

April 2025

PR24 redeterminations

# **Response to Southern Water's statement of case**

**ofwat**

## **PR24 redeterminations: response to Southern Water's statement of case**

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# 1. Navigation assistance

- 1.1 To assist the Competition Markets Authority (CMA), table 1.1 below shows where we have responded to the points raised in Southern Water Services Limited's (Southern Water) statement of case.
- 1.2 Many of the points raised by Southern Water are responded to in the following documents:
- PR24 redeterminations – overview of our response to the statements of case;
  - PR24 redeterminations – expenditure allowances – common issues;
  - PR24 redeterminations – outcomes – common issues; and
  - PR24 redeterminations – risk and return – common issues.
- 1.3 This document starts with a brief description of Southern Water, from our regulatory perspective, then sets out a summary of our Price Review 2024 (PR24) final determination.
- 1.4 If we consider that a point raised by Southern Water in its statement of case is company-specific, and our response or CMA's considerations are unlikely to have a wider impact on other companies, or the whole sector, we set out our response in the final section of this document. In order to further assist with navigation of our response to company-specific points we provide a list of the points covered in each sub-section.
- 1.5 Our summary of the PR24 final determination for Southern Water, and the remainder of this document, and the suite of documents comprising our response to the five statements of case, is generally structured around the building blocks of the price review: expenditure allowances; outcomes; and risk and return.

**Table 1.1 – Navigation assistance**

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
Imbalance of risk and return, with downside skew	Executive Summary (ES), Section 1 Chapter 1	PR24 redeterminations – risk and return – common issues.  Section – Overall balance
Base – Wastewater econometric modelling	ES, Section 2.1, para 18 Chapter 2, section 1.1 Chapter 2, Section 2.1.1	PR24 redeterminations – expenditure allowances – common issues.  Section – Wholesale water base cost models
Base – Water econometric modelling	ES, Section 2.1, para 18 Chapter 2, section 1.1 Chapter 2, section 2.1.2	PR24 redeterminations – expenditure allowances – common issues.



Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
		Section – Wastewater network plus base cost models
Base – Advanced anaerobic digestion cost adjustment claim (CAC)	ES, Section 2.1, para 19 Chapter 2, section 1.1 Chapter 2, section 3.1.1	PR24 redeterminations – expenditure allowances – cost adjustment claims.  Section – Southern Water – Advanced anaerobic digestion upgrades.
Base – Regional labour cost CAC	ES, Section 2.1, para 19 Chapter 2, section 1.1 Chapter 2, section 3.1.2	PR24 redeterminations – expenditure allowances – cost adjustment claims.  Section – Southern Water – Regional wage differentials.
Base – Coastal population CAC	ES, Section 2.1, para 19 Chapter 2, section 1.1 Chapter 2, section 3.1.3	PR24 redeterminations – expenditure allowances – cost adjustment claims.  Section – Southern Water – Coastal population
Base – Frontier shift	ES, Section 2.1, para 20 Chapter 2, section 1.1 Chapter 2, section 4.1.1	PR24 redeterminations – expenditure allowances – common issues.  Section – Frontier shift efficiency and real price effects.
Base – Power cost share and energy prices	ES, Section 2.1, para 20 Chapter 2, section 1.1 Chapter 2, section 4.1.2	PR24 redeterminations – expenditure allowances – common issues.  Section – Energy.
Base – Asset health funding ('gated allowance')	ES, Section 2.1, para 20 Chapter 2, section 1.1 Chapter 2, section 4.1.3	PR24 redeterminations – expenditure allowances – addressing asset health  Section – Our response to the disputing companies' concerns.
Enhancement – Water supply interconnectors	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.1, para 58 Chapter, 3, section 5.1	PR24 redeterminations – expenditure allowances – common issues.  Section – Supply interconnectors
Enhancement – Bioresources IED	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.1, para 58 Chapter 3, section 5.2	PR24 redeterminations – expenditure allowances – common issues.  Section – Industrial Emissions Directive (IED)

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
Enhancement – WINEP – flow monitoring at sewage treatment works	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.2, para 65 Chapter 3, section 6.1	PR24 redeterminations – expenditure allowances – common issues.  Section – Flow monitoring at sewage treatment works.
Enhancement – WINEP – monitoring at emergency overflows	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.2, para 65 Chapter 3, section 6.2	PR24 redeterminations – expenditure allowances – common issues.  Section – Monitoring Certification Scheme (MCERTS) monitoring at emergency overflows.
Enhancement – WINEP – Water	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1	PR24 redeterminations – expenditure allowances – common issues.  Section – WINEP water investigations.
Enhancement – Wastewater shallow dives	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.2, para 65 Chapter 3, section 6.3	PR24 redeterminations – expenditure allowances – common issues.  Section – Company-specific shallow dive efficiency challenge
Enhancement – mains replacement	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.3, para 65 Chapter 3, section 7.1	PR24 redeterminations – expenditure allowances – common issues.  Section – Water mains renewal cost adjustment.
Enhancement – water resilience	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.3, para 68 Chapter 3, section 7.2	PR24 redeterminations – expenditure allowances – common issues.  Section – Water enhancement expenditure allowances.
Enhancement – water supply scheme	ES, Section 3.1, Table 3 and para 27 Chapter 3, section 1.1 Chapter 3, section 4.3, para 68 Chapter 3, section 7.3	PR24 redeterminations – expenditure allowances – common issues.  Section – Water enhancement expenditure allowances.
Uncertainty mechanisms – Delivery mechanism	ES, Section 4.1, para 34 Chapter 4, section 1.1 Chapter 4, section 3	PR24 redeterminations – expenditure allowances – common issues.  Section – Delivery mechanism
Uncertainty mechanisms – Large Gated Schemes	ES, Section 4.1, para 34 Chapter 4, section 1.1 Chapter 4, section 4.2.1	PR24 redeterminations – expenditure allowances – common issues.



Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
		Section – Large Schemes Gated Process.
Uncertainty mechanisms – DPC	ES, Section 4.1, para 34 Chapter 4, section 1.1 Chapter 4, section 4.2.2 and 4.2.3	PR24 redeterminations – expenditure allowances – cost adjustment claims.  Section – Southern Water – Advanced anaerobic digestion upgrades.
Uncertainty mechanisms – Notified items	ES, Section 4.1, para 34 Chapter 4, section 1.1 Chapter 4, section 5.1	PR24 redeterminations – overview of our response to the statements of case.  Section – Areas for deprioritisation.
Uncertainty mechanisms – Boundary box replacements	ES, Section 4.1, para 34 Chapter 4, section 1.1 Chapter 4, section 6.1	This document  Section – Southern Water's boundary box replacement uncertainty mechanism.
Price control deliverables (PCDs)	ES, Section 5.1 Chapter 5	PR24 redeterminations – expenditure allowances – common issues.  Section – Price control deliverables.
Performance commitments and outcome delivery incentives (PCs and ODIs)	ES, Section 6.1, para 45 and 46 Chapter 6, section 3.1	PR24 redeterminations – outcomes – common issues  Section – Approach to setting common performance commitment levels & Calibration of ODI rates and risk protections.
Water supply interruptions	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1	This document  Section – Water Supply Interruptions.
Compliance risk index	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.1	This document  Section – Compliant risk index.
Total pollution incidents	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.2	This document  Section – Total pollution incidents.
Serious pollution incidents	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.3	This document  Section – Total pollution incidents.
Storm overflows	ES, Section 6.1, para 47	This document

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
	Chapter 6, para 6 Chapter 6, section 4.1.4	Section – Storm overflows.
C-MeX, D-MeX, BR-MeX	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.5	This document  Section – C-MeX, D-MeX, BR-MeX.
Bathing water quality	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Bathing water quality.
Leakage	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Leakage.
Water quality contacts	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Customer contacts about water quality.
Discharge permit compliance	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Discharge permit compliance.
WACC	Chapter 7	PR24 redeterminations – risk and return – common issues.  Section – Balance of Risk.
Return on equity – market tests	ES, Section 7.1, para 56 onwards Chapter 7, para 5 Chapter 7, section 3.2 Chapter 7, section 4	PR24 redeterminations – risk and return – common issues.  Section – Allowed Return on Equity.
Return on equity – Parameters	ES, Section 7.1, para 59 onwards Chapter 7, para 8 Chapter 7, section 3.2 onwards	PR24 redeterminations – risk and return – common issues.  Section – Total Market Return.
Cost of debt	ES, Section 7.1, para 60 onwards Chapter 7, para 9 onwards Chapter 7, section 3.4	PR24 redeterminations – risk and return – common issues.  Section – Embedded Cost of Debt.
Notional gearing	ES, Section 7.1, para 63 Chapter 7, para 12 onwards Chapter 7, section 3.5	PR24 redeterminations – risk and return – common issues.  Section – Retail Margin Adjustment.
Impact/affordability	ES, section 8.1, para 75 onwards Chapter 8, section 1.2	PR24 redeterminations – risk and return – common issues.  Section – Overall balance.
Outturn adjustment mechanism (OAM)	Chapter 1, Section 8.1	PR24 redeterminations – risk and return – common issues.

PR24 redeterminations – response to Southern Water's statement of case

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
		Section - Outturn Adjustment Mechanism
Aggregate sharing mechanism (ODI and totex)	Chapter 1, Section 8.2	PR24 redeterminations – risk and return – common issues.  Section - Aggregate Sharing Mechanisms.
DDCM	Chapter 5, section 6.4	PR24 redeterminations – expenditure allowances – common issues.  Section - PCDs overlap with other incentives.
Retail price control – bad debt	Annex 3, para 1	PR24 redeterminations – risk and return – common issues.  Section - Retail Margin Adjustment.



## 2. Introduction

- 2.1 Southern Water is both a water undertaker and a sewerage undertaker. It supplies water services to 2.7 million customers and wastewater services to 4.7 million customers in the South of England. Southern Water is a privately owned company. It is owned by Greensands Holdings Limited (GSH). GSH is owned by a group of long-term investors representing infrastructure investment funds, pension funds and private equity. In September 2021, a fund managed by Macquarie Asset Management acquired a majority stake in GSH.
- 2.2 Price controls are set for the company as a whole and references to 'Southern Water' in our submissions to the CMA refer therefore to the company as a whole, and all of its relevant operational areas, unless otherwise specified.
- 2.3 Southern Water's operational performance in the current price control period (2020–25) has been classed as 'lagging behind' since April 2020. This includes current performance in 2023–24 as covered in the most recent annual water company performance report.<sup>1</sup> As with all companies in this category, we require it to produce a service commitment plan (SCP). A SCP outlines the company's commitments to improve performance and meet customer expectations. It details how the company plans to address areas where they fell short in previous performance and how they will maintain or improve service quality.
- 2.4 In 2023–24, Southern Water met the performance targets for only three of the 12 key performance indicators: priority services register, unplanned outage and treatment works compliance. The areas of poor performance include leakage and drinking water quality, and pollution incidents and internal sewer flooding.
- 2.5 In our most recent monitoring financial resilience report, we categorised Southern Water as 'elevated concern', which means that we have identified some concerns or potential concerns with the company's long-term financial resilience that may require action to redress.<sup>2</sup>
- 2.6 We assessed the business plan Southern Water submitted in October 2023 against our quality and ambition assessment.<sup>3</sup> We considered Southern Water's plan to be inadequate, as it did not meet our minimum expectations in the round.<sup>4</sup> The company made progress, as evidenced in its August 2024 representation ('representation') following our draft determination. In our final determination we moved Southern Water's plan out of the inadequate category but stated that we would continue our

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<sup>1</sup> [OF-OU-017] Ofwat, Water company performance report 2023–24, October 2024, p. 8.

<sup>2</sup> [OF-OAA-003] Ofwat, Monitoring financial resilience report, October 2024, p. 7.

<sup>3</sup> [OF-SRN-008] Ofwat, PR24 Final Methodology: QAA section, December 2022, pp. 149–150.

<sup>4</sup> [OF-SRN-013] Ofwat, PR24 draft determinations: Southern Water – Quality and ambition assessment appendix, July 2023, p. 1.



ongoing financial monitoring and engagement with the company, as well as monitoring its delivery plan.<sup>5</sup>

- 2.7 At draft determination we introduced a delivery mechanism for Southern Water as it was unable to provide assurance in its February 2024 business plan that it could deliver its business plan in full.<sup>6</sup> The delivery mechanism includes an additional oversight and monitoring regime that provides the best delivery opportunity. It also protects customers from paying upfront for benefits that Southern Water may not be able to deliver to schedule. Once Southern Water shows that it can deliver a scheme, the mechanism will release funding for the scheme. This is the point at which the scheme cost allowance could be reflected in customer bills.
- 2.8 The expenditure figures in this document include the value of the schemes within the delivery mechanism. More information on how the delivery mechanism works and which schemes are included within it can be found in 9.-PR24-final-determinations-Expenditure-allowances.pdf section 4.7.4.<sup>7</sup>
- 2.9 The allowed revenue and bill values in this document exclude the value of the schemes in the delivery mechanism. The bill and revenue values quoted are the amounts customers will be expected to pay and the company allowed to collect in 2025-30 based on what the company has assured us it can deliver. If as explained above as part of the delivery mechanism process Southern Water can show it can deliver the schemes in the delivery mechanism the average household bill and revenue Southern Water can collect will increase.

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<sup>5</sup> [OF-OA-016] Ofwat, PR24 final determinations: Quality and ambition assessment summary. December 2024, pp. 13-14.

<sup>6</sup> [OF-CA-025]. Ofwat, PR24 draft determinations: Expenditure allowances – Ofwat, July 2024, pp. 184-187.

<sup>7</sup> [OF-OA-022] Ofwat, PR24 final determinations: Expenditure allowances, February 2025, p. 339, table 43.

### 3. Southern Water: A summary of our final determination

- 3.1 We summarise in this section what was included in our final determination in each of these three main areas of expenditure allowances, outcomes and risk and return and provide more information on the key issues that arose between us and Southern Water during the PR24 process.
- 3.2 Table 3.1 sets out the key metrics included in Southern Water's February 2024 PR24 business plan submission to Ofwat, our draft determination and the company's representation on our final determination.

**Table 3.1: Containing summary of key metrics**

	Revised business plan (Feb 2024)	Draft determination	Company view (August 2024 representations)	Final determination
Totex, 2025–2030 (£million) (post frontier shift/RPEs)	7,911	6,947	9,614	8,530
PAYG rate (%)	34.4	34.7	30.9	33.2
Allowed return (%)	–	3.72	–	4.03
RCV run-off rate (%)	4.49	4.18	4.49	4.36
Allowed revenue, 2025–30 (£million)	6,713	5,769	7,516	6,466
Average bill per household customer, 2025–30 (£)	670	562	747	620

### Expenditure allowances

- 3.3 In our final determination we allowed Southern Water a total expenditure allowance of £8.5 billion for the period 2025–30. This is 11% (£1.1 billion) less than the £9.6 billion requested by Southern Water in its representation in response to our draft determinations. Table 3.2 below shows the expenditure allowances requested by Southern Water and those proposed and allowed by Ofwat through the stages of PR24.

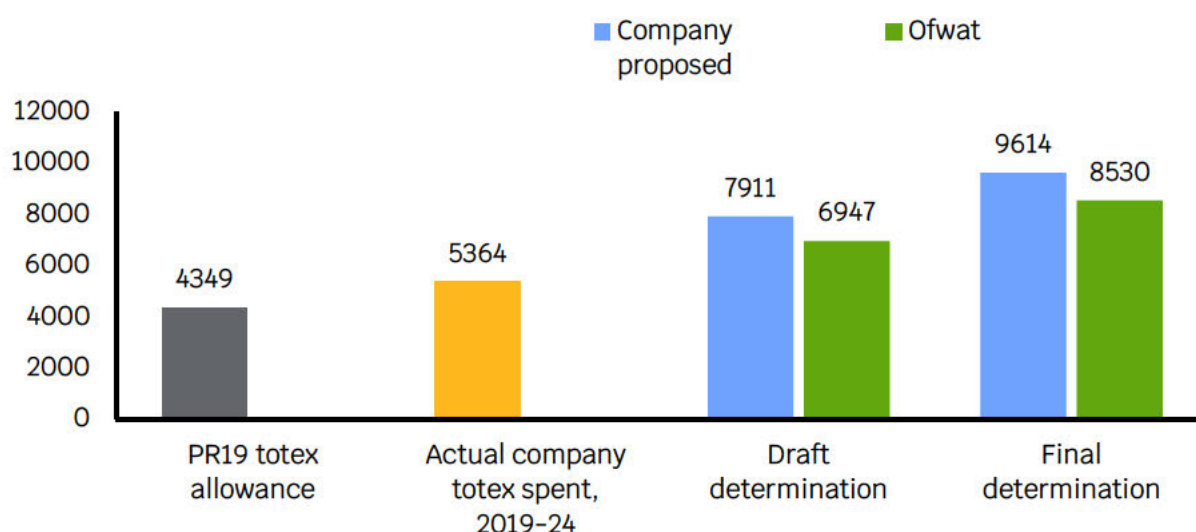
**Table 3.2: Final determination total expenditure allowances and previous stages of PR24 for Southern Water £m (five year period, after frontier shift/ RPEs, 2022-23 prices)**

Five-year total	BP- Oct 23 (£m)	BP – Feb 24 (£m)	DD (£m)	Rep – Aug 24 (£m)	FD (£m)	FD vs Rep (%)	FD vs Rep (£m)
Overall expenditure	6,606	7,911	6,947	9,614	8,530	-11	-1084
Base expenditure	3,541	3,857	3,649	4,319	3,991	-8	-328
Enhancement expenditure	3,065	4,054	3,298	5,296	4,539	-14	-757

- 3.4 As shown in table 3.2, Southern Water's overall expenditure request increased between its original business plan submission in October 2023 and updated business plan in February 2024.
- 3.5 The main reason for this increase was as a result of Southern Water providing, at Ofwat's request, revised total expenditure information which included its full programme of activity required by the Environment Agency and DEFRA to fulfil its PR24 WINEP programme within the 5 years (2025-30) price control rather than phased over 9 years as submitted by Southern Water in its original October 2023 business plan.
- 3.6 Southern Water further increased its overall expenditure request in its representation in response to Ofwat's draft determination. The increase was mainly attributed to increases in water and wastewater enhancement expenditure and new cost adjustment claims for water treatment economies of scale and wastewater growth network reinforcement.
- 3.7 In figure 3.1, we show how PR24 expenditure proposals and allowances compare to PR19 expenditure allowances and the most recent actual expenditure levels.



**Figure 3.1: Overview of totex allowances for Southern Water £m (2022-23 prices) <sup>8</sup>**



3.8 We consider that Southern Water's total expenditure allowance at final determination forms part of an in-the-round package that is stretching but achievable and is set at a level that ensures that customers only pay for efficient costs.

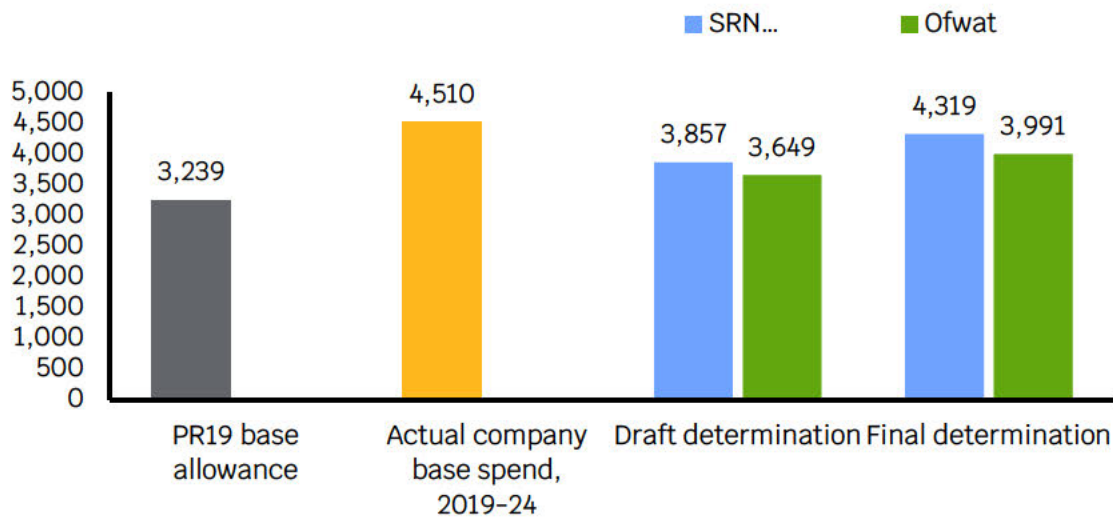
3.9 Our final determination includes £538 million of expenditure for schemes included in the delivery mechanism. As explained in the introduction of this document, this mechanism allows Southern Water to claim additional revenue through customer bills to cover the cost of the schemes during 2025-30 when it submits a delivery plan and provides assurance that it can deliver the particular scheme.

## Base expenditure

3.10 As shown in figure 3.2 we increased Southern water's base allowance by £342 million (9%) to £3,991 million from draft to final determination. We allowed:

- higher allowances for energy costs (£70 million more) and business rates (£60 million more);
- additional allowances to facilitate growth through the network reinforcement sector wide cost adjustment (£46 million more);
- an allowance to reflect our partial acceptance of the company's economies of scale at water treatment works cost adjustment claim (£19 million that was not included in the February business plan, and therefore not in the draft determination allowance).

<sup>8</sup> Data provided by Southern Water in its yearly APR submissions, converted to 2022-23 price base. Includes wholesale water, sewage, bioresources & retail. Excludes grants & contributions.

