south east water

Draft Determination of in-period ODIs

South East Water response

18th October 2023

South East Water
Rocfort Road
Snodland Kent
ME6 5AH

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1. Introduction

We have reviewed the draft determination for in-period ODIs published 26th September 2023. Following the publication of our 2025-30 business plan we would like to take this opportunity to highlight a change to our reported performance in 2022-23 for Mains Repairs, which has a very minor effect on the ODI.

Separately we have also identified a change to our Per Capita Consumption (PCC) baseline figures (2017-18, 2018-19, 2019-20) and therefore the impact of our three year average performance in 2020-21 and 2021-22. This does not affect the in-period ODIs because the PCC ODI is not applied in the 2024/25 billing year, but we thought it appropriate to bring your attention to it here.

Finally, we note that Ofwat has adjusted the tax rate in our “In period adjustments model” from ‘0%’, as we submitted it, to 25%. The reason that we set it at 0% is because we are very confident that we will not pay any corporation tax in 2024/25, and that this would be true, with or without, the ODI penalties in question. The correct marginal tax rate is therefore 0%.

2. Mains repairs

During the process of completing the business plan tables we picked up an increase in the mains length at year end for 2022-23, this is due to a lag of data inputting following the completion of the work order.

This increase in mains length has resulted in a small reduction in the final mains repairs per 1,000km of main for the year, from 170.3 down to 169.7. The reduction in reported performance reduces the underperformance payment reported from -£0.084m to -£0.042m.

3. Per Capita Consumption (PCC)

In table OUT4 and CW5 of the business plan we have populated the underlying demand figures to bring in line with the data submitted to Ofwat in August 2022, the data request was to provide updated historic water balance data following the introduction of the standard PCC and leakage methodology at the beginning of AMP7. The previous figures which had been used were calculated via an uplift percentage at the start of the AMP, we calculated this percentage based on the first year difference between the PR14 methodology and the new PR19 methodology, this approach was audited and explained to Ofwat in our ARP21 submission.

However, for the data request a recalculation was carried with a better understanding of how the new methodology affected historical data. When these figures are inputted into table 3F of the ODI performance model the result is a higher 2019-20 three year average baseline figure. the change in annual figures also impacts the three year averages for the first 2 years of the period. The following tables shows the figures as reported in APR23 and the resulting impact of the change.

APR23	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Annual	143.6	145.3	143.1	165.9	158.6	150.3
3 year average			144	151.4	155.9	158.3
% difference				5.1%	8.3%	9.9%

Business plan	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Annual	146.7	148.2	146.2	165.9	158.6	150.3
3 year average			147.1	153.5	156.9	158.3
% difference				4.4%	6.7%	7.6%

We estimate that this would change our forecasted underperformance payment from c.9.8m to c.8.3m, for the AMP should Ofwat not intervene at PR24.

4. Marginal tax rate

It is not correct to reduce our revenue to account for a tax shield that does not exist. The year in question is 2024/25, the year when these penalties are applied. There is little risk that we will make a taxable profit in this year. We also will have considerable carried forward tax losses from 22/23 (c£47m), and probably also 23/24 (not yet known).

The reason that our marginal tax rate is 0%, is due to a number of factors which are mostly beyond our control such as:

- A very harsh PR19 settlement (totex overspending and ODI penalties are not unique to SEW, but widespread, particularly in the water service, as demonstrated in the 2022/23 Ofwat Service Delivery report)
- Real price effects which have caused costs to rise faster than revenue, most notably power prices, but in other areas too.
- Adverse weather. Whether this is due to normal weather fluctuations or due to global climate change, it is hard to be certain. It appears that climate change is at least partly to blame.
- Index linked debt costs have increased substantially due to high inflation and movements in the market which were not anticipated at PR19

Ofwat are right to ensure that the right level of ODI penalties are paid, including the tax effects. However, in this case, that means that a marginal tax rate of 0% should be applied. A number of regulatory mechanisms are based on getting this calculation correct, including RoRE calculations and the willingness to pay work on which the ODI rates were based at PR19. 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.

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Contact Us

South East Water
Rocfort Road
Snodland
Kent
ME6 5AH

southeastwater.co.uk

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