the 2025-30 period, so the deferral would therefore be in customers' interests. This is because it would offset any additional increase in bills, reducing any step change in bills between the 2020-25 and 2025-30 period.
- Customer support – it provides evidence from its PR24 business plan customer acceptability testing that customers prefer smooth bills and bill stability, that they want to see investment for improvements now and that a delay to the company's turnaround programme is not in customers' interests. The company has discussed the deferral with CCWater. CCWater said that it understood the benefit of making bill increases smoother but flagged the need to ensure the right support is in place for customers. The company has explained the support it has in place to address the short-term impact on customers.
- CCWater support – it states that it has discussed the deferral with CCW who agree on the benefit of smoother bill transition into 2025-30 price control period.

Consideration of responses and final determination

Having considered the information and arguments provided to us by Southern Water, we are making a deferral of £21.451m of the company's underperformance payments for 2023-23, in line with the company's request. Our intervention means that £21.451m will not be applied to customer bills in 2024-25 but will instead be applied to customer bills in 2025-26. The remaining £21.451m of the company's underperformance payments for 2022-23 will be applied to customer bills in 2024-25. We consider this decision is consistent with our statutory duties.

We have considered the company's request against the requirements of the [PR19 reconciliation rulebook](#) (the Rulebook). The Rulebook states that, where ODI adjustments exceed $\pm 1\%$ of notional regulatory equity at an appointee level, companies can ask us to defer the excess to a subsequent year, for example to manage bill volatility. 1% of the company's notional regulated equity at an appointee level (in 2017-18 prices) is £20.825m. This means

that, per the Rulebook, the company can request to defer up to £22.078m (net underperformance payments of £42.903m less £20.825m). The company's request to defer £21.451m of underperformance payments is therefore within the limit set out in the Rulebook.

We have reviewed the evidence provided by the company, including the projected increase in bills in the 2020-25 period. We consider that there is sufficient reason to make this deferral, recognising the potential benefits to help manage bill volatility, an issue other companies have identified as a reason to defer payments in previous determinations.

We are mindful that this means there will be a delay of one year in customers seeing a reduction in bills from the proportion of underperformance payments which will be deferred. However, on balance, we recognise the benefits to customers of smoother more predictable bills for the remainder for the 2020-25 period and into the 2025-30 period, compared to lower bills now and a much larger bill increase at the beginning of the 2025-30 period. We also note that the deferral will be net present value (NPV) neutral, meaning that there will be no benefit to the company arising from the time value of money. We have also considered the company's expected performance for the remainder of the price control period and note that in its PR24 business plan it is forecasting additional net underperformance payments across the next 2 years.

Having considered all the points above, we consider that there is sufficient reason to apply a deferral of £21.451m of its 2022-23 underperformance payments to 2025-26.

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	-0.958	0.479	-0.479
Water network plus	-15.193	7.597	-7.597
Wastewater network plus (WaSCs only)	-21.209	10.605	-10.605
Bioresources (WaSCs only)	-1.286	0.643	-0.643
Residential retail	-4.257	2.128	-2.128
Total	-42.903	21.451	-21.451

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;
- our final determinations on 2022-23 deferrals and abatements; 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 Southern Water is also set out in the in-period adjustments model published on our website.

Final determination of Southern 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	-0.958	-0.958	0.000	0.479	0.000	0.000	0.000	0.000	-0.479
Water network plus	-14.399	-14.399	0.000	7.597	0.000	0.000	0.000	-0.795	-7.597
Wastewater network plus (WaSCs only)	-20.187	-20.187	0.000	10.605	0.000	0.000	0.000	-1.022	-10.605
Bioresources (WaSCs only)	-1.286	-1.286	0.000	0.643	0.000	0.000	0.000	0.000	-0.643
Residential retail	-0.600	-0.600	0.000	2.128	0.000	0.000	-3.657	0.000	-2.128
Total	-37.429	-37.429	0.000	21.451	0.000	0.000	-3.657	-1.817	-21.451

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
Wastewater network plus (WaSCs only)	0.000	0.000	0.000	0.000
Bioresources (WaSCs only)	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	-2.04	2.55	1.54	-3.45
	Revised	-2.04	2.55	1.54	-5.26
Water network plus (K factors)	Previous determination	0.83	-4.00	0.69	-0.10
	Revised	0.83	-4.00	0.69	-4.75
Wastewater network plus (K factors)	Previous determination	0.99	-9.29	2.90	4.29
	Revised	0.99	-9.29	2.90	1.61
Bioresources (unadjusted revenue, Urt - £m, 2017-18 FYA CPIH prices)	Previous determination	46.880	45.628	46.688	48.187
	Revised	46.880	45.628	46.688	47.543
Residential retail (total revenue, TRt - £m, nominal prices)	Previous determination	50.921	44.094	48.454	52.911
	Revised	50.921	44.094	48.454	50.184

We have based Southern Water's final determination on the data and commentary provided to us by Southern 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.

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

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

© Crown copyright 2023

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

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

OGL