**Figure 3.2: Overview of base allowances for Southern Water £m (2022–23 prices)**

- 3.11 Southern Water submitted seven base cost adjustment claims in its representation. We accepted one for meter replacement in full, including the upward adjustment to its requested expenditure that the company had made from its February business plan. We allowed £19 million of a £24 million claim for economies of scale at water treatment works, and we accepted £46 million of a claim for £50 million (increased by the company from £11 million in its February business plan).
- 3.12 We did not accept the claims for regional labour costs, which the company stated was required due to higher wages than the national average. We consider that regional wage differentials are accounted for in our benchmarking analysis.
- 3.13 We did not accept a claim for advanced anaerobic digestion (AAD) upgrades at two sludge treatment centres. There is an implicit allowance in the base cost models for AAD, and we consider that these costs should be funded through the base allowance.
- 3.14 We did not accept the claim for coastal population, which Southern Water states leads to higher costs at coastal wastewater sites. We consider this claim lacked engineering rationale and the econometric results were not robust.
- 3.15 We did not accept a claim for capital maintenance to address asset health issues, Southern Water stated that our approach is not forward-looking. We rejected the claim on the basis that the asset condition information provided by the company in its PR24 business plan data tables and through the PR24 query process did not suggest that the assets included in the claim were in materially poor condition and there was a risk of customers paying twice and discouraging the sector from delivering renewals with base expenditure allowances.

- 3.16 In our wastewater econometric modelling, to capture economies of scale at large treatment works we include two variables. Southern Water disagreed with our use of one of the variables (percentage of load treated in sewage treatment works bands 1-3) as it had relatively weaker statistical significance and engineering rationale compared to the other variables. We set out in the final determination that the bands 1-3 variable does have a strong rationale and is statistically significant in wastewater network plus models and bioresources models. We explain this in 'PR24 final determinations; base expenditure modelling'.<sup>9</sup>
- 3.17 In water modelling, Southern Water also wanted us to remove the 'average pumping head' explanatory variable for capturing network topography. It stated this was because the data for this variable was not good quality. However other companies including South East Water argues for the inclusion of both boosters per length of mains and average pumping head together in the models.<sup>10</sup> We considered that the sector had made sufficient improvement in the quality of this data for us to include it in the modelling. We explain this in 'PR24 final determinations; base expenditure modelling'.<sup>11</sup>
- 3.18 In the final determination, we made an unmodelled adjustment to energy costs for Southern Water from draft determination. Differences between forecasts and actual energy prices will be accounted for in the end of period energy price reconciliation mechanism. More detail on our decisions around energy expenditure is in 'PR24 final determinations: expenditure allowances'.<sup>12</sup>
- 3.19 At final determination, we set a frontier shift of 1%. Southern Water requested 0.5% in its August 2024 representation. We expect companies to innovate and take advantage of new technologies to become more cost efficient. We explain our rationale for the 1% frontier shift in 'PR24 final determinations: expenditure allowances'.<sup>13</sup>

## Enhancement expenditure

### Water

- 3.20 As shown in Figure 3.3 we allowed Southern Water £1,917 million for water enhancement expenditure in our final determination. This was £139 million more than it requested in its February business plan, but £436 million less than it requested in its August 2024 representation.

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<sup>9</sup> [OF-OA-024] Ofwat, PR24 final determinations; base expenditure modelling, December 2024, p. 32-34.

<sup>10</sup> [OF-OA-005] South East Water, 'South East Water Limited Statement of Case', March 2025, pp. 37-38, para. 4.19-4.20.

<sup>11</sup> [OF-OA-024] Ofwat, 'PR24 final determinations: Base expenditure modelling' December 2024, pp. 22-24

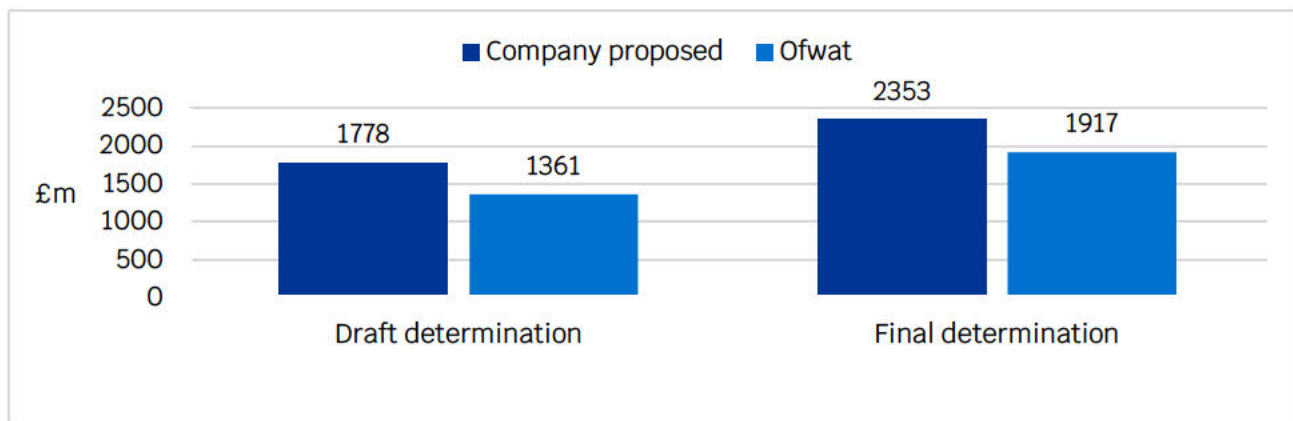
<sup>12</sup> [OF-OA-022] Ofwat, PR24 final determinations: Expenditure allowances', December 2024, p. 49.

<sup>13</sup> [OF-OA-022] Ofwat, PR24 final determinations: Expenditure allowances', December 2024, pp. 261-268.



- 3.21 The largest components of the difference between the amount requested by Southern Water and our final determination for enhancement expenditure relate to strategic resources options (mainly for Havant Thicket reservoir), leakage and water supply. We considered the Havant Thicket expenditure was covered by other mechanisms. For leakage and water supply the company put forward unit costs that were high compared to other companies, without sufficient evidence to support the higher costs.

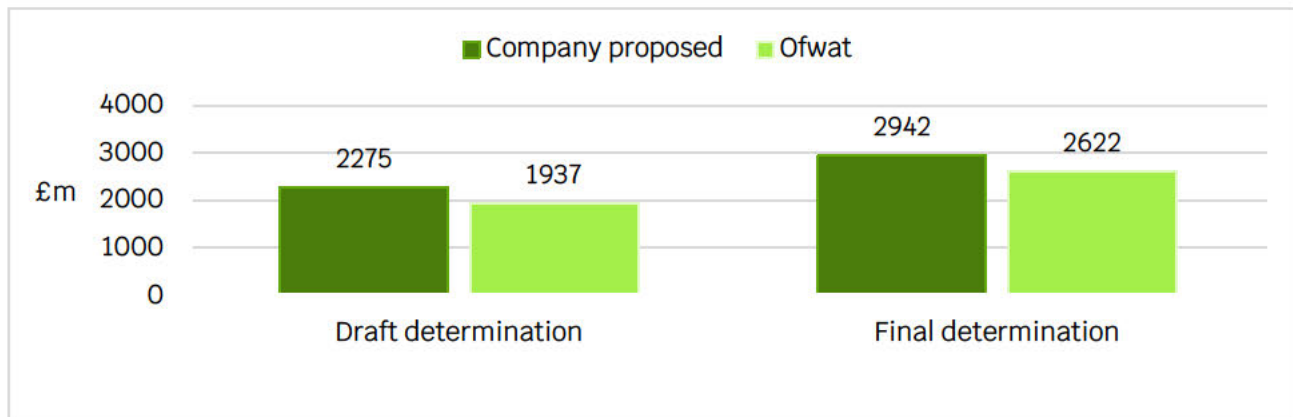
**Figure 3.3: Water enhancement requests and allowances, draft and final determination (after frontier shift/RPEs)**



## Wastewater

- 3.22 As shown in figure 3.4 we allowed Southern Water £2,622 million for wastewater enhancement expenditure in our final determination. This was £347 million more than it requested in its business plan, but £320 million less than it requested in its representation (August 2024).
- 3.23 The largest component of the gap for wastewater relates to storm overflows. Our enhancement allowance in the final determination covers most of these requested costs. We allowed £1,066 million enhancement expenditure to reduce the use of storm overflows compared to a request for £1,184 million. Our allowance for storm overflows is lower than the request as we found the schemes to be inefficient compared to other companies.

**Figure 3.4: Wastewater enhancement requests and allowances, draft and final determination (after frontier shift/RPEs)**



## Delivering outcomes for customers and the environment

- 3.24 We considered that, in the round, Southern Water's performance commitment levels (PCLs) in its representation (August 2024) were moderately ambitious, with an upper-quartile improvement rate for some performance commitments compared to actual 2023–24 performance. Because of this, many of the final determination PCLs are similar to the PCLs proposed in the company's representation.
- 3.25 The PR24 PCL for water supply interruptions is less stretching than the PCL proposed by the company, as we apply a sector wide PCL for this performance commitment. However, given Southern Water's performance in the 2020–25 period, we still consider the final determination PCL to be sufficiently stretching.
- 3.26 As shown in table 3.3, we applied greater levels of stretch than proposed by Southern Water on the repairs to burst mains, total pollution incidents and storm overflows performance commitments. This reflects the additional expenditure allowed in the final determination as a result of which customers should expect to see a step-up change in performance where Southern Water has received an additional expenditure allowance and consequently allowed to increase bills.



**Table 3.3: Changes in proposed performance commitment levels for PR24**

Performance Commitment	Company view (Representation 2024) <sup>14</sup>	Company 2023-24 outturn	Final determination <sup>15</sup>
Mains repairs per 1,000km mains (number)	153.6	121.1	113.9
Total pollution incidents per 10,000 km of sewer length (number)	21.76	58.90	18.63
Average number of spills per overflow – assuming 100% monitoring (number)	17.27	33.09	13.71

- 3.27 In its representations, Southern Water proposed deadbands on leakage and three underperformance-only ODIs (compliance risk index, discharge permit compliance and serious pollution incidents). It stated that this application of deadbands and collars is critical due to the relationship between ODIs and events outside of management control, for example, extreme weather.
- 3.28 In our final determinations, we acknowledged that companies might sometimes just fall short of performance targets due to operational challenges. To account for this, we introduced deadbands for a few performance commitments.<sup>16</sup> These helped address negative skew, while still keeping companies incentivised to perform near the target level. We applied deadbands for all companies in three areas, discharge permit compliance, repairs to burst mains and serious pollution incidents.
- 3.29 We also kept the deadband from our draft determinations for the compliance risk index, as, in that case, performance can be affected by customer-side issues, which fall outside companies' legal responsibilities.<sup>17</sup>
- 3.30 In its representation, Southern Water proposed lowering the RoRE strength of ODI rates we set at draft determination. At final determination, we did not change the starting allocation of 0.5% RoRE as our analysis showed that the 0.5% remained valid and our

<sup>14</sup> [OF-SRN-010] Business Plan 2025-30 – Southern Water – srn\_pr24\_dd\_submission\_data\_tables.xlsb.

<sup>15</sup> [OF-SRN-009] Ofwat, PR24-Key-Dataset-1-Outcomes-data-V6.xlsx, March 2025.

<sup>16</sup> The outcomes framework sits in the broader context of a company's statutory and licence requirements for service delivery. Independently of the outcomes framework, each company also has to ensure that it complies with its legal obligations, or risk enforcement action. If a company's performance falls below the level set for a performance commitment (irrespective of the existence of any deadband or collar), we will consider whether this is indicative of wider compliance issues to the detriment of consumers and whether enforcement action, with the potential for remedial and fining measures, is warranted.

<sup>17</sup> [OF-OA-014] Ofwat, PR24 final determinations: Our approach, Chapter –7.-PR24-final-determinations-Delivering-outcomes-for-customers-and-the-environment-1, December 2024, page 42

risk modelling even in some of the more extreme scenarios we test<sup>18</sup>, are within the range of  $\pm 1$ –3% RoRE we were aiming for in the PR24 methodology.<sup>19</sup>

## Aligning risk and return

### Risk and Return

- 3.31 We are satisfied that our final determination for Southern Water provided a reasonable balance of risk and return.
- 3.32 Southern Water's October 2023 business plan used a WACC of 3.82% (real, CPIH), which was higher than our December 2022 'early view,' of the allowed return of 3.29%, and it stated the allowed return should be 4.58%. In its representation in response to our draft determination, Southern Water proposed a wholesale allowed return of 4.49%, higher than our draft determination allowed return of 3.72%.
- 3.33 In our final determination we intervened to extend the period over which Southern Water recovers costs by reducing the RCV run-off rate by 0.13%. We made this small extension to help manage bill profiles and affordability challenges in the short term. More information is available in 'PR24: Aligning risk and return – appendix'.<sup>20</sup>

### Financeability

- 3.34 In our final determination we assessed that Southern Water was financeable on the basis of the notional company, such that it will be able to raise the necessary levels of debt and equity to deliver the required investment. To support financeability and to maintain reasonable gearing levels, our final determination included an equity injection of £1.23 billion, with £30.6 million allowance for issuance costs, and allowed for dividends of £955 million (4% yield). We found that the financial metrics under our final determination were consistent with the target credit rating for the notional company.
- 3.35 We set out our reasoning for our assessment in 'PR24: Aligning risk and return – appendix'.<sup>21</sup>

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<sup>18</sup> [OF-OA-018] Ofwat, Outcomes approach to risk modelling appendix, December 2024, section 3.2, pp. 21–23.

<sup>19</sup> [OF-OU-002] Ofwat, Creating tomorrow, together: Our final methodology for PR24, December 2022, section 5.5, p. 69.

<sup>20</sup> [OF-OA-020] Ofwat, PR24: Aligning risk and return – appendix, December 2024, p. 55.

<sup>21</sup> [OF-OA-020] Ofwat, PR24: Aligning risk and return – appendix, December 2024, pp. 58–82.

## Actual company structure

- 3.36 Southern Water reported gearing of 71.6% at 31 March 2024. Southern Water's October 2023 business plan stated a target credit rating of Baa1/BBB+ for the actual capital structure which is in line with the notional target set in our final determination. The business plan proposed no new equity, a dividend yield of 2% and gearing of 71.9% in 2030.
- 3.37 In its representation to our draft determination, Southern Water was required to provide additional board assurance and a financial resilience plan, with evidence of investor support to demonstrate how it will take forward its responsibility to maintain financial resilience. In response, the company provided evidence of investor support to inject £650 million of fresh equity into the business in 2027, subject to the outcome of the final determination. Reflecting the scale of the investment programme and the need for a performance turnaround, we consider a greater level of equity support will need to be provided, sooner than proposed by the company, and the company's investors have since announced an intention to raise £900 million equity in 2025.
- 3.38 The company remains a priority for our ongoing monitoring and engagement on its financial resilience. It has been categorised as "Action required" in our monitoring financial resilience report for the last two years.<sup>22</sup> Southern Water remains in a trigger event under its financing documents and is also in cash lock-up under its licence and would be unable to pay a dividend without our approval. While the company carries a credit rating that is below the investment grade with Moody's, it maintains credit ratings with Fitch and S&P that remain within the investment grade. We consider that Southern Water needs to take steps to support its long term financial resilience and we discuss the issues concerning Southern Water's financial resilience in further detail in Section nine of the PR24 redeterminations – risk and return – common issues document.

## Affordability

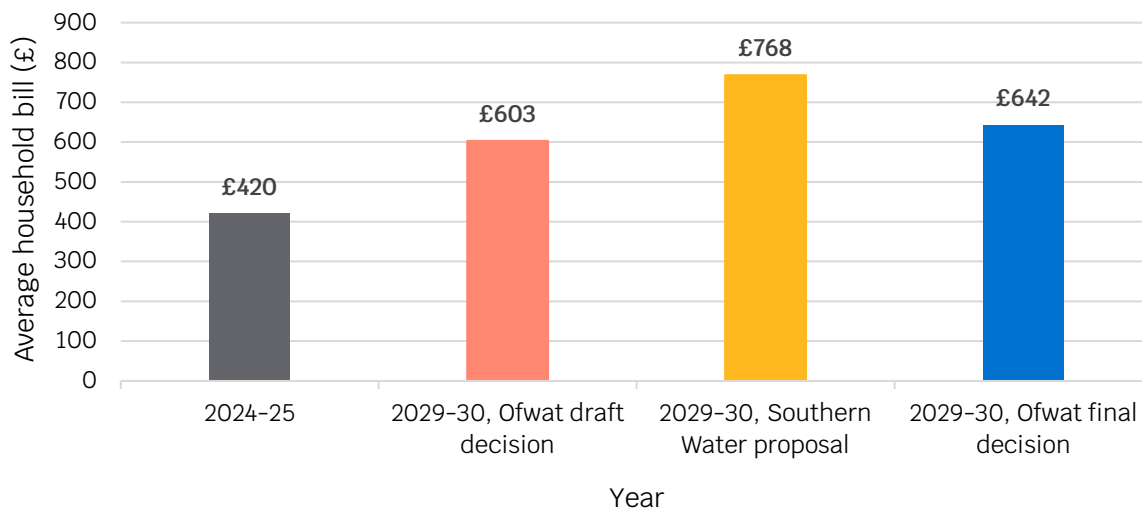
- 3.39 As illustrated in figure 3.5 the final determination increased Southern Water's average bills by 53% from 2024–25 to 2029–30, excluding the impact of the delivery mechanism.
- 3.40 This compares to an 83% bill increase proposed in SRN's representation. The final determination bill increase is lower than requested by Southern Water primarily because we set a lower allowed return, expenditure allowances and RCV run-off rates than requested.
- 3.41 It is important to note when comparing figure 3.5 that the bill profile shown for Southern Water's representation includes the impact of the delivery mechanism. This

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<sup>22</sup> [OF-OAA-003] Ofwat, Monitoring Financial Resilience report 2023–24, November 2024, p. 7.

is because Southern Water did not provide a financial model setting out the bill profile excluding the delivery mechanism and the only comparable bill profile we have from representations.

**Figure 3.5: Figure 3.5 Average household bills for Southern Water, 2024-25 and 2029-30, before inflation<sup>23 24</sup>**



3.42 Southern Water plans to increase social tariff provision from 6% of households in 2020-25 to 7% in 2025-30. Southern Water has committed to a shareholder contribution of £10 million on matching payments which are made by customers repaying debts and £6 million on other support schemes. This is forecast to represent 0.09% of Southern Water's Return on Regulated Equity (RoRE): this was the sixth lowest percentage of RoRE from a water company at final determination.<sup>25</sup>

3.43 In its response to our draft determination, Southern Water recognised the challenges customers will face with the proposed bill increase and so proposed to extend its affordability support by using underperformance payments to fund customer support schemes. Southern Water sought endorsement from Ofwat for its proposals and maintained that this is not a reduction in underperformance payments but an allocation to support customers who are struggling to pay.

3.44 In the final determination, we noted that Southern Water can vary its social tariff provision in the usual way through its retail revenue control. However, if Southern Water treated the underperformance payments as a social tariff “pot” within the wholesale

<sup>23</sup> Southern Water's proposal reflects the wholesale allowed return on capital (4.49% real, CPIH) proposed by the company as an alternative to the allowed return in our draft decision.

<sup>24</sup> Southern Water's proposal assumes the full expenditure allocated to the DM is funded via bills during 2025-30. Our draft determination and final determination bills exclude the potential bill impact of the DM.

<sup>25</sup> [OF-OA-048] Ofwat, Summary of water companies' published plans for affordability for 2025-30, December 2024, table 1.3, p. 10.



revenue control, the funding would be from both household and non-household customers, and our endorsement would be explicitly against government guidance which specifies that social tariffs are funded by households only.

- 3.45 If Southern Water found a solution to the Government guidance, then there would still be a likely impact on the application of the charging rules. If the company were to return underperformance payments to particular customer groups only, the company would be at risk of breaching licence condition E, which requires companies to not set charges that result in undue discrimination.
- 3.46 In its statement of case Southern Water have again proposed using underperformance payments from their ODIs to fund their social tariff, which helps vulnerable customers. The company believe that this is a fair response to the recent cost of living crisis, in which they increased their social tariff from 45% to 90%.<sup>26</sup>
- 3.47 Southern Water has made no effort to resolve the issues we raised at final determinations in its statement of case, and therefore we do not believe its current proposal is suitable to progress.

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<sup>26</sup> [OF-OA-003] Southern Water, Southern Water statement of case, March 2025, Chapter 8, Section 1.2.2, pp. 517–518.

## 4. Southern Water: Our response to its statement of case

### Introduction

- 4.1 If we consider that a point raised by Southern Water in its statement of case is company-specific, and our response or CMA's considerations are unlikely to have a wider impact on other companies, or the whole sector, we set out our response in the following section of this document. In order to further assist with navigation of our response to company-specific points we provide a list of the points covered in each sub-section.
- 4.2 In the 'PR24 redeterminations – overview of our response to the statements of case' Annex, 'Fulfilling our duties' we explain how our PR24 final determinations reflect our statutory duties. It also provides our response to any specific comments about our duties, made by companies in statements of case, including those from Southern Water.

### Expenditure allowances

- 4.3 At final determination, we allowed costs of 11% less than Southern Water requested in its representation. However, our final determination allowed more than the company originally requested in its updated February 2024 business plan.
- 4.4 The company has requested an additional £1.5 billion compared to our final determination,<sup>27</sup> which is £2.1 billion more than its original business plan. This includes the new request for a £500 million asset health gated base expenditure allowance.

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<sup>27</sup> The CMA may want to request updated business plan data tables from the company.

**Table 4.1: Cost gap at final determination by area (five-year period, after frontier shift/RPEs, 2022-23 prices)**

	Company view (February 2024) (£m)	Company view (August 2024) (£m)	Final determination (£m)	Statement of case (£m)	Cost gap FD vs SoC (£m)
Total expenditure	7,911	9,614	8,530 <b>Error! Bookmark not defined.</b>	9,986	-1,456
Base expenditure	3,857	4,319	3,991	5,083	-1,092
Enhancement expenditure	4,054	5,296	4,539 <b>Error! Bookmark not defined.</b>	4,903	-364

## Setting our base allowances

- 4.5 Our base expenditure allowance in Southern Water's final determination totalled £4.0 billion, which was 23 percent higher than the company's PR19 base expenditure allowance.
- 4.6 It was 8% less than Southern Water requested in its draft determination representation but was 3.5% higher than company requested in its updated February 2024 business plan. This highlights the material increase in requested base expenditure in the company's draft determination representation (£462 million).
- 4.7 In its statement of case, Southern Water raises several issues in relation to our base cost assessment:
- 4.8 **Wastewater network plus base models** – Southern Water proposes that the CMA does not use the PR19 economies of scale at sewage treatment works variable (percentage of load treated in sewage treatment works less than 2,000 people) to help set wastewater network plus base expenditure allowances. The company states the variable does not have a strong rationale, and raises concerns with statistical robustness.
- 4.9 **Water base models** – Southern Water proposes that the CMA excludes models that include the average pumping head variable to reflect the impact of network topography. While it acknowledges the strong engineering rationale, the company raises concerns with the quality of the data underpinning the variable.
- 4.10 **Advanced anaerobic digestion** – Southern Water asks the CMA to allow its proposed cost adjustment claim for investment in advanced anaerobic digestion (AAD) at two sludge treatment centres. The company also proposes that the project should be

included in the Direct Procurement for Customers (DPC) process. The company does not provide new evidence to support its request.

- 4.11 **Regional labour costs** – Southern Water asks the CMA to allow its proposed cost adjustment claim to reflect higher labour costs in its operating area. The company provides new evidence to support the approach used in its original submission.
- 4.12 **Impact of coastal operation on sewage treatment work costs** – Southern Water asks the CMA to allow its cost adjustment claim relating to additional costs of operating near the coast. The company states there were a number of methodological errors in our analysis of the claim at final determination, and presents additional evidence to support its claim.
- 4.13 **Energy costs** – Southern Water asks the CMA to recalculate the average power cost share used to calculate the energy sector wide adjustment. The company considers that using the last five years only, where the company was "well hedged", misrepresents its expected power share going forward. It considers it is more appropriate to base this on the historical modelling period (2011-12 to 2023-24).
- 4.14 **Asset health** – Southern Water proposed a gated allowance of £500 million to address potential asset health issues across its water and wastewater asset bases. The company provides limited evidence to demonstrate how this money would be invested, or how it considers the mechanism would work in practice. This replaces the capital maintenance cost adjustment claim worth £74 million it submitted in its draft determination representation.
- 4.15 **Frontier shift** – Southern Water proposes a frontier shift adjustment of 0.5% per year compared to our adjustment of 1.0% per year.
- 4.16 Southern Water also raises concerns with our residential retail allowances and the average bill size variable used in the econometric models. It also asks the CMA to consider its proposed boundary box replacement uncertainty mechanism that was rejected at final determination. These issues are discussed below.
- 4.17 The remaining issues have potential cross company impacts and so are discussed in detail in the following documents:
- PR24 redeterminations – expenditure allowances – common issues;
  - PR24 redeterminations – expenditure allowances – cost adjustment claims; and
  - PR24 redeterminations – expenditure allowances – addressing asset health.



**Table 4.2: Key base cost issues in statement of case**

Base expenditure area	Change to FD allowance (£m)	Ofwat response	Document reference
Wastewater base models	41	<ul style="list-style-type: none"> <li>We consider our decision to use the PR19 economies of scale at sewage treatment works variable remains appropriate.</li> <li>The variable has a strong engineering and economic rationale, performs well across different model specifications and was supported by the majority of wastewater companies.</li> </ul>	Expenditure allowances – common issues – section 2 – Wastewater network plus base cost models.
Water base models	53	<ul style="list-style-type: none"> <li>We disagree with the exclusion of average pumping head from the water base models.</li> <li>We consider the decision to use models with either boosters per length of mains or average pumping head as network topography explanatory variables remains appropriate due to improved data quality, the strengths and weaknesses of each measure, and the mixed feedback received from companies throughout the PR24 consultation process.</li> </ul>	Expenditure allowances – common issues – section 2 – Water base cost models
Cost adjustment claim – AAD	101	<ul style="list-style-type: none"> <li>We consider the company has failed to present compelling evidence to demonstrate the need for adjustment or that proposed costs are efficient.</li> <li>Our assessment supports the view that AAD investment should be delivered through Southern Water's base allowance.</li> <li>The proposed investment is not eligible under the DPC regime as it does not meet the relevant criteria and DPC is not intended to focus on bioresources.</li> </ul>	Expenditure allowances – cost adjustment claims – section 7
Cost adjustment claim – Regional labour	158	<ul style="list-style-type: none"> <li>We rejected the need for adjustment at final determinations, and retain this view based on the new evidence provided.</li> <li>The company's "accounting approach" to calculate in the claim fails to take into account the implicit allowance the company receives through the base models.</li> <li>Its "within model adjustment approach" using a real wage variable in the base cost model risks picking up interactions with real price effects and potentially other trends over time.</li> <li>Our own analysis, using the "pre-modelling adjustment approach", shows that the impact of regional wages on Southern Water's allowance is immaterial. This indicates that regional wage differentials are sufficiently explained by cost drivers in the base cost models.</li> </ul>	Expenditure allowances – cost adjustment claims – section 8
Cost adjustment claim – coastal	126	<ul style="list-style-type: none"> <li>We recognise that there are factors related to operating in coastal areas that could drive higher costs for companies. The magnitude of these impacts or the extent to which they are already captured by cost drivers used in the base cost models is uncertain.</li> <li>We have concerns about the use of a coastal population variable in the base cost models to quantify the cost impact of operating in coastal areas. The econometric results are sensitive to the</li> </ul>	Expenditure allowances – cost adjustment claims – section 9

Base expenditure area	Change to FD allowance (£m)	Ofwat response	Document reference
		<p>exclusion of Southern Water and the impact on allowances for some companies is counterintuitive.</p> <ul style="list-style-type: none"> <li>We carried out unit cost analysis which is inconclusive on whether companies incur more costs to operate and maintain coastal sewage treatment works than inland sewage treatment works, even after accounting for economies of scale at sewage treatment works.</li> </ul>	
Frontier shift	66	<ul style="list-style-type: none"> <li>We continue to consider a 1% per year frontier shift adjustment is appropriate.</li> <li>This is consistent with recent CMA and UK regulatory decisions on frontier shift and is in the middle of CEPA's recommended range of 0.8% to 1.2%.</li> <li>That considers both pre and post financial crisis productivity growth and other relevant factors such as the most recent OBR productivity growth forecasts; embodied technical shift; and the step-change in investment over the 2025-30 period, which should facilitate a 'learning by doing' productivity effect.</li> </ul>	Expenditure allowances – common issues – section 6
Energy cost adjustment	47	<ul style="list-style-type: none"> <li>We consider our decision to focus on the last 5 years of historical data to calculate the power cost shares used in our sector wide energy cost adjustment continues to be appropriate.</li> <li>This is because it strikes the appropriate balance in placing weight on more recent years which reflect current company energy usage and not placing excessive weight on the energy price crisis which may have created unusual patterns in the data.</li> <li>Additionally, we considered this issue carefully through draft and final determinations, and we note the company did not raise this issue in response to draft determinations.</li> </ul>	Expenditure allowances – common issues – section 2 – cost adjustment claims
Asset health	500	<ul style="list-style-type: none"> <li>We do not consider that Southern Water's request for a gated allowance for capital maintenance should be allowed.</li> <li>The company does not provide compelling evidence to support its proposal, including evidence of the scope of its proposal and the associated costs.</li> <li>We also have concerns around the maturity of Pioneer deterioration modelling used by the company to inform its assessment.</li> <li>There is ongoing work with the sector to enhance asset health understanding where we will work with the sector to collect more robust asset health data to inform an assessment of whether additional allowances are needed during the PR24 period to improve asset condition.</li> </ul>	Expenditure allowances – cost adjustment claims – section 10
<b>Total</b>	<b>1092</b>		
<b>Other issues</b>			
Residential retail	24	<ul style="list-style-type: none"> <li>The CMA may want to consider excluding residential retail cost assessment from the scope of its redeterminations due to immateriality.</li> </ul>	Expenditure allowances – common issues – section 2



Base expenditure area	Change to FD allowance (£m)	Ofwat response	Document reference
		<ul style="list-style-type: none"> <li>We did not reflect the updated average bill size figures in allowances because they were not stated in representations.</li> </ul>	

## Enhancement allowances

- 4.18 Our final determinations enhancement allowance was £0.5 billion above the company view from its business plan (February 2024) but £0.6 billion below its representation on our draft determinations (August 2024). The company requests additional enhancement expenditure allowances compared to our final determinations in the following areas.
- 4.19 **Water WINEP** – Southern Water requests that CMA provides allowances in full (additional £3.6 million) where shallow dive efficiency challenges (see Table 4, wastewater and water shallow dive) have been applied, as it considers the company specific challenge to be unreliable. This applies to shallow dive challenges on INNS, drinking water protected areas and water framework directive.
- 4.20 **Supply demand balance** – This covers water supply schemes, supply interconnectors and mains replacement. On water supply, Southern Water asks the CMA to fund the Smock Valley scheme in full (£21 million), disagreeing with our decision not to fund the Smock Alley supply scheme under water enhancement at PR24, as we stated it was funded in PR19. The company states the PR19 scope was much narrower. On supply interconnectors (£20 million), Southern Water states that historical costs are not a good predictor of future costs and that our allowances do not sufficiently take not account scheme specific factors. On water mains renewal (£107 million) the company challenges our assumptions on what base buys and unit rates for renewals.
- 4.21 **Water resilience** – Southern Water are asking to close the £60 million of the gap associated with the transitional expenditure for the water treatments works resilience schemes. The gap was incorrectly defined as £35 million at final determinations due to the inclusion of [REDACTED] supply scheme contingent allowance within resilience rather than supply. The final determination cost gap should read £105 million, this does not affect the overall final determination cost gap on enhancement. Southern Water are not asking to close the rest of the £105 million gap.
- 4.22 **Other wastewater WINEP** – Southern Water asks CMA to redetermine allowances for flow monitoring at sewage treatment works (see Table 4, Flow Monitoring) (additional £21 million) and Monitoring at emergency overflows (see Table 4, MCERTs monitoring) (additional £27.9 million), stating that we applied an arbitrary cost reduction and did not properly account for bottom up evidence. It also requests that CMA provides allowances in full where shallow dive efficiency challenges (see Table 4, wastewater and water shallow dive) (additional £10.2 million) have been applied as it considers the



company specific challenge to be unreliable. This appears to increase Southern Water's request for wastewater WINEP expenditure as the company received £24.9 million more than requested in the sanitary determinants allowances as its proposed costs were below the cost benchmark. This offset the other wastewater WINEP challenges. This is not acknowledged by Southern Water in the additional cost request.

- 4.23 **Industrial emissions directive** – Southern Water asks the CMA to redetermine allowances on industrial emissions directive and allow in full (additional £33.6 million) with reference to bottom up costs, stating that our top-down modelling approach for secondary containment, tank covering and other IED costs is not robust.
- 4.24 **Frontier shift efficiency adjustment** – Southern Water proposes a frontier shift adjustment of 0.5% per year compared to our adjustment of 1.0% per year.
- 4.25 The issues on water treatment works resilience and the Smock Alley water supply scheme are company specific and so are discussed in this document. The remaining issues are covered in the "PR24 redeterminations – expenditure allowances – common issues".

**Table 4.3: Enhancement cost gaps (before the application of frontier shift and real price effects)**

Enhancement expenditure area	Company view (February 2024) (£m)	Company view (August 2024) (£m)	Final determination allowance (£m)	Cost gap at FD (£m)	Statement of case request (£m)	Cost gap to SoC (£m)
Water WINEP	74	73	68	-5	72	-4
Supply/Demand balance and metering	1,111	1,409	1,096	-313	1,244	-148
Resilience and security (w)	465	614	579	-35	639	-60
Water quality improvements	103	115	102 <sup>28</sup>	-13		
Other water enhancement areas	32	99	99	0		
Total water enhancement allowance	1,785	2,311	1,944	-367		
Storm overflows	735	1,184	1,060 <sup>29</sup>	-124		
Nutrients	734	632	627	-5		

<sup>28</sup> This represents the published final determinations allowance. Post final determinations corrections have determined that this figure should be increased by £1 million.

<sup>29</sup> This represents the published final determinations allowance. Post final determinations corrections have determined that this figure should be increased by £6 million.

Enhancement expenditure area	Company view (February 2024) (£m)	Company view (August 2024) (£m)	Final determination allowance (£m)	Cost gap at FD (£m)	Statement of case request (£m)	Cost gap to SoC (£m)
Other WINEP (ww)	366	422	395	-27	454	-59 <sup>30</sup>
Resilience and security (ww)	94	61	48	-13		
Growth at sewage treatment works	237	348	306 <sup>31</sup>	-42		
Industrial emissions directive	172	171	138	-33	171	-34 <sup>32</sup>
Other enhancement areas (ww)	-14	93	101	8		
Total wastewater enhancement allowance	2,325	2,911	2,674	-237		-305

4.26 The following table provides additional navigation assistance for CMA. It sets out each of the key enhancement issues raised in Wessex Water's statement of case, a summary of our response, and the location of our more detailed response.

**Table 4.4: Key enhancement issues in statement of case**

Enhancement area	Change to FD allowance (£m)	Ofwat response	Document reference
Wastewater and Water shallow dive	14	We consider that the application of shallow dive efficiency challenges is appropriate given the low materiality of the expenditure. We consider that the enhancement benchmarking models used in the assessment are robust and provide a good indication of the efficiency of enhancement expenditure of each company.	"PR24 redeterminations – response to Southern Water's statement of case", section 9.
Supply	21	This is a new issue as Southern Water did not put forward Smock Alley as a scheme in the draft determination response. We disagree with the statement of case concerns, as we believe the company should still have delivered the benefit the PR19 scheme committed during the 2020–25 period, utilising cost	"PR24 redeterminations – response to Southern Water's statement of case", section 4.

<sup>30</sup> In the final determination Southern Water received £24.91 million more than it requested for Sanitary Det as it was deemed efficient. If the CMA provides all the 'Other WINEP (WW)' allowances Southern Water is requesting, it will receive £24.91 million more than it requested in its draft determinations response.

<sup>31</sup> This represents the published final determinations allowance. Post final determinations corrections have determined that this figure should be increased by £28 million.

<sup>32</sup> In the final determinations the cost gap on the industrial emissions directive was £33.47 million. In the [OF-OA-003] Southern Water Statement of case (page 35) Southern Water state they want to close a cost gap of £33.6 million.



Enhancement area	Change to FD allowance (£m)	Ofwat response	Document reference
		sharing where required for increased scopes. We also view the increased scope as overlapping considerably with base activities.	
Supply interconnectors	20	This is an existing issue with new evidence on scheme scope. We disagree with the statement of case concerns, as Southern Water were asked for details on complexities including crossings, which we provided an uplift of £4.3 million for, and other cost drivers such as materials were included across benchmarked schemes. We also maintain that incorporating historical scheme costs increases model robustness and offsets uncertainty seen in forecast scheme costs, including in Southern Water's own forecast schemes.	"PR24 redeterminations – expenditure allowances – common issues", section 4.
Mains – mains replacement	107	We disagree with the company's assumptions on what base buys, and therefore consider it is sufficiently funded through its base allowance to deliver most of its proposed leakage enhancement kilometres. It is appropriate to determine what base buys using the historical period used to determine long-term base expenditure allowances. Southern Water disagrees with the mains renewals unit cost used in the final determination. The unit cost is based on the sector median unit rate, using a range of unit cost data that represents a mix of renewals. The company does not provide compelling evidence for why its unit costs are higher than other companies.	"PR24 redeterminations – expenditure assessment – common issues", section 2.
Water resilience	60	This is an existing issue. It has not provided sufficient and convincing evidence for the need for enhancement. The investment overlaps with previously funded PR19 commitments to the DWI and DEFRA. Our assessment used a balanced judgement to provide sufficient enhancement funding despite the overlap with PR19. The company also does not provide sufficient and convincing evidence that its costs are efficient. It has internally benchmarked only 37% of the scope of works and externally benchmarked less than 10% of the scope of works.	"PR24 redeterminations – response to Southern Water's statement of case", section 4.
Flow monitoring	21	This is an existing issue with new evidence. Southern Water was a significant outlier on costs in all subcategories and did not provide sufficient and convincing evidence to justify its higher costs. While it provides new information that indicates it incorrectly categorised its investment, it remains an outlier on cost and so we consider the efficiency challenge to be justified.	PR24 redeterminations – expenditure assessment – common issues", section 5

Enhancement area	Change to FD allowance (£m)	Ofwat response	Document reference
MCerts monitoring	28	This is an existing issue. Southern Water assigned 98% of its cost to schemes in the most complex / high cost category, and its costs for this category were 5 times the median. It did not provide sufficient and convincing evidence for the scale of the difference, and therefore the efficiency challenge was considered reasonable.	PR24 redeterminations – expenditure assessment – common issues", section 5
IED	34	<p>This is an existing issue. We consider that our secondary and tank covering cost models are robust and appropriate for assessing costs because the selected cost drivers have engineering and economic rationale, are the main cost drivers after testing several others and perform well.</p> <p>We also consider that our approach to other IED costs is reasonable because it was not possible to identify robust cost drivers of other costs given the range of companies' proposals. Moreover, Southern Water's other IED costs were much higher than other companies and it was not clear why this was the case given that IED permit requirements have a consistent approach across the sector.</p> <p>Our final determinations also include 25:25 cost sharing rates for IED so companies are protected during 2025-30 should they incur in costs.</p>	PR24 redeterminations – expenditure assessment – common issues", section 5
Frontier shift	59	This is an existing issue. We continue to consider a 1% per year frontier shift adjustment is appropriate. This is consistent with recent CMA and UK regulatory decisions on frontier shift and is in the middle of CEPA's recommended range of 0.8% to 1.2%. That considers both pre and post financial crisis productivity growth and other relevant factors such as the most recent OBR productivity growth forecasts; embodied technical shift; and the step-change in investment over the 2025-30 period, which should facilitate a 'learning by doing' productivity effect.	PR24 redeterminations – expenditure assessment – common issues", section 6
<b>Total</b>	<b>364</b>		

## Other key Issues in setting expenditure allowances

4.27 Southern Water raised the following key issues in relation to price control deliverables and uncertainty mechanisms applied to enhancement allowances:

- Price control deliverables framework is punitive, inflexible and adds a negative skew to the balance of risks;
- Delivery mechanism should allow allowances to be reassessed in period; and



- Large scheme gated approach should be extended to all schemes within its "five-sites strategy" ( [REDACTED] )

4.28 We summarise our response to these issues in the table below. We set out a more detail in document PR24 redeterminations – expenditure allowances – common issues.

**Table 4.5: Other key issues in setting expenditure allowances in statement of case**

PCD area	Ofwat response	Document reference
<b>Price control deliverables</b>	We have built in significant flexibility into PCDs so that companies can deliver programme outputs in the best way possible. We achieve this by tracking generic outputs at the programme level, rather for specific schemes. We do not apply PCD claw-back where companies are slightly late in delivering the funded output by the end of the five-year period, but reserve the right to apply claw-back where they are significantly late. Our time incentives encourage companies to deliver schemes on time, based on a fair bet calibrated on outturn PR19 data. Companies are delivering similar schemes across PR19 and PR24. Given that we do not expect to apply claw-back unless company is not planning to deliver output (in which case the company would have no need of allowance) we do not consider that PCDs introduce a negative skew on the balance of risks.	"PR24 redeterminations – Expenditure allowances – common issues", section 7
<b>Delivery mechanism</b>	We introduced the delivery mechanism to address our concerns over the delivery of Southern Water's PR24 programme as the company was not able to assure delivery of its plan and was still engaging with environmental regulators on the details of its final WINEP. The company's request to reopen all schemes within the delivery mechanism (irrespective of value) to access revised costs throughout the price control appears to be an attempt to de-risk its enhancement programme. We have proactively moved some of the company's enhancement schemes that met the threshold into the large scheme gated process. For schemes included in the delivery mechanism we have pre-set the expenditure allowance in final determinations. This is the same approach we use to set allowances for other companies in relation to similar schemes.	"PR24 redeterminations – Expenditure allowances – common issues", section 8
<b>Large gated scheme approach</b>	We apply a gated approach to large schemes costing £100 million or more to deliver and where company is not already late in delivering scheme. Work at [REDACTED] and [REDACTED] has a combined value of £50 million. The delivery of these schemes has been pushed back from AMP7 into AMP8, so applying a large gated approach would only cause further delays in the delivery of these schemes.	"PR24 redeterminations – Expenditure allowances – common issues", section 8

## Company specific issues

### Southern Water's boundary box replacement uncertainty mechanism

#### Our final determinations

4.29 We rejected Southern Water's boundary box replacement uncertainty mechanism proposal at final determination. The company submitted this as a new request in its



draft determination representations.<sup>33</sup> It stated that it did not have data available on these assets at the time of its original business plan submission but had collected it in the interim.

- 4.30 We stated that the replacement of boundary boxes is covered through the metering sector wide cost adjustment and accompanying PCD. The unit rate used to determine the cost adjustment reflects a mix of work based on assumptions in company business plans. Cost sharing sufficiently mitigates the risk that companies need to deliver more or less complex mix of work than forecast.<sup>34</sup>

### Issues raised by Southern Water

- 4.31 Southern Water asks the CMA to accept its boundary box uncertainty mechanism for smart metering boundary box costs. It states that this should be linked to the number of boundary boxes required so that its cost allowances increase at an agreed rate should it need to carry out a greater volume of work.<sup>35</sup>
- 4.32 The company states that its reason for requesting the mechanism is that its older boundary boxes may not be designed to accommodate modern meters. Also, additional boundary boxes may need to be replaced because they sustain damage when installing a new meter.<sup>36</sup> The company states that it was not until it sought to gather the evidence on these assets that it "understood the potential associated risk".<sup>37</sup>
- 4.33 The company states that surveys on its own assets indicate that it will need to replace 6.7% of its boundary boxes.<sup>38</sup> In its draft determination representations, the company requested a £42 million uncertainty mechanism to cover the associated costs. However, Southern Water states that its engagement with other companies with aged boundary box estates indicate that up to 35% could need replacing. Southern Water states that, if it also needed to replace 35% of its boundary box assets, it would cost around £180 million.<sup>39</sup> It therefore considers this range of costs in the scope of its proposed uncertainty mechanism.
- 4.34 The company states that the meter replacement sector wide adjustment does not address uncertainty in replacement volumes. It states that the unit cost allowance does not provide any additional allowance for the uncertainty in boundary box costs, and that overall, it is underfunded by £26 million for its metering programme.<sup>40</sup> We assume the

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<sup>33</sup> [OF-CA-163] Southern Water, Draft Determination Response Document, pp. 99-101.

<sup>34</sup> [OF-SRN-014] PR24 final determinations: Base cost adjustment claim feeder model – Anglian Water, ANH\_CAC\_3.

<sup>35</sup> [OF-OA-003] Southern Water, Statement of Case, p. 324, para 159.

<sup>36</sup> [OF-OA-003] Southern Water, Statement of Case, p. 321, para 135.

<sup>37</sup> [OF-OA-003] Southern Water, Statement of Case, p. 321, para 137.

<sup>38</sup> [OF-OA-003] Southern Water, Statement of Case, p. 322, para 141.

<sup>39</sup> [OF-OA-003] Southern Water, Statement of Case, p. 322, para 141 – 143.

<sup>40</sup> [OF-OA-003] Southern Water, Statement of Case, p. 322, para 145.

company means it considers it is underfunded across its base and enhancement allowances.

- 4.35 The company states that the meter replacement PCD does not provide scope for additional funding should replacement volumes increase.<sup>41</sup>

## Our assessment

- 4.36 In its draft determination representations Southern Water requested an uncertainty mechanism to cover its boundary box replacement costs, valued at £42 million. In its statement of case, the company states that the proposed mechanism may need to cover the costs of up to £180 million. This equates to 17% of the company's wholesale water base expenditure request at final determination. Therefore it is important that the company provides compelling evidence to justify why its customers need to pay for this investment at this time.
- 4.37 The company has not provided new evidence to support its proposed boundary box uncertainty mechanism in its statement of case. The company fails to demonstrate good knowledge of its boundary box assets. It also highlights extreme uncertainty in its proposal, and the lack of robustness in its assumptions.
- 4.38 Statements made by the company such as "potential associated risk" when referring to its new understanding of the assets fail to provide confidence in the proposal, and more broadly the company's understanding of its assets and associated investment decisions.<sup>42</sup> Other statements such as "Our collaboration with other water companies who have aged boundary box estates has confirmed that there is significant uncertainty over the volume of likely boundary box replacement" also do not provide confidence in the company's knowledge, nor does it strengthen its case.<sup>43</sup> The company does not provide any further detail on the collaboration. It is therefore unclear why this has led to a robust assessment of the potential costs to customers, which could be more than four times the cost proposed in its draft determination representations.
- 4.39 The company states that it needs to replace aging assets that are no longer compatible with smart meters, or that may become faulty as a result of new meter installs.<sup>44</sup> The company provides no supporting evidence to demonstrate how its boundary box replacements up until this point have been driven by these factors, and what the impact of this has been on the company's costs. Nor does it provide quantifiable evidence of any impacts to performance, or customers and the environment.

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<sup>41</sup> [OF-OA-003] Southern Water, Statement of Case, p. 322, para 145.

<sup>42</sup> [OF-OA-003] Southern Water, Statement of Case, p. 321, para 137.

<sup>43</sup> [OF-OA-003] Southern Water, Statement of Case, p. 322, para 142.

<sup>44</sup> [OF-OA-003] Southern Water, Statement of Case, p. 321, para 135.

- 4.40 As we also discuss in our assessment of Anglian Water's proposed cost adjustment claim, age is just one factor that is important when considering the need for replacement.<sup>45</sup> Often assets can provide the functionality required well beyond the average expected asset life. For example, Victorian sewers are still operating despite being over 100 years old.
- 4.41 We maintain the view that Southern Water has received an appropriate allowance to undertake its base expenditure metering programme. This is through its modelled base allowance and an additional £104.1 million adjustment to its base allowance to undertake additional meter replacements to facilitate the smart metering programme.<sup>46</sup> At the time of its business plan submission, the company submitted a meter replacement cost adjustment claim that requested an £88.782 million adjustment to its allowance.<sup>47</sup> This means that the company received an additional £15.4 million above what it requested for its base meter replacement programme. We therefore disagree that the company has not been sufficiently funded.
- 4.42 Overall, we still have concerns about the company's proposed mechanism. At final determination, we found that the company did not provide compelling evidence to support its proposal. It also demonstrated close alignment to the mechanism proposed by Anglian Water in its business plan submission, reverting back to many of the points made by Anglian Water and providing no additional evidence specific to Southern Water to support its proposal.<sup>4849</sup>
- 4.43 Southern Water has not provided additional evidence to be considered as part of its statement of case, and has implied the value of its proposed mechanism could quadruple when compared to its original draft determinations representation request (£42 million) with no evidence to support its assumption.
- 4.44 We intend to collect more information from companies on boundary box replacements ahead of PR29. This will include installation data, replacement rates, and associated costs. We will collect this as part of our forward planning for PR29, which is discussed further in the 'PR24 redeterminations – expenditure allowances – addressing asset health' document.

## Resilience enhancement at [REDACTED] and [REDACTED] water treatment works

<sup>45</sup> Ofwat, PR24 redeterminations: Expenditure allowances – cost adjustment claims, Anglian Water – Boundary box replacements.

<sup>46</sup> [OF-OA-022] Ofwat, [PR24 final determinations: Expenditure allowances](#), December 2024 pp. 39–42.

<sup>47</sup> [OF-SRN-015] Southern Water, SRN24 Meter Replacement Cost adjustment claim, October 2023.

<sup>48</sup> [OF-ANH-005] Anglian Water, ANH23 Cost Adjustment Claims, October 2023, pp. 106–129.

<sup>49</sup> Anglian Water resubmitted this as a cost adjustment claim at draft determination. We later rejected this at final determination. The company's claim is discussed in our supporting cost adjustment claims annex.



- 4.45 In the PR24 methodology we set out that resilience enhancement investment can be requested to manage increasing risks, or changing acceptance or acceptability of risk, from hazards that are beyond company control and not covered by other enhancement areas (for example, increasing risk of source water pollution, river or coastal flooding). We excluded funding to manage existing risk from all hazards and funding to address the failure of assets managed through maintenance, as these should be managed through base costs<sup>50</sup>. Investment should be prioritised and promoted based on an understanding of the current level of risk, how this would change under the proposed investment, and how this compares to the risk appetite of customers and the company's board.
- 4.46 Companies requested additional allowances to improve water production and supply resilience. For example, new water treatment works (WTW), increased capacity or treatment capability at current WTW and additional treated storage. Companies stated benefits to mitigate climate change risks, hot weather demand peaks and to address water quality issues (where there isn't a DWI legal instrument in place already requiring this).

## Our final determinations

- 4.47 Southern Water requested £436 million for upgrades at five WTWs: [REDACTED] and [REDACTED]. In our final determination, we allowed £367 million split between £115 million upfront allowance, and £252 million gated allowance for [REDACTED] contingent on progression through the large scheme gated process<sup>51</sup>. The total cost gap is £69 million (including contingent allowances and contributions to [REDACTED] WTW from South East Water). This comprises of challenges at: [REDACTED] WTW (£35 million), [REDACTED] WTW (£28 million) and [REDACTED] WTW (£13 million).

**Table 4.6: Summary of final decisions at Southern Water water treatment works**

Site	Requested £m	Allowed £m	Contingent allowance £m	Cost gap £m	Mechanism
[REDACTED]	101.455	12.175	89.280	0.000	Large scheme gated process
[REDACTED]	79.206	9.505 <sup>52</sup>	69.701	0.000	Large scheme gated process, requested through supply
[REDACTED]	105.714	12.686	93.028	0.000	Large scheme gated process
[REDACTED]	27.740	14.823	None	12.917	None
[REDACTED]	47.210	26.073	None	21.137	None
[REDACTED]	74.336	39.688	None	34.648	None

<sup>50</sup> [OF-CA-001] Ofwat, Creating tomorrow, together: Our final methodology for PR24: Appendix 9 Setting expenditure allowances, December 2022, pp. 51–56.

<sup>51</sup> Ofwat, PR24 Final determinations: Expenditure allowances, February 2025, p. 223

<sup>52</sup> The development allowance of £9.505 million has been funded through the supply cost model, see [OF-CA-138] 'PR24-FD-CA29-Water-Supply-enhancement-expenditure-model', February 2025, tab 'Scheme Allowances', cells O156:P156

Site	Requested £m	Allowed £m	Contingent allowance £m	Cost gap £m	Mechanism
Total (excluding contributions from SEW)	435.661	114.950	252.009	68.702	As above
[REDACTED]	15.450	8.684	None	6.766	25% contribution from SEW
Total (including contributions from SEW)	451.111	123.633	252.010	75.468	As above

4.48 [REDACTED]<sup>53</sup>. We provided the full allowances (£286 million) for [REDACTED] and [REDACTED] with 12% of this upfront and 88% contingent through the large scheme gated process. We have significant delivery concerns at both [REDACTED] and [REDACTED] therefore, part of the allowance is contingent on progression through the large scheme gated process.

4.49 [REDACTED]. For [REDACTED] and [REDACTED] we carried out a deep dive assessment of the requested enhancement costs. We adjusted the company's costs to account for base funding for delivery in AMP7, rejected the company's transitional funding request and had concerns that the remaining costs were not efficient. We made two adjustments<sup>54</sup> to the £149 million request (reflective of the concerns):

1. We removed the 2023–25 transitional request of £60 million. We had concerns that the company did not provide evidence that the transitional request was bringing forward AMP8 work, planning or early starts for the next price control (2025–30). We had concerns the company was intending to use transitional funding to cover activities that should have been delivered through base expenditure allowances in AMP7.
2. We applied a 10% efficiency challenge to the remaining £90 million to provide an allowance of £80.5 million. We had concerns that the company did not provide sufficient and convincing evidence of efficient costs.

## Issues raised by disputing companies

4.50 Southern Water states that rejecting transitional funding at three of the water treatment works is inconsistent with Ofwat making enhancement allowances for expenditure on the same programme of investments when the funding requested falls in 2025–30<sup>55</sup>. It states that rejecting transitional funding also sets a precedent that

<sup>53</sup> [OF-OA-022] Ofwat, 'PR24 Final determinations expenditure allowances', February 2025, p. 223.

<sup>54</sup> [OF-CA-147] Ofwat, PR24-FD-CA31-Water-Resilience-enhancement-expenditure-model\_redacted, December 2024, tabs 'SRN WTW' and 'SEW\_WTW contribution'.

<sup>55</sup> [OF-OA-003] Southern Water, "Southern Water Statement of Case", March 2025, page 283, paragraphs 332 to 334.



undermines the purpose of transition funding and incentivises delay in investment until there is regulatory certainty at future price controls.

- 4.51 Southern Water states that we did not properly consider evidence that they had spent over their base allowance of £41.9 million (the companies calculated implicit allowance for capital maintenance at the three WTWs). It states that our deductions applied through the deep dive are therefore not appropriate.

## Our assessment

- 4.52 We continue to consider that our final determination adjustments are justified:

- The investment does not meet the criteria for transitional funding because Southern Water have pushed back the DWI's deadlines from the previous price control.
- Southern Water has been provided sufficient investment at PR19 and PR24 to deliver maintenance and renewal work but is requesting significant funding to upgrade its five largest WTWs at the same time.
- At [REDACTED], Southern Water is requesting funding to rebuild a water treatment works that it committed to Defra would be complete by February 2024.
- Southern Water has not provided efficient costs nor sufficient evidence of cost assurance.

- 4.53 We provide further detail on these issues below.

- 4.54 Key issue 1: At [REDACTED] WTW and [REDACTED] WTW, Southern Water have pushed back the regulatory delivery deadlines on multiple occasions from the previous price control. The investment does not meet the criteria for transitional funding as it does not qualify for enabling an early start to AMP8 schemes.

- 4.55 Southern Water said the transitional funding for [REDACTED] WTW and [REDACTED] WTW was required to meet DWI deadlines for activities early in the next price review [REDACTED]  
[REDACTED] The company stated in its PR19 business case they would deliver DWI mandated improvements to [REDACTED] WTW through £32.820 million in base allowances<sup>57</sup>, and improvements to [REDACTED] surface water works compliance through £9.377 million in base allowances<sup>58</sup>. In its business case,

<sup>56</sup> [OF-CA-169] Southern Water, SRN25 Supply Resilience Enhancement Programme Enhancement Business Case, August 2023, pp 161-169, Table 80: Scope and delivery schedule ([REDACTED])

<sup>57</sup> [OF-CA-170] Southern Water, TA.11.WN03 Water Treatment Business Case, September 2018, p. 6.

<sup>58</sup> [OF-CA-170] Southern Water, TA.11.WN03 Water Treatment Business Case, September 2018, p. 22.



they stated their aim was to ensure all DWI requirements were largely addressed by AMP7<sup>59</sup>:

- 4.56 "We will ensure that the requirements of our customers and regulators are met in AMP7 and dramatically improve our Compliance Risk Index (CRI) score. We are aiming for upper quartile performance in CRI by the end of AMP7."
- 4.57 "We are investing £213m over AMP7 to both maintain and improve the resilience of our water treatment works in AMP7. Investment in this area can be broken down into 3 broad areas: Maintenance (£119m) – Responding to DWI surface water scheme notices, carrying out the DWI mandated hazard review (hazrev) and responding to hazrev outputs covers the majority of spend in this area. This investment is either already covered by mandatory notices or will be covered by notices in the future if not resolved following hazrev..."

- 4.59 [REDACTED] As illustrated in table 4.7, all 65 of these steps can be mapped to previous (no longer published) versions which had deadlines before 31 March 2025, in the previous price control. [REDACTED]

- 4.60 [REDACTED] Out of these new actions, several actions are duplicative commissioning activities and should have been completed in the previous price control period. The remaining actions include investigative actions and remedial steps with no scope defined (e.g. £1.2 million for desludging rate control and £3.7 million for a risk assessment), these are typically carried out through base expenditure allowances.

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<sup>59</sup> [OF-CA-170] Southern Water, TA.11.WN03 Water Treatment Business Case, September 2018, p. 3.

Table 4.7:

1	2	3	4	5
6	7	8	9	10
11	12	13	14	15
16	17	18	19	20
21	22	23	24	25
26	27	28	29	30
31	32	33	34	35
36	37	38	39	40
41	42	43	44	45
46	47	48	49	50
51	52	53	54	55
56	57	58	59	60
61	62	63	64	65
66	67	68	69	70
71	72	73	74	75
76	77	78	79	80
81	82	83	84	85
86	87	88	89	90
91	92	93	94	95
96	97	98	99	100

4.61 In its business plan, Southern Water did not provide sufficient or convincing evidence that the schemes at [REDACTED] and [REDACTED] are eligible for the transitional expenditure programme. The company states that it has early statutory deadlines in the next price control for [REDACTED] and [REDACTED] which require it to make an early start on

the investment in 2023–25 period. Evidence from DWI notices suggests that this expenditure is the result of the company pushing back work from the 2020–25 period, which should have already been completed. Therefore, we rejected the investment put forward in its transitional expenditure programme as the expenditure is not related to a new requirement but rather meeting an existing requirement.

- 4.62 The company claims that we have been inconsistent in our rejection of its transitional expenditure compared to other companies. Other companies met the need for enhancement investment (ie new need for customers to fund) but did not meet the transitional expenditure programme criteria. In these instances, the costs included in the transitional expenditure request were moved to the 2025–30 period, rather than removed completely as we agreed with the need to fund the scheme. For Southern Water the expenditure does not meet the transitional expenditure programme criteria, and the expenditure does not fully meet the need for enhancement criteria as the requested activities should already be in progress in AMP7 and therefore are not related to a new requirement.
- 4.63 We consider that our approach, of rejecting transitional expenditure funding but funding the proposed expenditure for the AMP8 period, strikes the right balance between providing the company with appropriate funding and protecting customers. [REDACTED]  
[REDACTED] Providing additional funding could therefore create a perverse incentive for companies to delay the completion of work to obtain additional funding. However, we recognise that the customers of Southern Water need the company to complete this work.
- 4.64 Key issue 2: Southern Water has been provided sufficient investment at PR19 and PR24 to deliver maintenance and renewal work at [REDACTED] WTW and [REDACTED] WTW. The company is undertaking significant upgrades at five large WTWs at the same time, when it should have delivered maintenance and renewals historically. At Burham, it has previously committed to delivering improvements through PR19 base funding.
- 4.65 [REDACTED] The DWI said in a letter dated 30 May 2018 that £33.5 million estimated capex was required for upgrades at [REDACTED] WTW (£39.551 million after converting 2017–18 price base to 2022–23 price base and including contributions from South East Water). In its business plan Southern Water calculated that it received a PR19 implicit base allowance for [REDACTED] of £15.000 million (2022–23 prices). It submitted £32.760<sup>62</sup> million in a PR19 base request in 2017–18 prices for [REDACTED] WTW (£38.678 million in 2022–23 prices). It stated that it would commit this funding to address the DWI deliverables<sup>63</sup>. At PR19 it received 7.6% less on wholesale base costs, and only 2.2% less

<sup>62</sup> [OF-CA-170] Southern Water, TA.11.WN03 Water Treatment Business Case, September 2018, p. 23.

<sup>63</sup> [OF-CA-170] Southern Water, TA.11.WN03 Water Treatment Business Case, September 2018, p. 3.



across all of base<sup>64</sup>. This implies it received an AMP7 implicit allowance at [REDACTED] of £35.738 million (in 2022/23 prices; 38.678 minus the 7.6% cost challenge). We have significant concerns with Southern Water's AMP7 base allowance calculation of only £15.000 million<sup>65</sup>, which would imply a 61.20% cost challenge to its base request. At PR24 we also funded an enhancement uplift of £34.757 million (2022-23 price base). The funding is to complete activities that the company has previously committed to from its PR19 historic base allowance.

- 4.66 [REDACTED] At [REDACTED] WTW, there was a PR19 request of £9.377 million of base<sup>66</sup> (£11.065 million in 2022-23 prices). The company states we allowed PR19 base funding of £19.000 million for this site (2022-23 prices)<sup>67</sup>. We calculate that it received £10.229 million (11.065 minus 7.6% cost challenge). In its PR24 business case, the company did not provide sufficient or convincing evidence that it has been historically underfunded at this site. It said as of February 2024, it had spent only £8.700 million (in 2022-23 prices)<sup>68</sup>, but was forecasting total AMP7 spend in 2022-23 prices (including actual up to February 2024) of £21.300 million<sup>69</sup>. The company should have used PR19 base funding to maintain and renew the site to prevent DWI escalation. In our PR24 final determination, we allow enhancement uplift of £14.823 million to enable the company to address its DWI requirements at the site.
- 4.67 We have made no adjustments to the implicit allowance on base for the work at the five sites as part of the PR24 cost assessment.
- 4.68 Key issue 3: At [REDACTED], Southern Water is requesting funding to rebuild a water treatment works that it committed to Defra would be complete by February 2024.
- 4.69 The funding request of £74.336 million at [REDACTED] is to rebuild a water treatment works. The site was served a DWI notice in January 2020 to undertake general improvements before 31 March 2025. In June 2020 the company notified the DWI of biological growth in the contact tank, in response the DWI modified the notice with a prohibition clause preventing the site being put in supply. In 2022-23 the company decided to demolish the site because it claimed the costs were increasing and the water quality risks were failing to diminish<sup>70</sup>. The £74.336 million requested is to rebuild the site and is not delivering any new enhancement for its customers.

<sup>64</sup> [OF-CA-169] Southern Water, SRN25 Supply Resilience Enhancement Programme Enhancement Business Case, August 2023, page 97, figure 24 chart 'Totex Allowance' (£m).

<sup>65</sup> [OF-CA-169] Southern Water, SRN25 Supply Resilience Enhancement Programme Enhancement Business Case, August 2023, page 97, figure 24 chart 'Totex Allowance' (£m).

<sup>66</sup> [OF-CA-170] Southern Water, TA.11.WN03 Water Treatment Business Case, September 2018, page 23

<sup>67</sup> [OF-CA-169] Southern Water, SRN25 Supply Resilience Enhancement Programme Enhancement Business Case, August 2023, page 76, figure 21 chart 'Totex Allowance' (£m).

<sup>68</sup> [OF-CA-169] Southern Water, SRN25 Supply Resilience Enhancement Programme Enhancement Business Case, August 2023, page 76, table 32.

<sup>69</sup> [OF-CA-095] Ofwat, Query response: OFW-OBQ-SRN-217, February 2024.

<sup>70</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, pp. 39-40.

4.70 The company says it has a WRMP requirement to deliver a minimum of [REDACTED] from this site by April 2025. [REDACTED]

[REDACTED] Southern Water did not include the rebuild scheme in its original August 2023 business plan. The company has now pushed delivery of this back into April 2025 early in this price control period and requested funding in the draft determination representation.

4.71 In its representations the company requested £30.238<sup>72</sup> million through the transitional expenditure programme in 2024–25 to rebuild the site. There is no cost breakdown of the £30.238 million. The company proposed to deliver [REDACTED] of benefits by March 2025 costing £18.95 million<sup>73</sup>, it is not clear what the additional £11 million will deliver (out of the total £30 million transitional expenditure programme request).

4.72 The company also said it spent £18.4 million over the last two AMPs (£11 million in AMP6 and £7.4 million in AMP7<sup>74</sup>), and of that £7.4 million in AMP7 expenditure was related to general improvements in response to the DWI notice. The company subsequently demolished the site in 2022–23. This effectively removed £18.4 million of customer funded improvements to the previous site.

4.73 We continue to consider that customers should not provide £30.238 million of additional expenditure allowances for work to be carried out in 2024–25. The expenditure does not meet the transitional expenditure programme criteria as the scheme is not new as the company committed to delivering the scheme during the 2020–25 period, and the company has not provided a breakdown of the £30.238 million figure. We assessed the AMP8 expenditure of £44.098 million for an enhancement expenditure allowance (£74.336 million – £30.238 million).

4.74 We had minor concerns that the costs presented were not efficient and made a 10% adjustment. The company said it benchmarked most of its £52 million phase 2 works (86% scope of net direct works and scope 78% of indirect costs<sup>75</sup>) but did not provide an asset/activity level cost breakdown of the benchmarks, and we had remaining concerns that there was a lack of external assurance. Based on the adjustments we allowed an enhancement uplift of £39.688 million for the company to replace the site (90% of £44.098 million).

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<sup>72</sup> [OF-CA-165] Ofwat, Query response: OFW-REP-SRN-063, September 2024.

<sup>73</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, p. 46.

<sup>74</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, pp 39–40.

<sup>75</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, p. 45.

- 4.75 Key issue 4: Southern Water has not provided efficient costs nor sufficient evidence of cost assurance at [REDACTED] WTW and [REDACTED] WTW.
- 4.76 At final determinations we had concerns that the costs were not efficient and made a 10% adjustment for enhancement funding for [REDACTED] WTW and [REDACTED] WTW. In its draft determination representations the company provided three items of evidence on cost efficiency at [REDACTED] and [REDACTED]: an internal shadow estimate/benchmark, an external benchmark and a breakdown of a 14% cost increase at [REDACTED] WTW since draft determination. From the benchmarks provided, we had minor concerns that only 37% of the scope was internally benchmarked, and less than 10% of this scope was externally benchmarked focusing on net direct works<sup>76</sup>. In our PR24 final methodology<sup>77</sup> we said we would focus our cost efficiency assessment in three areas: clarity on cost estimation/calculation, evidence of efficiency (through benchmarks) and evidence of third-party assurance.
- 4.77 The company increased its cost for [REDACTED] WTW by £8.3 million in its response to our draft determinations [REDACTED]  
[REDACTED] It provides a breakdown in its business case for the £8.3 million increase: an extra £2.5 million for a low lift pump refurbishment (originally £5.5 million at draft), an extra £4.9 million for enabling works to build a bypass (originally £0.6 million at draft as enabling works [REDACTED]), a new request of £0.5 million for an additional pump, and £0.4 million for the expansion of a low voltage distribution board to accommodate scope growth<sup>78</sup>. The company does not provide sufficient and convincing evidence that these changes are reasonable. It says that a "detailed design development" revealed an increase of £8.300 million was needed<sup>79</sup>. It did not provide the new design in representations or its statement of case. The company provides brief notes on each cost increase<sup>80</sup>, but there is no optioneering evidence or cost efficiency evidence submitted to support the cost increase. Despite the cost increase we continued to apply a 10% efficiency challenge. We consider our assessment used a balanced judgement to provide sufficient funding even though the company did not provide sufficient evidence for the cost increases at [REDACTED].

## Supply enhancement – Smock Alley scheme

- 4.78 Smock Alley is a groundwater scheme proposed to deliver 3.12 Ml/d of water available for use (WAFU) benefit to the company supply demand balance by 2028. Southern Water requested £21.288 million in additional funding for the scheme at PR24.<sup>81</sup> The

<sup>76</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, pp. 23-25, tables 6, 7 and 8.

<sup>77</sup> [OF-CA-001] Ofwat, Creating tomorrow, together: Our final methodology for PR24: Appendix 9 Setting expenditure allowances, December 2022, p. 154.

<sup>78</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, p. 25.

<sup>79</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, p. 24.

<sup>80</sup> [OF-CA-161] Southern Water, SRN-DDR-027 Supply Resilience Enhancement Programme, August 2024, p. 25.

<sup>81</sup> [OF-CA-138] Ofwat, PR24-FD-CA29-Water-Supply-enhancement-expenditure-model, February 2025,



scheme was originally funded at PR19 for £3.754 million as part of the company's 2020–2025 supply programme to deliver 3.12 Ml/d of benefit by 2024. This scheme is currently delayed, and the expected benefit has not been delivered. In its draft determination representation, the company stated the original scheme option is no longer feasible and therefore proposed a change in scope which requires the replacement and reinstatement of existing treatment processes.<sup>82</sup>

## Our final determinations

4.79 For the final determination we assessed company enhancement expenditure proposals to determine if they were properly justified and did not overlap with previously funded or base expenditure. Southern Water did not provide sufficient and convincing evidence to demonstrate that its Smock Alley scheme was valid enhancement expenditure which had not been previously funded in the 2020–2025 period. It also did not provide evidence that the additional scope presented in the 2025–2030 period had no overlap with base expenditure provided from the base model allowances. Due to significant concerns over both duplicate funding and base overlap, we rejected the investment request for the Smock Alley scheme and applied a 100% adjustment to the requested costs.<sup>83</sup>

## Issues raised by disputing company

4.80 In its statement of case, Southern Water raises three main issues<sup>84</sup> with our assessment of the Smock Alley scheme, namely that:

- Southern Water claims that Ofwat was wrong to assume that the full scope of the Smock Alley scheme was funded in the 2025–2030 period.
- The company states that Ofwat's approach to funding the delayed 2020–2025 Rogate groundwater scheme is inconsistent with the approach for Smock Alley.
- Southern Water states that it is not practicable or feasible to fully scope and cost each scheme in its WRMP. The company states the time it would take to do this for all 141 supply schemes in its WRMP24 would severely delay the plan's production.

4.81 The company requests a redetermination of the allowance that accounts for the difference between the funding requested in the draft determination representation and a calculated allowance to account for its non-delivery in the 2020–2025 period.<sup>85</sup>

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<sup>82</sup> [OF-SRN-017] Southern Water, SRN-DDR-028: Water Resources – Supply Enhancement Cost Evidence Case, page 14, August 2024.

<sup>83</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'Non-Enhancement' and "Scheme Allowances" tabs, February 2025.

<sup>84</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, Section 7.3.

<sup>85</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, Section 7.3.6.

## Our assessment

### 4.82 Key issue 1: Overlap with 2020–2025 funding requests

4.83 Southern Water claims that Ofwat was wrong to assume that the full scope of the Smock Alley scheme was funded in the 2025–2030 period. The company accepts that the original Smock Alley scheme has not been delivered as planned and that while the scope of the scheme has changed, there will be no increase in benefit to that already funded in the 2020–2025 period (3.1Ml/d). However, the company states Ofwat was incorrect in its assessment that the scheme is the same as that funded in the 2020–2025 period, as the new scope includes the installation of new treatment processes, which are significantly more expensive than the elements included in the 2020–2025 scope.<sup>86</sup>

4.84 Our assessment determined that the Smock Alley groundwater scheme was originally funded at PR19 for £3.750 million as part of the company's 2020–2025 supply programme. We assessed that the original scheme to deliver a WAFU benefit of 3.1Ml/d by 2024 had not been delivered.<sup>87</sup> In its representation, Southern Water stated this is due to the original scheme no longer being feasible. The company proposed a change in scope which requires the replacement and reinstatement of existing treatment processes.<sup>88</sup> The company requested £21.288 million in additional funding at PR24 draft determination representations for 3.1Ml/d of WAFU benefit with an updated delivery date of 2028. Therefore, in the final determination, we concluded that the proposed scheme represents the same WAFU benefit funded as part of the company's 2020–2025 supply programme, expected to have been delivered by 2024. We funded the benefit (Ml/d of WAFU) of schemes at PR19 just as we have done at PR24, meaning that the outcome of investments is tracked, and in this instance the benefit has not been delivered.

4.85 Due to the significant concerns over both duplicate funding and base overlap, we rejected the investment request for the Smock Alley scheme and applied a 100% adjustment to the requested costs.

4.86 A summary of this history is provided in table 4.8 below, alongside the Rogate groundwater scheme, which the company compares to Smock Alley.

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<sup>86</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, Section 7.3.5.

<sup>87</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'Non-Enhancement' tab, February 2025.

<sup>88</sup> [OF-SRN-017] Southern Water, 'SRN-DDR-028: Water Resources – Supply Enhancement Cost Evidence Case', page 14, August 2024.

**Table 4.8: Summary of the 'Smock Alley' and 'Rogate' supply-side schemes across the 2020-2025 and 2025-2030<sup>89</sup> periods.**

Scheme Name	PR19 2020-2025 allowance (£m)	PR19 original benefit (Ml/d)	PR19 original delivery date	PR24 2025-2030 request (£m)	PR24 2025-2030 allowance (£m)	PR24 updated benefit (Ml/d)	PR24 updated delivery date
Smock Alley	3.75	3.12	2024	21.29	0.00	3.12	2028-29
Rogate	0.61	1.60	2025	12.54	7.19	1.60	2028-29

4.87 Where scope changes occur, companies are still expected to deliver schemes and associated benefit<sup>90</sup> and may utilise funding mechanisms such as cost sharing if necessary to share an overspend between the company and customers<sup>91</sup>. As a result, companies should not wait or delay schemes to subsequent price reviews to avoid overspends as this delays the delivery of much needed benefit for supply resilience. While Southern Water is now requesting a redetermination of the allowance that accounts for the difference between the total funding requested and a calculated allowance to account for its non-delivery in the 2020-2025 period, it is notable that it did not itself apply a non-delivery adjustment to the scheme before requesting that it be refunded in the 2025-2030 period (until this was challenged in the final determination).<sup>92</sup>

4.88 This scheme and associated benefit was not included in the total 12.6Ml/d of PR19 non-delivery of benefit adjustment applied to the company, which was applied as a result of five of its PR19 supply side schemes being cancelled, delayed or expected to deliver a reduced benefit.<sup>93</sup> This was to avoid double-penalising and reflects the expectation that the 'Smock Alley' scheme and associated 3.1Ml/d benefit should still be delivered as proposed in the 2020-2025 supply programme, with any additional scope funded through cost sharing or base allowances.

4.89 Key Issue 2: Base-overlap and inconsistency in funding approaches with Rogate groundwater scheme

4.90 The company states that Ofwat's approach to funding the delayed 2020-2025 Rogate groundwater scheme is inconsistent with the approach for Smock Alley. Both schemes were re-evaluated during the early stages of delivery and were found to require new treatment processes. The company notes that Ofwat accepted the case for the Rogate

<sup>89</sup> [OF-CA-138] Ofwat, Water – Supply; enhancement expenditure model v2, February 2025.

<sup>90</sup> [OF-CA-001] Ofwat, PR24 final methodology: Appendix 9 – setting expenditure allowances, section 5.4.1, pp. 86-87.

<sup>91</sup> [OF-CA-001] Ofwat, PR24 final methodology: Appendix 9 – setting expenditure allowances, section 2.4.5

<sup>92</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, Section 7.3.6.

<sup>93</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'PR19 Non-Delivery' tab, February 2025.



scheme with only a 15% adjustment for base overlap and an adjustment for non-delivery in the 2020–2025 period but fully rejected the Smock Alley scheme due to concerns that at least 50% of the presented costs were base overlap.

- 4.91 The company additionally states that the proposed assets are not due to be replaced as part of its capital maintenance programme, but note that even if there was base overlap, Ofwat should have allowed funding for the 50% of non-base overlap costs in line with the approach for Rogate, where the company has accepted the proposed adjustment.<sup>94</sup>
- 4.92 In its representation on the draft determination, Southern Water requested £12.537 million in additional funding for the Rogate groundwater scheme.<sup>95</sup> The scheme was originally funded for £0.610 million as part of the company's 2020–2025 supply programme to deliver a water available for use (WAFU) benefit of 1.6Ml/d by 2025. Similarly to Smock Alley, the company stated in its representation that the original scheme option was no longer feasible and therefore required new treatment processes to realise the expected benefit.<sup>96</sup> In the final determination, we concluded that the proposed scheme represented the same WAFU benefit funded as part of the company's 2020–2025 supply programme, expected to have been delivered by 2025.<sup>97</sup>
- 4.93 However, we concluded that the scope change extent that had occurred on Rogate warranted a new efficient PR24 allowance to be modelled, but that a non-delivery adjustment must first be made to account for the PR19 allowance that did not result in benefit being delivered.
- 4.94 A non-delivery adjustment of 1.6Ml/d was therefore first applied to the company's PR24 allowance. The adjustment was calculated as 1.6 multiplied by the PR24 modelled low-complexity unit cost (£0.71 million per Ml/d) and applied to the company's allowance. The low-complexity unit cost rate was chosen as the original 2020–2025 scope of the 'Rogate' scheme would have fallen into the 'Low' modelling category in the PR24 final determination modelling.<sup>98</sup>
- 4.95 A new efficient PR24 allowance was then modelled for Rogate as we determined that the majority of costs were associated with new assets and processes (for example, new caustic dosing) which were not originally scoped. However, the scope breakdown<sup>99</sup> for

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<sup>94</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, Section 7.3.5.

<sup>95</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'Scheme Allowances' tab, February 2025.

<sup>96</sup> [OF-SRN-017] Southern Water, SRN-DDR-028: Water Resources – Supply Enhancement Cost Evidence Case, page 14, August 2024.

<sup>97</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'Non-Enhancement' tab, February 2025.

<sup>98</sup> [OF-CA-138] Ofwat, Water – Supply; enhancement expenditure model v2, Non-Enhancement tab, February 2025.

<sup>99</sup> [OF-SRN-018] Southern Water, OFW-REP-SRN-018 and OFW-REP-SRN-018 Rogate-Process-Flow-Diagram', September 2024.

Rogate indicated that some of the scope, and at least 15% of the presented costs<sup>100</sup> were associated with replacing age-expired or non-compliant assets. A 15% adjustment to the company's 2025-2030 cost request for the scheme was therefore applied to reflect this overlap in base expenditure. An allowance for the 2025-2030 period was then determined through modelled efficiency benchmarking in the supply model, based on the new scheme scope falling under the 'Treatment' category.<sup>101</sup>

4.96 It is in this way that the Rogate scheme differs from Smock Alley. Unlike Rogate, the company's additional scope and cost request for Smock Alley was determined to be intrinsically linked to replacing existing age-expired or non-compliant assets.<sup>102</sup> The existing groundwater borehole is non-compliant with current standards and the proposed new pressure filtration, disinfection, orthophosphoric acid dosing and refurbished wash-water treatment processes are all upgrades of existing assets which are age-expired and non-compliant. This request represented at least 50% of the new costs proposed in the 2025-2030 period,<sup>103</sup> which is considered a significant overlap with base funding.<sup>104</sup> Insufficient evidence was provided by the company when queried to determine the exact percentage of base overlap, which is likely to be higher still than the 50%.

4.97 Key Issue 3: Costing and scoping schemes in the 2024 water resources management plan (WRMP24)

4.98 Southern Water states that the scheme costs for Smock Alley are based on a concept design and that it is not practicable or feasible to fully scope and cost each scheme. The company states the time it would take to do this for all 141 supply schemes in its WRMP24 would severely delay the plan's production.<sup>105</sup> The company did not present specific scheme costs for the Smock Alley scheme (named [REDACTED] in its revised draft WRMP24 for its autumn 2024 WRMP re-consultation.<sup>106</sup> This means we don't know the assumed costs used in its decision-making process to determine a best value WRMP investment programme.

4.99 Section 37A of the Water Industry Act 1991<sup>107</sup> sets out the duty for water companies to develop and maintain a WRMP. The requirements for developing the WRMP are then set out in the Water Resources Planning Guideline.<sup>108</sup> The Water Resources Planning

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<sup>100</sup> [OF-SRN-019] Southern Water, OFW-REP-SRN-092, September 2024.

<sup>101</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'Scheme Allowances' tab, February 2025.

<sup>102</sup> [OF-SRN-018] Southern Water, OFW-REP-SRN-018, September 2024.

<sup>103</sup> [OF-SRN-019] Southern Water, OFW-REP-SRN-092, September 2024.

<sup>104</sup> [OF-CA-138] Ofwat, 'Water – Supply; enhancement expenditure model v2', 'Non-Enhancement' tab, February 2025.

<sup>105</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, Section 7.3.1.

<sup>106</sup> [OF-SRN-016] Southern Water, draft WRMP24 table (Autumn 2025), sheet ' 5a-5c. Cost Profiles', table 5a.

<sup>107</sup> [OF-CA-194] UK Government, 1991, Water Industry Act, Section 37A.

<sup>108</sup> [OF-SRN-020] EA, Ofwat, NRW, 2023, Water Resources Planning Guideline.

Guideline specifies that robust and consistent costs must be developed for options, with requirements for this set out in the following sections:

4.100 Section 1.5 – Assurance requirements on robust evidence including those relating to costs;

4.101 Section 1.6 – Links to other plans, including clear links to Business Plans using robust and consistent cost estimates, and referencing Ofwat's 'PR24 and Beyond: Final guidance on long-term delivery strategies';<sup>109</sup>

3. Section 8.3.1 – Costing requirements of options, including expectations that:
  - a. Costs are provided for the full option to realise the gain in WAFU;
  - b. Costs are robust and efficient with evidence provided to support this;
  - c. Board assurance statements have considered and assured costing approaches, calculations and resulting option costs;
  - d. Costs presented in the plan are consistent with those submitted in the company's business plan, and if variance occurs, that the impact of the variance on the optimisation of the plan is reassessed.

4.102 WRMP24 is the sixth round of WRMPs. Most companies, including Southern Water, assess options which are then refined to a feasible list which builds on previous plans. As such, either the same or a very similar suite of options are assessed and optimised every five years. There is ample opportunity for the company to develop robust costings sufficient for planning and business plan submission for these schemes. The company had issues with option costing at WRMP19 and PR19 and appears not to have learned from this experience<sup>110</sup>.

4.103 The robustness and consistency of costs is particularly important in the WRMPs as costs, alongside metrics on environmental and social impacts, underpins the best value decision making in the plans. This ensures that the options selected for the preferred plan are best value for both customers and the environment.

4.104 We maintain our conclusion that Southern Water has not provided sufficient and convincing evidence to demonstrate that its Smock Alley scheme was valid enhancement expenditure which had not been previously funded in the 2020-2025 period. The company has not demonstrated that it shouldn't have still delivered the benefit it committed to in this scheme, utilising funding mechanisms such as cost sharing for additional scope. It also did not provide evidence that the additional scope presented in the 2025-2030 period did not overlap with base activities, and therefore overlaps with base expenditure provided from the base model allowances. We maintain

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<sup>109</sup> [OF-SRN-012] Ofwat, 2022, PR24 and beyond: Final guidance on long-term delivery strategies.

<sup>110</sup> For example, Smock alley and Rogate schemes were scoped and costed at PR19 at £3.754 million and £3.365 million respectively. These schemes were not delivered and costs requested again at PR24 for £21.288 million and £12.537 million respectively, citing new additional scope. This demonstrates poor understanding of scheme scope and subsequent certainty of costs at the point of business plan submission.



that our approach of applying a 100% adjustment to the requested costs is appropriate and retain the expectation that the 'Smock Alley' scheme and associated 3.1Ml/d benefit should still be delivered as proposed in the 2020-2025 supply programme, with any additional scope funded through cost sharing or base allowances.

## Delivering outcomes for customers and the environment

4.105 In its representations Southern Water proposed a moderately ambitious set of performance commitment levels (PCLs) when compared to other companies. SRN recognised that being a company in turnaround means it must go further and do more than the 'average' or 'median' company in the sector. Southern Water stated it is committed to continuing to turn its performance around, which is why it is proposing a level of stretch that puts it at upper quartile improvement rate from its actual 2024/25 baseline on water supply interruptions, water quality, internal sewer flooding and total pollution incidents.

4.106 Where necessary, we respond to Southern Water's comments on the outcomes framework within the following documents:

- PR24 redeterminations – outcomes – common issues; and
- PR24 redeterminations – risk and return – common issues.

**Table 4.9: Navigation of key issues in outcomes**

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
Performance commitments and outcome delivery incentives (PCs and ODIs)	ES, Section 6.1, para 45 and 46 Chapter 6, section 3.1	PR24 redeterminations – outcomes – common issues  Section – Approach to setting common performance commitment levels & Calibration of ODI rates and risk protections.
Water supply interruptions	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1	This document  Section – Water Supply Interruptions.
Compliance risk index	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.1	This document  Section – Compliant risk index.
Total pollution incidents	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.2	This document  Section – Total pollution incidents.
Serious pollution incidents	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.3	This document  Section – Total pollution incidents.
Storm overflows	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.4	This document  Section – Storm overflows.
C-MeX, D-MeX, BR-MeX	ES, Section 6.1, para 47 Chapter 6, para 6 Chapter 6, section 4.1.5	This document

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
		Section – C-MeX, D-MeX, BR-MeX.
Bathing water quality	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Bathing water quality.
Leakage	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Leakage.
Water quality contacts	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Customer contacts about water quality.
Discharge permit compliance	ES, Section 6.1, para 48 Chapter 6, para 7 Chapter 6, section 4.1.6	This document  Section – Discharge permit compliance.

## Total pollution incidents

### Performance commitment level

#### Final determination

4.107 At PR24, we set the total pollution incidents PCL at a common level for all companies, except for Hafren Dyfrdwy.<sup>111</sup> The 2024–25 baseline was set at a level of 26.61 incidents per 10,000km of sewer length and was calculated from the median of the average performance from 2020–24 for each company.<sup>112</sup> This was an adjustment we made from our draft determinations and puts greater emphasis on recent performance levels.

4.108 We applied a 30% improvement to the baseline to derive the 2029–30 PCL of 18.63 incidents. This level of performance improvement aligns with the ambition set out by the Environment Agency in the Water Industry Strategic Environmental Requirements (WISER).<sup>113</sup>

### Company statement of case

<sup>111</sup> We set company-specific PCLs for Hafren Dyfrdwy because the company's small size relative to other water and sewerage companies. For further details see [OF-OU-020] Ofwat, PR24 final determinations: Hafren Dyfrdwy – Outcomes appendix, December 2024, pp. 3–8.

<sup>112</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), December 2024, p. 183.

<sup>113</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), December 2024, p. 184.



4.109 Southern Water states several reasons why it considers delivery of our common PR24 PCL will be challenging in its region and proposes amendments that would result in less stretching performance targets for the 2025–30 period. These reasons can be summarised at a high level as follows:

- Exogenous factors, in particular;
- impacts of climate change and severe weather; and
- the ecological characteristics of the region it serves; and
- calibration of the PCL, by adjusting the baseline using the 2023–24 performance.

4.110 Southern Water considers that the implications of climate change, in particular more frequent and severe storm events, will mean it will not meet the final determinations target.<sup>114</sup> The company also considers that its region has statistically higher exposure to ecological characteristics that may be subject to stricter discharge requirements and increase the likelihood of pollution incidents.<sup>115</sup>

4.111 The company proposes the PR24 PCL is amended using the median of the sector's 2023–24 outturn data (excluding Hafren Dyfrdwy) to set the 2024–25 baseline. This is equivalent to 32.54 incidents per 10,000 km of sewer length. Southern Water then proposes to retain our 30% reduction across the 2025–30 period to deliver a 2029–30 PCL of 22.78 incidents per 10,000 km of sewer length. The extrapolated 2025–26 PCL would be 30.59 incidents per 10,000 km sewer. The company considers these to be stretching targets when compared to the 2023–24 median and upper quartile positions of 32.54 and 28.33 incidents per 10,000 km of sewer length respectively. Table 4.10 below shows the details of Southern's proposed PCL.

**Table 4.10: Southern Water's proposed PCL versus Ofwat final determination PCL for Total Pollution Incidents**

Total Pollution PCL	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30
Southern Water proposal	32.54	30.59	28.64	26.69	24.73	22.78
Ofwat Final Determination PCL	26.61	25.02	23.42	21.82	20.23	18.63

4.112 The company considers focus on the 2023–24 data to be appropriate in order to reflect changes to the reporting methodology and technology used to capture data (event

<sup>114</sup> [OF-OA-003] Southern Water, Southern Water PR24 Redetermination: Statement of Case, March 2025, p. 393.

<sup>115</sup> This is based on shellfish waters, bathing water, chalk streams and areas of outstanding natural beauty (AONB) See [OF-OA-003] Southern Water, Southern Water PR24 Redetermination: Statement of Case, March 2025, p. 384–385.

duration monitoring). Southern Water proposes that this has led to an increase in recorded pollution incidents, which justifies a resetting of the 2024-25 baseline.<sup>116</sup>

4.113 Southern Water also suggests an alternative approach would be to use 2024-25 outturn performance data to derive a 2024-25 baseline and revise the PCLs following the approach described above.

## Our response

4.114 Regarding the points made by the company concerning exogenous factors made by the company, we do not consider these justify setting a less stretching PCL for the 2025-30 period. Our policy on exclusions should be considered within the context of the whole outcomes framework: our approach to exclusions goes hand in hand with the risk protections that we have also put in place.<sup>117</sup>

4.115 Southern Water considers that their operational area presents unique challenges, such as diverse geography, high population density and environmental sensitive areas which may explain its poorer performance in total pollution incidents in comparison to other regions. For example, the KPMG report, commissioned by Southern Water to assess the ecological characteristics on the company's pollution incidents performance in the 2020-25 period and the impact of weather on performance across key wastewater ODIs, recognises there may be ecological factors and demographic factors that play a material role in Southern Water's total pollution incidents ODI performance. These include, for example, sites of special scientific interest (SSSIs), Ramsar sites and local nature reserves.<sup>118</sup>

4.116 However, the company fails to provide compelling evidence to support a less stretching PCL. While the company has identified specific factors that present a challenge in its region, these ecological challenges are not unique to the company's area; there are a wide variety of environmental challenges that different companies will face. These challenges necessarily influence the activities needed to manage performance across the range of common performance commitments.

4.117 Furthermore, the environmental permits in a company's region will reflect the environmental characteristics of that region. These requirements in turn influence the Water Industry National Environmental Programme (WINEP).<sup>119</sup> We provide efficient cost allowances of £67.53 million in PR24 to Southern Water for the delivery of these programmes and therefore we consider it is funded to manage these specific

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<sup>116</sup> [OF-OA-003] Southern Water, Southern Water PR24 Redetermination: Statement of Case, March 2025, p. 391

<sup>117</sup> For further information, see Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, pp. 34-39 (s.4).

<sup>118</sup> Ramsar sites are wetlands of international importance designated under the Convention on Wetlands. See [OF-OU-089] Ramsar, The Convention on Wetlands.

<sup>119</sup> The WINEP is the programme of actions water companies need to take to meet statutory environmental obligations, non-statutory environmental requirements or delivery against a water company's statutory functions.

challenges and this delivery is consistent with its legal obligations and environmental duties.<sup>120</sup>

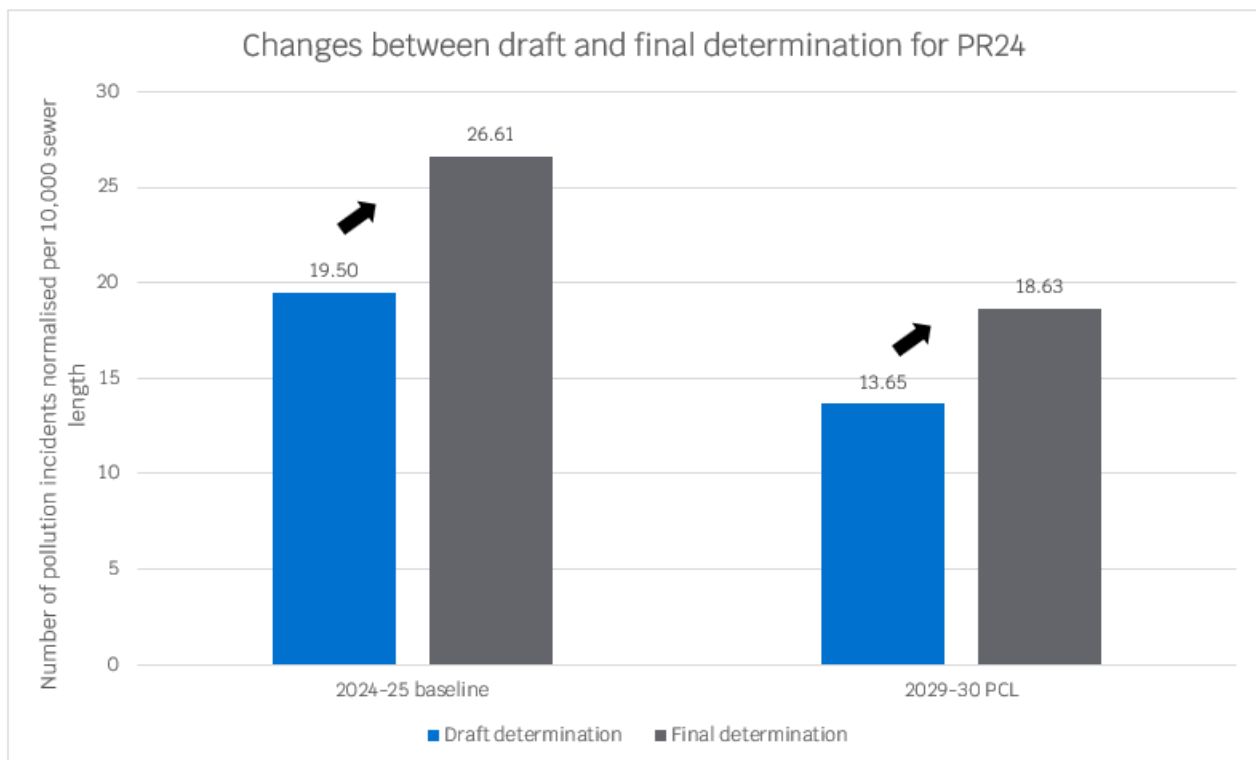
- 4.118 Further to this, we consider that performance of sewage pumping stations and wastewater treatment works can be better monitored by deploying sensors at the right locations and preventing total pollution incidents from these assets. The KPMG report highlights that "outdated and poorly maintained assets are more likely to break or malfunction which could induce a pollution incident." We expect that sewage pumping stations and wastewater treatment works are operated resiliently by having standby systems to reduce the risk of pollution incidents. We consider that the performance can be improved with effective operational and maintenance strategies. In fact, in the KPMG report, it highlights "operational inefficiencies such as insufficient monitoring and slow response times may result in more pollution incidents".
- 4.119 We have already intervened at final determinations to reduce the stretch for this performance commitment from final determinations in response to company feedback and considered the 2020-24 performance data. We changed the 2024-25 baseline from 19.50 to 26.61 and the 2029-30 PCL from 13.65 to 18.63, which represented a 36% reduction in performance stretch between draft determinations and final determinations.

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<sup>120</sup> [OF-OA-022] Ofwat, PR24-final-determinations-Expenditure-allowances-V2, December 2024, pp. 148, 164-165.



**Figure 4.1: Change of Total Pollution Incidents PCL from draft determination to final determination**



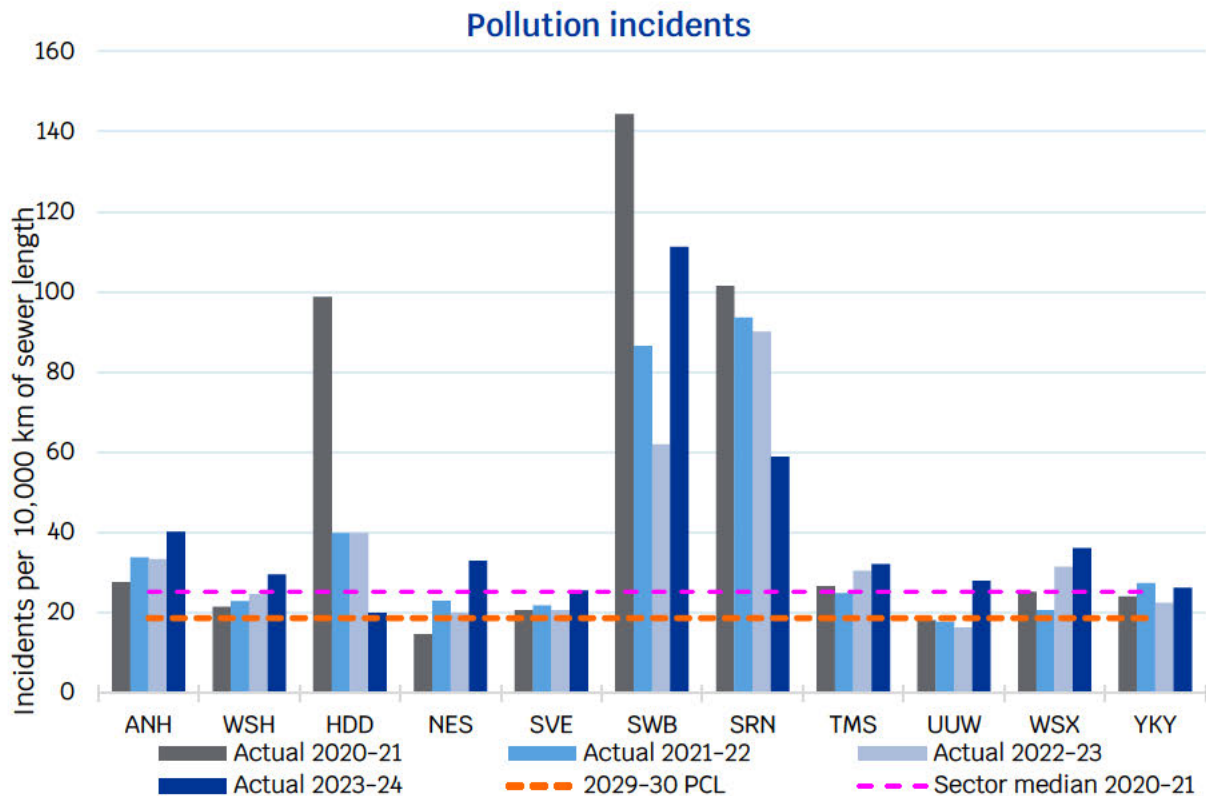
4.120 We consider that this results in a common PCL that is stretching yet achievable. This is supported by consideration of company forecasts with four companies proposing to meet the 2025-26 PCL and six companies proposing to meet the 2029-30 PCL.<sup>121</sup> Companies have been more ambitious nearer the end of the 2025-30 period. Therefore, our final determinations have a 2029-30 PCL of 18.63 incidents per 10,000km of sewer, which sits between the sector lower quartile and median performance levels forecast by companies.<sup>122</sup>

4.121 Reflecting on sector performance for total pollution incidents, most companies need to only replicate their best 2020-24 performance to meet the 2025-20 PCL.

<sup>121</sup> Analysis excluding Hafren Dyfrdwy.

<sup>122</sup> Company 2029-30 forecast median is 15.18 incidents and lower quartile is 22.24 incidents, excluding Hafren Dyfrdwy.

**Figure 4.2 Total Pollution Incidents performance over the 2020-24 period**



4.122 Southern Water references the impact of performance data from event duration monitors as part of its proposal to focus on 2023-24 data for PCL setting. We do not consider focusing on 2023-24 to the exclusion of the rest of the 2020-24 period to be appropriate. We note that nine of eleven companies deteriorated in total pollution incident performance from 2022-23 to 2023-24, with the majority of companies attributing this to the impact of weather, specifically rainfall. We still consider use of the 2020-24 data to provide a more representative baseline of what the sector can be expected to deliver than focusing on 2023-24 exclusively.

4.123 At present, companies are not required to include dry day storm overflow spills as category 3 incidents

[REDACTED]

We explain in Section 6 of the PR24 redeterminations – outcomes – common issues document, that we would expect to consider changes made to the EPA reporting requirements and consult, in line with our change control process, to determine if and

how to reset the relevant aspects of the Total pollution incidents performance commitment.<sup>124</sup>

- 4.124 Our concern is Southern Water has not demonstrated, through compelling evidence, that its deterioration is solely attributable to external factors and does not represent failures that are within companies' control to address.<sup>125</sup> External factors may also have an effect but, in many cases, companies can mitigate the impact of external factors, such as weather events, on customers through how they prepare for and respond to such factors, including by working with third parties. We want to incentivise companies to stretch their influence in this way when delivering their functions.
- 4.125 Another key way we address the impact of external factors is through risk protections. As explained in the 'PR24 redetermination – outcomes – common issues' document, rather than relying on exclusions, we ensure that companies have a reasonable balance of risk and return on their overall packages using tools such as caps, collars and deadbands. At PR24, we received strong feedback from non-company stakeholders emphasising the importance of holding companies to account for delivering environmental improvements.<sup>126</sup> In fact, in Southern Water's customer acceptability testing, pollution incidents was ranked as priority level 1 for customers and a top area to improve and see ambition.<sup>127</sup>
- 4.126 In the most recent Environmental Performance Report (EPA) published by the EA, Southern Water was rated 2 stars (out of 4), with a red status on both the total pollution incidents and serious pollution incident metrics over the last three years, indicating that the company's performance is significantly below target and requires improvement.<sup>128</sup> Southern Water customers want them to push hard when addressing pollution, citing that they were "shocked" and "really horrified" by its poor performance and question whether they are "comfortable taking [people] into the sea".<sup>129</sup> Therefore, we do not consider it is in the interests of customers or the environment to reduce performance stretch in this area.
- 4.127 In summary, on the basis of our considerations above, we recommend that the CMA continues to apply the common PCLs for total pollution incidents to Southern Water that we set at PR24 final determinations.

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<sup>124</sup> Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, pp. 45–49 (s.6).

<sup>125</sup> Failures such as asset failure and operational errors.

<sup>126</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), pp.19–20.

<sup>127</sup> [OF-OU-090] Southern Water, SRN14 Customer Insight Technical Annex. October 2023, p. 81.

<sup>128</sup> [OF-OU-056] Environment Agency, Environment-Agency-Environmental-Performance-Assessment-results-2023-for-water-and-sewerage-companies.ods, July 2024, line 7.

<sup>129</sup> [OF-SRN-011] Relish, Affordability and acceptability for PR24: Qualitative research debrief, June 2023, p.40–41



## ODI rate

### Final Determination

4.128 The ODI rate is calculated using a top-down rate setting methodology based on equity return at risk. We use historical data starting from PR14 to calculate the performance range used to calculate the ODI rate for total pollution incidents. For final determinations, we included additional data from 2023–24 in the performance range, which led to a 40% reduction in the strength of the median ODI rate from draft determinations. The median ODI rate is still 103% stronger than at PR19.<sup>130</sup>

4.129 At PR24, total pollution incidents was allocated to the "high" starting RoRE risk to align with the UK government's strategic priorities for Ofwat.<sup>131</sup> The 0.6% RoRE starting allocation is then spread across the calculated performance range to give a final unit rate, which in the case of Southern Water is £0.248m per pollution incident.<sup>132</sup>

### Statement of Case

4.130 Southern Water objects to our use of PR14 historical data to calibrate the ODI rate for total pollution incidents. It says that this approach does not reflect broader industry trends because PR14 targets were bespoke for each company. Instead, the company contends that the PR19 performance is more representative of the likely P10/P90 performance at PR24 because we set common performance targets across companies in that period. When focusing on the PR19 time series, the variation in company performance (measured through the P10/P90 ranges) increased significantly, from 66% to 284%, which results in a reduction of the ODI rate by a factor of 2.6 times, from £0.984m to £0.379m.<sup>133</sup>

### Our response

4.131 Southern Water has not provided compelling new evidence to change our final determinations approach of including PR14 historical data when calculating the performance range for total pollution incidents at PR24. In its representation to our draft determinations Southern Water proposed different overarching modifications to the top-down methodology not a specific proposal for the total pollution incidents ODI rate. For existing performance commitments where there is a longer time series of data, we use all available historical performance data in the calculation of the P10/P90

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<sup>130</sup> [OF-OA-017] Ofwat, PR24 Final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), pp. 185–186.

<sup>131</sup> [OF-OU-011] Ofwat, PR24 draft determinations: Delivering outcomes for customers and the environment, July 2024, section 4, p. 24.

<sup>132</sup> [OF-OU-074] Ofwat, PR24 Final determinations: PR24-FD-OC03-ODI-rates – ODI Rates, December 2024

<sup>133</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 392.

performance range.<sup>134</sup> This approach is demonstrated in the ODI performance range 1 model.<sup>135</sup> It reflects performance across multiple periods to provide the most robust estimates of future performance. We apply this methodology consistently regardless of whether performance ranges at PR19 were narrower or wider than at PR14. Using the maximum available data points mitigates the impact of outliers on performance ranges, such as company-specific performance or exceptional weather years like the extreme high rainfall referenced by companies in 2023–24.<sup>136</sup>

4.132 Total pollution incidents was allocated to the "high" starting RoRE risk category to align with the UK government's strategic priorities for Ofwat.<sup>137</sup> It would not be in the interests of customers or the environment to lower the ODI rate as proposed by Southern Water. Adjusting the top-down calculation to use the company's proposed performance range of 284% equates to a unit rate of £0.058m per pollution incident. The unit rate proposed by Southern Water is 39% lower than its unit rate at PR19 of £0.095m per pollution incident and 77% lower than our final determinations unit rate of £0.248m.<sup>138</sup> This does not align with our PR24 approach that ODI rates must be at least as strong as PR19 to ensure ODI rates incentivise improvements in performance.<sup>139,140</sup>

4.133 The ODI rate for final determinations represents a robust estimate of the historical performance for total pollution incidents, which reflects the importance of this measure for customers and the environment. Narrowing the performance range to artificially lower the ODI rate would reduce the strength of the incentive for Southern Water to improve performance in an area where it has underperformed its PR19 targets by over 250% during the 2020–24 period.<sup>141</sup>

## Serious pollution incidents

### Risk protections

#### Final determination

<sup>134</sup> [OF-OU-112] Southern Water, Our response to Ofwat's draft determination on our Business Plan for 2025–30, August 2024, pp. 173–177.

<sup>135</sup> [OF-OU-079] Ofwat, PR24 ODI Rates – Performance Range Model 1, December 2024

<sup>136</sup> [OF-OU-017] Ofwat, 'Water company performance report 2023–24', October 2024, p.22

<sup>137</sup> [OF-OU-011] Ofwat, 'PR24 draft determinations: Delivering outcomes for customers and the environment', July 2024, section 4, p. 24.

<sup>138</sup> [OF-OU-074] Ofwat, PR24 Final determinations: PR24-FD-OC03-ODI-rates – ODI Rates, December 2024.

<sup>139</sup> [OF-OA-017] Ofwat, 'PR24 final determinations: Delivering outcomes for customers and the environment', December 2024 (republished February 2025), p. 31.

<sup>140</sup> At PR19, Southern Water's unit ODI rate for total pollution incidents was the median rate of all wastewater companies. At PR24, we compared the outputs of the top-down methodology to the PR19 median unit rate to determine if the output was sufficiently strong to incentive companies to improve performance. As a result, Southern Water's PR19 unit rate for total pollution incidents is an appropriate point of comparison.

<sup>141</sup> [OF-OU-036] Ofwat, PR24-FD-CA13-Total-pollution-incidents-v2-1, March 2025.

4.134 We received strong support through representations for targeting zero serious pollution incidents for this measure.<sup>142</sup> Therefore, we did not provide any risk protections for this performance commitment for draft determinations. However, for final determinations, we included a deadband that allows companies one serious pollution incident per year without triggering ODI payments. We consider this adjustment preserves the incentive to improve operation and maintenance while also contributing to a more balanced overall risk profile of the package by reducing the likelihood of expected negative payments.<sup>143</sup>

## Company statement of case

4.135 Southern Water says that of the stretch of the performance commitment level, the strength of the incentive rate and exogenous factors (specifically drier conditions) combine to make this a high-risk area for the company.<sup>144</sup> It therefore suggests a collar set at 0.5% RoRE (equivalent to an average of 10 incidents per year from 2025–30). It contends that this is necessary to protect against unforeseen risks while supporting the company's efforts to address performance challenges. The company also suggests that, as this is a new performance commitment, it meets our criteria for applying a collar to underperformance.

## Our response

4.136 Southern Water has not provided compelling evidence to justify the introduction of a collar at 0.5% for serious pollution incidents. The issues raised by the company, such as the potential impact of drier conditions, can and should be mitigated by effective maintenance and screening. Companies are expected to be prepared for dry summer conditions as much as for prolonged wet conditions and respond accordingly with maintenance or operational interventions.

4.137 We recognise that there may be an increase in serious pollution incidents following a dry spell, if blockages that have formed due to lack of flushing are removed by the first storm. However, companies should be proactive to ensure that blockages, especially those around storm overflows, are dealt with before the first storm after a dry period occurs. Introducing a collar in this context may disincentivise companies to take this kind of proactive action.

4.138 Similarly, the first rain after a prolonged dry spell can result in a higher concentration of pollutants in the initial discharge from a sewage treatment works, making it more likely to cause a serious pollution incident. Again, however, it is the responsibility of companies to maintain their sewerage systems, ensuring that storm tanks have

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<sup>142</sup> [OF-OA-017], Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p. 176.

<sup>143</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering for customers and the environment, December 2024, Section 5.2, p. 45.

<sup>144</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025 p. 395.



sufficient capacity to manage such risks. We do not consider this an acceptable reason for serious pollution incidents and therefore it does not warrant additional risk protection.

4.139 While serious pollution incidents is a new performance commitment introduced at PR24, we have taken a proportionate approach. Unlike other new performance commitments, we have not set a collar on serious pollution incidents, but have instead introduced a deadband allowing for one serious pollution incident per year without triggering ODI payments, as explained above. The deadband represents an improvement for the majority of companies over current performance levels. It also helps to balance the package as a whole as it would reduce the size of negative expected ODI payments.<sup>145</sup> Given the significant impact that serious pollution incidents have on consumers and the environment, we consider that introducing further risk protections would weaken the incentive for companies to improve their performance in this area.

## Storm overflows

### Performance commitment level

#### Final determination

4.140 At PR24, we committed to hold companies to account to rapidly reduce spills from storm overflows over the 2025–30 period and to maintain high levels of monitoring. This approach recognises the importance of this performance commitment to customers and the need to strengthen the accuracy and transparency of storm overflow data reporting.<sup>146</sup>

4.141 Our draft and final determinations made it clear that we expect companies to be compliant with their legal obligations, such as those under section 94 of the Water Industry Act 1991 as supplemented by the Urban Waste Water Treatment (England and Wales) Regulations (UWWTR) 1994 as well as the duty on companies to report on storm overflow spills within an hour of them starting and stopping, which came into force on 1 January 2025.<sup>147</sup> We expected companies to forecast their spill performance based on an average rainfall year, noting that performance commitments should not be considered in isolation and it is important that companies continue to meet legal obligations to

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<sup>145</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024, p. 45 (s.5.2).

<sup>146</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), Section 11.4 Storm overflows, pp.157–173.

<sup>147</sup> [OF-OU-059] UK Government, The Urban Waste Water Treatment (England and Wales) Regulations 1994; and UK Government, Water Industry Act 1991, s.141DA.

effectually drain their areas and effectually deal with the contents of sewers, including their more specific obligations under Regulation 4 of the UWWTR.<sup>148</sup>

4.142 At final determinations, we expected English companies to reach a baseline level of 20 average spills per overflow by 2025. This target level 'provided an incentive that takes account of companies' existing legal obligations and supports priorities in the UK government's Strategic Priority Statement and the long-term targets in the Storm Overflow Discharge Reduction Plan (SODRP). These targets include that by 2050: no storm overflows will be permitted to discharge above an average of ten rainfall events per year and storm overflows will only be permitted to discharge where companies can demonstrate that there is no local adverse ecological impact'.<sup>149,150</sup>

4.143 We applied a stretch from base expenditure, challenging English companies to 'do more to reduce spills from operations and maintenance activities. We did this by challenging them to reduce average spills by at least 5% less than the 20 average spills level (the equivalent of one average spill) through base expenditure.'<sup>151</sup> We consider this level of stretch is credible based on sector outturn, company proposed improvements and as a result of companies' Storm Overflow Assessment Framework (SOAF) assessments where root causes of high spilling overflows, including operations and maintenance issues, are identified.<sup>152</sup>

4.144 The five per cent stretch from base was supported by responses from non-company stakeholders, with no non-company stakeholders suggesting companies should be held to a less stretching target. Some environmental, local-government and customer groups were 'concerned that companies should be performing better as part of a well-managed system and from previous investment. This view is reflected from Rowlands Castle and North Mundham Parish Councils, who state that Southern Water has not adequately maintained its sewer network.'<sup>153</sup>

4.145 We provided an opportunity for outperformance for English companies that proposed to reach below 20 average spills by 2025, by applying stretch improvements from base in the final year of the period, 2029–30. This incentivised companies to deliver maintenance and operational improvement sooner.<sup>154</sup>

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<sup>148</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 12.

<sup>149</sup> [OF-OA-017] Defra, Storm Overflows Discharge Reduction Plan (publishing.service.gov.uk), 2023

<sup>150</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 163.

<sup>151</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 162.

<sup>152</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 164.

<sup>153</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 166.

<sup>154</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 168.

- 4.146 We incentivised companies to maintain Event Duration Monitors (EDMs), that record spill performance on all overflows, by applying the 'unmonitored storm overflows adjustment' when assessing company performance. This adjustment adds additional spills to the companies' total monitored spills recorded per overflow. To make the adjustment it is assumed that overflows with monitors that are not operational are spilling at a rate equivalent to 100 average spills a year. This is a high rate to incentivise high levels of monitoring (in comparison, Environment Agency 2024 EDM returns shows average spills per overflow was 31.8 across English overflows).<sup>155, 156</sup>
- 4.147 We used EDM 'uptime' to determine the number of monitors that are not operational and calculate the unmonitored storm overflows adjustment. Uptime is the percentage of the reporting period that a company's event duration monitors were operational (for all storm overflows as of 1st January of the reporting period). This is a simple average of the percentage of the reporting period that the monitor is reported as operational.<sup>157</sup>
- 4.148 At PR24, we requested all companies to forecast performance in the 2025–30 period assuming 100% EDM uptime across all overflows. In this scenario, there is no requirement to apply an unmonitored storm overflow adjustment. Where companies did not forecast performance assuming 100% uptime, we applied our own adjustment to their data to estimate historical and forecast trends based on 100% uptime. We applied such an adjustment for three companies including Southern Water as the company had assumed 97% uptime throughout the 2025–30 period in its data submission.<sup>158</sup>
- 4.149 At PR24, we intervened to set Southern Water a more stretching delivery profile than that proposed by the company, as we were concerned it had 'forecast to improve its performance more slowly than the rest of the sector prior to 2029–30 without compelling evidence to justify the difference'. As set out in our final determination storm overflows model, English companies proposed to deliver 63% of their 2025–30 spill reductions by 2028–29. Southern Water proposed to reach only 27% of its 2025–30 improvements by this year. We therefore 'adjusted Southern Water's PCL profile to align more closely with the rest of the sector and to incentivise it to reduce spills earlier'.<sup>159 160</sup>

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<sup>155</sup> [OF-OU-062] Ofwat, Storm overflows – PC definition, December 2024 (republished March 2025).

<sup>156</sup> [OF-OU-066] Environment Agency, Event Duration Monitoring – Storm Overflows – Annual Returns, March 2025.

<sup>157</sup> [OF-OU-062] Ofwat, Storm overflows – PC definition, December 2024 (republished March 2025), p. 4.

<sup>158</sup> Our 100% uptime calculation is set out in our PR24 storm overflows model. We removed the unmonitored adjustment and calculated monitored spills by monitored overflows (rather than total overflows). This provided a more accurate view of forecast performance. For more details, please see: [OF-OU-022] Ofwat, PR24 final determinations: Performance commitment model – storm overflows, December 2024, 'Analysis\_additional (ADJUSTMT)'.<sup>159</sup>

<sup>159</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 168.

<sup>160</sup> We stretched Southern Water's 2028–29 position to deliver 40.2% of its 2025–30 improvements by 2028–29 (rather than its forecast 26.5%). 40.2% represents the next lowest level of improvement by 2028–29 proposed to be delivered by any company. For more details, please see: [OF-OU-022] Ofwat, PR24 final determinations: Performance commitment model – storm overflows, December 2024, 'Analysis\_additional (ENG)' rows 135:142.



4.150 At PR24, we also introduced a financial adjustment called the EDM uptime adjustment, based on company proposals and outturn performance, and because full monitoring of storm overflows has been in place for only a short time. This is a deadband that applies to the calculation of incentive payments, based on the EDM uptime target. We said:

4.151 "In relation to ODI payments, we established a deadband that adjusts the payments that would ordinarily flow from the company's performance, by referencing the company's EDM uptime against the EDM uptime target. This has the effect of setting a threshold level of performance at or above which the underperformance payments relating to EDM uptime do not apply. This means;

- if the company's EDM uptime is equal to or better than the EDM uptime threshold, it is relieved of the underperformance payments attributable to the USOA element of its performance; and
- if the company's EDM uptime is worse than the EDM uptime threshold, the company will make underperformance payments relative to the EDM uptime threshold level."<sup>161</sup>

## Company statement of case

4.152 In Southern Water's statement of case it raises a number of concerns. It proposes adjusting its PCL on the basis of differences in calibration (in terms of the calculated performance assuming 100% uptime figure). Southern Water's areas of concern include:

- PCL stretch for the 2025–30 period;
- consideration of exogenous factors;
- expectation of improvements from base expenditure;
- calculation of performance assuming 100% uptime of all overflows; and
- adjustments to delivery profile for improvements across 2025–30.<sup>162</sup>

4.153 Southern Water states that the PCL set for storm overflows is not justified because holding it to frontier performance implies expected performance that is 20% more stretching than the rest of the sector.

4.154 The company states that we did not consider exogenous factors (i.e. weather) that it considers it has no control over nor the most recent outturn data (2024–25 outturn).

4.155 Southern Water considers that the stretch from base expenditure applied to set its PR24 2029–30 PCLs is incorrect as improvements should be driven by enhancement (i.e.

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<sup>161</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering Outcomes for Customers and the Environment, December 2024 (republished February 2025), p. 159.

<sup>162</sup> [OF-OA-003] Southern Water, PR24 CMA Redetermination Statement of Case, p.396

improvements aligned with the delivery of the Water Industry National Environmental Programme (WINEP) only).

4.156 The company considers that we incorrectly applied the uptime adjustment to forecast performance assuming 100% uptime. It proposes re-calculated PCLs for the 2025-30 period.

4.157 In doing this, the company removes the profile adjustments we made at final determinations (the 5% stretch from base in 2029-30, and adjustment in 2028-29 to incentivise a rate of improvement in line with the rest of the sector). Southern Water proposes that the 2028-29 adjustment was invalid as performance improvements should be directly aligned to delivery of the WINEP.

4.158 Southern Water proposes an alternative PCL for this performance commitment, which is outlined in Table 4.11 below. This is based upon:

- the company's view of performance, assuming 100% uptime;
- no additional improvement from base expenditure in the 2025-30 period; and
- a delivery profile aligned to WINEP.<sup>163</sup>

**Table 4.11: PR24 storm overflow spills PCLs Southern Water proposes in its statement of case compared to previous data**

	2025-26	2026-27	2027-28	2028-29	2029-30
Southern Water SoC proposed PCL: Average spills per overflow (states 100% uptime)	20.45	20.41	19.61	19.61	17.27
Ofwat FD PCL: Average spills per overflow (assuming 100% uptime)	17.99	17.95	17.15	15.83	13.71

## Our response

4.159 We respond to Southern Water's areas of concern below.

### PCL stretch for the 2025-30 period

4.160 We consider that we have set appropriately stretching storm overflows PCLs for Southern Water. Our PCL includes the benefits from the enhancement programme the company proposes and receives an efficient cost allowance of £1.1bn to deliver during PR24. As outlined above, we apply an additional 5% performance stretch in 2029-30, which is aligned with the approach taken for all English companies to incentivise spill

<sup>163</sup> [OF-OA-003] Southern Water, Southern Water statement of case, March 2025, p.398

reductions from base expenditure in 2025–30. We also intervene to adjust the delivery profile to incentivise delivery of enhancement programme benefits at a rate better aligned with the rest of the sector (as outlined above).

4.161 The main driver for this stretch is the company's own proposals. In response to our draft determinations, Southern Water proposed a 2029–30 PCL of 17.27 and 97% uptime. This 2029–30 company forecast adjusted to assume 100% uptime is 14.71 average spills (as outlined in Our final determinations section above). This is 8% more ambitious than the English sector median PCL in 2029–30 of 16.02 average spills, and places Southern Water as the fourth best performing English company.

4.162 Our PCL aligns with the targets set out in the UK government's Storm Overflows Discharge Reduction Plan (SODRP) published in 2023, where Southern Water committed to reach 18 average spills in 2025, reducing to 15 average spills in 2030. The profile it proposes in its statement of case does not meet these SODRP targets.<sup>164</sup>

## Consideration of exogenous factors

4.163 Our approach to exclusions can be found in section 4 of Ofwat, 'PR24 redeterminations – outcomes – common issues'.<sup>165</sup> We expect companies to forecast performance for 2025–30 based on a 'typical weather' year. We expect all companies to be compliant with legal obligations to effectually drain their areas, deliver on existing commitments such as SODRP and meet our target of 20 average spills per year by 2025. We consider that Southern Water provides insufficient evidence to support treating them differently than other companies.<sup>166</sup>

4.164 There may be multiple reasons for spills, including asset health. For example, in Environment Agency 2023 EDM returns, Southern Water attributes 22% of high spilling overflows to exceptional rainfall (compared to 65% due to operational and maintenance issues). We expect companies to manage the impact of external factors, such as weather events, on customers and the environment through how they prepare for and respond to such factors. As such, we do not consider it appropriate to revise our PCL based on 2024–25 outturn data, or considering only recent years.<sup>167</sup>

## Expectation of improvements from base expenditure

4.165 For additional performance stretch from base expenditure, we do not consider that Southern Water provides compelling evidence (in all information provided to date) to be treated differently to other English companies. As seen in figure 4.3 below, we consider that Southern Water has opportunity to materially reduce spills through improved

<sup>164</sup> [OF-OU-057] Defra, Storm Overflows Discharge Reduction Plan (publishing.service.gov.uk), 2023, p. 40.

<sup>165</sup> Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, pp. 34–39 (s.4).

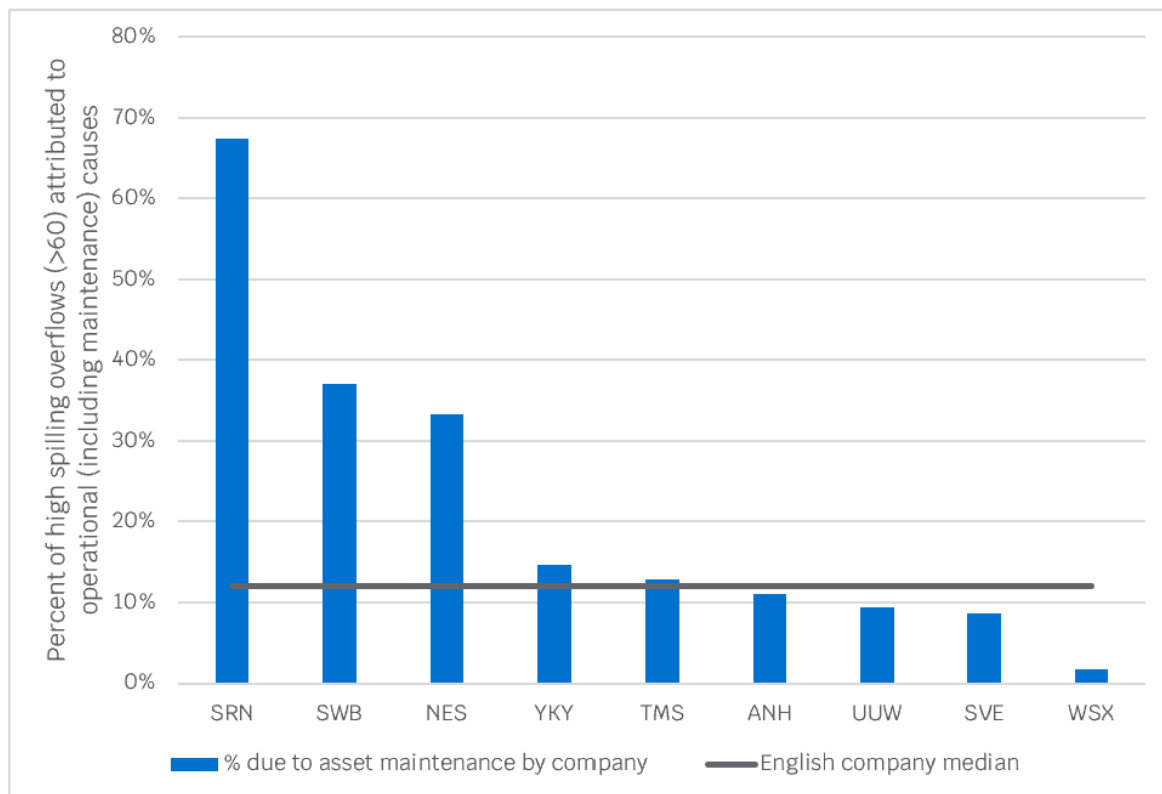
<sup>166</sup> Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, p. 16 (s.4).

<sup>167</sup> This data is from the 2023 annual returns, found on the Environment Agency EDM returns web page: [OF-OU-067] Environment Agency, Event Duration Monitoring – Storm Overflows – Annual Returns, March 2025.



operations and maintenance, as evidenced by the high number of high spilling overflows attributed to operational issues, which is the highest of all English companies.<sup>168</sup>

**Figure 4.3 Percent of high spilling storm overflows due to operational and maintenance issues based on Environment Agency EDM returns 2024.<sup>169</sup>**



### Calculation of performance assuming 100% EDM uptime across all overflows

4.166 We asked companies to forecast performance assuming 100% EDM uptime across all overflows. We adjusted Southern Water's forecast, following the calculation below, as it assumed uptime of 97% which added 3 average spills onto its forecast.<sup>170</sup>

<sup>168</sup> [OF-OU-067] Environment Agency, Event Duration Monitoring – Storm Overflows – Annual Returns, March 2025

<sup>169</sup> Data is from Table 5: storm overflow spill reasons "Of those that spilt over SOAF thresholds of >60x in one year, what % due to other operational (incl. asset maintenance)?" For more information, see: [OF-OU-066] Environment Agency, EDM 2024 Storm Overflow Annual Return – summary data.xlsx, March 2025

<sup>170</sup> For more details, please see: [OF-OU-022] Ofwat, PR24 final determinations: Performance commitment model – storm overflows, December 2024, 'Analysis\_additional (ADJUSTMT)'

**Table 4.12: Calculation of Ofwat's view of Southern Water's performance assuming 100% uptime adjusted figure**

Line	Description	Derivation	2025-26	2029-30
1.	Total overflows (no),	Company data	976	976
2.	Total monitored spills (no),	Company data	17,027	13,924
3.	Uptime (%),	Company data	97%	97%
4.	Effective no. of storm overflows where spills are recorded	(1*3)	946.72	946.72
5.	Average forecast spills per overflow (assuming 100% uptime and unmonitored overflows spill at equivalent rate to monitored)	(2 / 4)	17.99	14.71

**Adjustments to delivery profile for improvements across 2025-30**

4.167 We adjusted Southern Water's delivery profile at final determinations as we were concerned with the company's materially slower rate of delivery compared to the rest of the sector. This adjustment was applied in 2028-29 only, and incentivises Southern Water to deliver spill reductions beyond its WINEP delivery profile in 2028-29, as outlined in table 4.13 below. We still consider this approach is justified, as the company forecast to deliver only 27% of its improvements by 2028-29, compared with the median improvement proposed by English companies of 63%. We do not consider the company has provided compelling evidence to justify a materially slower rate of delivery than the rest of the sector.<sup>171</sup>

**Table 4.13: Adjustment to Southern Water's delivery profile to incentivise it to deliver improvements sooner.<sup>172</sup>**

Description	2025-26	2026-27	2027-28	2028-29	2029-30
Southern Water draft determination representation forecast (Ofwat view assuming 100% monitoring figure; delivering company forecast WINEP benefits only)	17.99	17.95	17.12	17.12	14.71
Adjustment 1: Deliver forecast WINEP improvements earlier in	17.99	17.95	17.15	15.83	14.71

<sup>171</sup> For more details, please see: [OF-OU-022] Ofwat, PR24 final determinations: Performance commitment model – storm overflows, December 2024, 'Analysis\_additional (ENG)'

<sup>172</sup> For more details, please see: [OF-OU-022] Ofwat, PR24 final determinations: Performance commitment model – storm overflows, December 2024, 'Analysis\_additional (ENG)' rows: 161:236

the 2025-30 period (2028-29)					
Adjustment 2: Deliver 5% improvement from base expenditure in 2029-30 only.	17.99	17.95	17.15	15.83	13.71

4.168 In summary, we do not consider that Southern Water has provided compelling evidence in its Statement of Case to support why its recommended changes are in the interests of customers and the environment. The company did not provide any new evidence in its storm overflow PCL statement of case. However, if Southern Water provides new compelling evidence about why its WINEP delivery is so much slower than the rest of the sector, then the CMA could consider this adjustment.

## ODI rate

### Final determination

4.169 At PR24, we set the ODI rate for storm overflows using the top-down approach outlined in our final determinations.<sup>173</sup> Storm overflows is a new common performance commitment for PR24. We used historical outturn data from 2021-24 to calculate the P10/P90 performance range. The performance commitment was allocated to the "high" starting RoRE risk category, to align with the UK government's strategic priorities for Ofwat and the importance of this measure to customers and the environment.<sup>174</sup>

### Statement of case

4.170 Southern Water says that because there are limited historical data points to estimate the performance range used to set the ODI rate, a more robust approach would be to set retrospective ('ex-ante') synthetic targets. The company proposes a target of 20 spills per overflow for 2023-24 and then calculates a glidepath in equal increments from outturn performance data in 2019-20. Southern Water's P10/P90 approach to calculating the performance range widens the range from 40% to 85%, which in turn lowers the ODI rate to £0.393m.<sup>175</sup>

4.171 Southern Water also contends that more recent outturn data from 2023-24 shows that this is a volatile metric driven by weather effects. The company argues this justifies a lower ODI rate to mitigate the effect of this volatility.<sup>176</sup>

<sup>173</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 172-173.

<sup>174</sup> [OF-OU-011] Ofwat, PR24 draft determinations: Delivering outcomes for customers and the environment, July 2024, section 4, p. 24.

<sup>175</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 398.

<sup>176</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 398.



## Our response

4.172 Southern Water's proposed proxy PCL target that the company used to calculate the storm overflows P10/P90 performance range, is neither realistic nor representative of Ofwat's storm overflows policy which was consulted on extensively as part of the PR24 process. The company's suggested target of 20 spills per overflow by 2023-24 does not reflect any proposals Ofwat consulted on during the PR24 process. In our final methodology, we challenged all companies to reduce their use of storm overflows and, where appropriate, go beyond an annual average of 20 spills per overflow from 2025 onwards.<sup>177</sup> This challenge was informed by the 2025 commitments made by the nine English water and wastewater companies (including Southern Water) in the Storm Overflow Discharge Reduction Plan (SODRP) published by Defra.<sup>178, 179</sup> The use of 20 spills per overflow by 2023-24 is therefore not a realistic proxy for a PR19 storm overflows PCL.

4.173 We set the proxy PCL for storm overflows as the midpoint of the P10/P90 performance range for each year during the 2021-24 period.<sup>180</sup> This proxy is representative of historical industry performance and provides a strong basis for the calculation of the historical performance ranges in the absence of a PR19 PCL. As a result, we do not consider it necessary to change the ODI rate for storm overflows for Southern Water. The company's proposed approach does not represent a realistic estimate of a PR19 PCL, and lowering the rate would not be in the interest of customers or the environment.

## Risk protections

### Final determination

4.174 At PR24, we set symmetrical caps and collars for storm overflows at  $\pm 0.5\%$  RoRE. Since storm overflows is a new performance commitment introduced at PR24, there is greater uncertainty around the range of possible future performance outcomes.<sup>181</sup> At PR24, we introduced the cap and collar to reflect this uncertainty.

## Company statement of case

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<sup>177</sup> [OF-OU-005] Ofwat, 'PR24 Final methodology: Appendix 7 – Performance Commitments', December 2022, pp. 70-72

<sup>178</sup> [OF-OU-057] Defra, 'Storm Overflow Discharge Reduction Plan', September 2023, pp. 40-41.

<sup>179</sup> Storm overflows is measured across the calendar year as opposed to the standard reporting year of April 1st – March 31st. The 2025 commitments made by companies in the SODRP therefore align to the 2025-26 performance year.

<sup>180</sup> [OF-OU-074] Ofwat, PR24 Final determinations: PR24-FD-OC03-ODI-rates – ODI Rates, December 2024

<sup>181</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), pp. 172-173.

- 4.175 Southern Water says that performance on storm overflows is dependent on exogeneous factors, particularly the level of rainfall, and that changing climate is likely to worsen storm overflow operational performance in the future. The company also states that we have not taken into account the correlation between rainfall and storm overflow performance in our risk analysis.<sup>182</sup>
- 4.176 Southern Water refers to risk analysis undertaken by KPMG saying it demonstrates underperformance of storm overflows in both the base-case (P50) and worst-case (P10) scenario, suggesting that these results would demonstrate that PR24 targets are materially more stretching than expected performance.<sup>183</sup>
- 4.177 Southern Water also contends that, due to natural limits of performance, it would be impossible for the company to achieve the maximum reward in 2028-29 and 2029-30.
- 4.178 In light of this, the company proposes a cap and collar of  $\pm 0.25\%$  RoRE, suggesting this would address both issues and provide a more balanced risk profile.

## Our response

- 4.179 We do not consider that Southern Water has provided compelling evidence to depart from the final determination cap and collar of  $\pm 0.5\%$  RoRE. Storm overflows is a performance commitment of significant importance to customers and the environment. Tightening the cap and collar would reduce the incentive for the company to improve its performance and would not be in the interests of consumers or the environment.
- 4.180 We do not make adjustments for exogenous factors such as high rainfall when setting the PCL for storm overflows, nor do we include a correlation factor in our risk analysis. As explained in paragraph 4.140 above, when setting the PCL we expected companies to forecast their spill performance based on an average rainfall year, noting that it is important that companies continue to meet their legal obligations to effectually drain their areas and effectually deal with the contents of sewers, including their more specific obligations under Regulation 4 of the UWWTR.
- 4.181 Our P10 risk model range is  $- 0.31\%$  RoRE.<sup>184,185</sup> This informed our decisions on the overall calibration of the storm overflows performance commitment, including setting the collar at  $0.5\%$ . We calculate that this is aligned to the KPMG's P10 outcome risk

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<sup>182</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 399.

<sup>183</sup> [OF-OU-021] Southern Water SOC-1-0004, KPMG, March 2025, Impact of exogenous risk factors on wastewater ODI performance, p. 28.

<sup>184</sup> [OF-OU-001] Ofwat, ODI risk – Monte Carlo RoRE payment consolidated, December 2024, 'P10 P90 by PC', cells T50 and T68.

<sup>185</sup> [OF-OU-001] Ofwat, ODI risk – Monte Carlo RoRE payment consolidated, December 2024, 'SOF – EDM uptime adj', cell M113.

view.<sup>186 187 188</sup> Therefore we do not agree that the company had provided compelling evidence to tighten the collar.

4.182 Furthermore, we have tested the robustness of the outcomes package by assuming more extreme correlations in our risk model across multiple performance commitments. This includes correlations across key performance commitments at PR24 which were identified by KPMG as being affected by weather events.<sup>189</sup> This tests for a scenario in which a single event impacts performance on multiple performance commitments. Our results showed that including extra correlations does not increase negative skew, as increases in payments are curtailed by risk protections.<sup>190</sup>

4.183 In response to Southern Water's criticism that some upside performance scenarios are not achievable, we note that our risk modelling serves as a check on the overall balance of risk, and that our overall package provides companies with simple and powerful incentives to deliver better performance where it is in the interests of consumers and the environment. Our risk modelling of a best case performance scenario (P90) accounts for a natural limit to outperformance for storm overflows.<sup>191</sup>

4.184 Our risk modelling for all companies, including Southern Water, is explained in our risk modelling appendix.<sup>192</sup> We have also published the model outputs showing the potential range of ODI payments for a company that operates efficiently. For Southern Water, the range is -2.21% (P10) to +1.52% (P90), resulting in a negative risk skew of -0.35% appointee RoRE.<sup>193</sup> The P10/P90 ranges align with our target of  $\pm 1\text{--}3\%$  RoRE, indicating that incentives are largely balanced.

4.185 These values represent our view of risk following a recalibration of our risk modelling, as explained in section 5 (paragraph 5.5) of our document 'PR24 redeterminations – outcomes – common issues.'<sup>194 195 196</sup>

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<sup>186</sup> KPMG's risk analysis suggests underperformance of 75% of the PCL as an estimate for a pessimistic (P10) scenario for performance on storm overflows. We calculate this to be equivalent to an average appointee RoRE impact of -0.27% over PR24.

<sup>187</sup> [OF-OU-021] Southern Water SOC-1-0004, KPMG, March 2025, Impact of exogenous risk factors on wastewater ODI performance, p. 25.

<sup>188</sup> In KPMG's analysis, an underperformance of 75% is listed as the P50 estimate and an underperformance of 50% is listed as the P10 estimate. We assume this to be a typing error and assume 75% to be the P10 estimate.

<sup>189</sup> One of the correlated groups in our extreme correlations testing includes storm overflows, internal and external sewer flooding, and serious pollution incidents.

<sup>190</sup> [OF-OA-018] Ofwat, Outcomes approach to risk modelling appendix, December 2024, section 3.2.5, p. 22.

<sup>191</sup> By assuming a truncated normal distribution for storm overflows and other relevant performance commitments.

<sup>192</sup> [OF-OA-018] Ofwat, Outcomes approach to risk modelling appendix, December 2024.

<sup>193</sup> [OF-OU-096] Ofwat, ODI risk – Monte Carlo RoRE payment consolidated (corrected version), May 2025, 'P10 P90 by company', cells H57 and I57.

<sup>194</sup> For Southern Water, the range for final determination was -2.20% (P10) to +1.53% (P90).

<sup>195</sup> [OF-OU-001] Ofwat, ODI risk – Monte Carlo RoRE payment consolidated, December 2024, 'P10 P90 by company', cells H57 and I57.

<sup>196</sup> Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, p. 41 (s.5)



## Water supply interruptions

### Performance commitment level

#### Final determination

4.186 At PR24, we set PCLs at a common level of 5 minutes across all years of the 2025-30 period for all companies. We expected companies to deliver this performance from their total expenditure allowances.<sup>197</sup> We considered this represented a stretching yet achievable common PCL target. The performance commitment measures average number of minutes lost per customer for the whole customer base for interruptions that lasted three hours or more. Further detail on setting the PCL and why we consider this PCL to be achievable but stretching for the sector as a whole is provided in Section 2 'Approach to setting common performance commitment levels (PCLs)'.

#### Company statement of case

4.187 Southern Water states that the target for water supply interruptions does not reflect the achievability of the industry.<sup>198</sup> In particular:

- Southern Water states that since removing the exclusion of extreme weather events in PR19, as set in our water supply interruptions reporting guidance, the volatility in companies' performance has increased and that this has contributed to deteriorating performance.<sup>199</sup>
- Furthermore, the exclusion of extreme weather does not align with other regulators regarding the supply interruptions metric, namely Ofgem and the Australian energy regulator, nor with Defra's position on guaranteed service standards;<sup>200 201202</sup>
- The water supply interruptions target does not reflect the achievability of the industry with 76% of the sector, including all WaSCs, not meeting the target based on the latest outturn data;<sup>203</sup> and
- The justification for 5 minutes does not give a fair balance of risk and reward and is not based on outturn performance given current cost allowances which does not consider the

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<sup>197</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 87

<sup>198</sup> [OF-OA-003] Southern Water, Southern Water PR24 Redetermination: Statement of Case, March 2025, p. 386.

<sup>199</sup> [OF-OU-023] Ofwat, Reporting Guidance Water Supply Interruptions, March 2018, p. 2.

<sup>200</sup> [OF-OA-003] Southern Water, Southern Water PR24 Redetermination Statement of Case, March 2025, p. 378-379.

<sup>201</sup> This relates to the UK government's recent consultation on updating the Water Supply and Sewerage Services (Customer Service Standards) Regulations 2008, which are commonly referred to in the water and sewerage sector as the 'Guaranteed Standards Scheme' or 'GSS'. See [OF-OU-092] [legislation.gov.uk](https://www.legislation.gov.uk), The Water Supply and Sewerage Services (Customer Service Standards) Regulations 2008.

<sup>202</sup> For further information see [OF-OU-093] Department for Environment, Food & Rural Affairs, Summary of responses and government response, December 2024.

<sup>203</sup> [OF-OA-003] Southern Water, Southern Water PR24 Redetermination: Statement of Case, March 2025, p. 386.

underlying difference between companies such as the water network and historical funding.

4.188 Southern Water proposes less stretching water supply interruption PCLs for the 2025–30 period. The company states the PCL target for 2025–26 should represent the 2023–24 median performance of 9 minutes and 18 seconds and the 2029–30 target set at the industry 2023–24 should represent the upper quartile performance of 5 minutes and 32 seconds with a straight-line improving trend between the two. We set out below their proposed PCL compared to the PCL in our final determination.

**Table 4.14: Southern Water's water supply interruptions PCL: company recommendation versus Ofwat's final determination (hh:mm:ss)**

	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30
Southern Water proposal (hh:mm:ss)	–	00:09:18	00:08:21	00:07:25	00:06:28	00:05:32
Ofwat final determination (hh:mm:ss)	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00

## Our response

4.189 The Water Supply Interruptions PCL is designed to incentivise companies to deliver good performance in an area that is of high priority to customers. We also consider that we have provided it with adequate funding to do just that.

4.190 In our final determinations, we set out that '... we do not consider that it is appropriate to have exclusions for factors that are outside a company's control.'<sup>204</sup> We do not consider making exclusions relating to extreme weather for water supply interruptions acceptable as companies can mitigate the impact on customers of weather events through how they prepare for and respond to such events. We have set out why we do not consider that it is appropriate to have general exclusions in place for exogenous factors, such as weather events in Section 4 of the PR24 redeterminations – outcomes – common issues document.<sup>205</sup>

4.191 It is also important to recognise that if companies do not bear these risks, they are transferred to customers. Risks should lie with those that can best mitigate or bear them, and as customers cannot mitigate these risks, we consider that it is appropriate to have performance commitments to incentivise companies to manage them

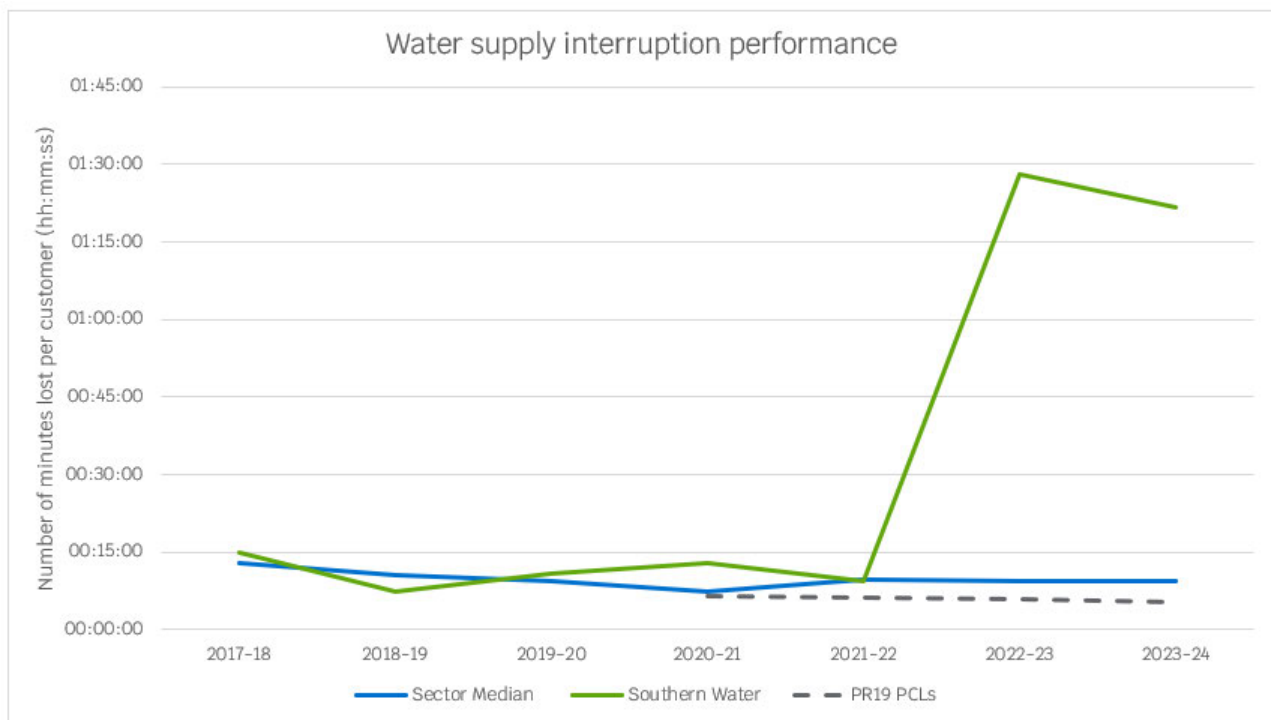
<sup>204</sup> [OF-OA-017], Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), pp. 13, 86–87, and 148.

<sup>205</sup> Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, pp. 34–39 (s.4).

effectively.<sup>206</sup> In fact, in excluding extreme weather from the PR19 performance commitment definition for water supply interruptions was supported by Southern Water at the time, recognising that it "better aligns with customers' concerns regarding extreme weather."<sup>207</sup>

4.192 Southern Water states that the volatility of performance has increased due to more extreme weather events. Looking at specific extreme weather events that have affected Southern Water, as stated in the Water Company Performance report 2023-24, Southern Water's customers experienced 34 minutes and 5 seconds of additional interruptions due to storm Cairan.<sup>208</sup> Even when we exclude this impact, Southern Water is still the worst performer in the sector. Additionally, Southern Water's average performance over 2020-24 is at 47 minutes and 54 seconds. This is approximately 400% worse than the sector median at 9 minutes and 38 seconds and this highlights the need for the company to take action to improve the service delivered for customers.

**Figure 4.4: Southern Water versus sector median WSI performance<sup>209</sup>**



4.193 It is also important to recognise that during 2015-20, only a limited number of companies' supply interruption PCs explicitly allowed for exclusions related to severe weather. This means that many of the data points for 2015-20 already include the impact of severe weather. We also note that not all of the peaks in interruptions during

<sup>206</sup> [OF-OU-005] Ofwat, Appendix 7 Performance commitments, December 2022, p. 14.

<sup>207</sup> [OF-OU-024] Southern Water, SRN Wholesale wastewater 2020-25 business plan, March 2018, p. 205.

<sup>208</sup> [OF-OU-017] Ofwat, Water Company Performance Report 2023-24, October 2024, p. 18.

<sup>209</sup> Ofwat analysis. Data from PR24 final determination Outcomes models. See [OF-OU-026] Ofwat, PR24 Performance Commitment Model – Water supply interruptions, December 2024.



the 2020-25 period relate to severe weather. For example, the driver of South West Water's water supply performance in 2021-22 related to an interruption due to a third party (increasing its reported performance in 2021-22 from 6 minutes 47 seconds to 13 minutes 40 seconds). In fact, a recent UK Water Industry Research report suggests that the majority of supply interruptions are caused by pipe failure, some of which take material longer than three hours to fix.<sup>210</sup> We consider the company has not provided compelling evidence to show us that the volatility is as strongly linked to the removal of severe weather exclusions as the company suggests.

4.194 We recognise that only 4 companies met the supply interruption PCL in 2023-24 and sector median outturn is closer to 9 minutes. However, we consider that historical performance and company forecasts support delivery of a 5 minute performance level by efficient and effective companies.

4.195 The Hastings incident which contributed to Southern Water's interruption performance of 1 hour 21 minutes of in 2023-24 was primarily due to a combination of asset health failures, the materiality of the affected pipes and ease of access difficulties. Water companies should be customer-centric, and it is their duty to improve and review how they quickly they respond to incidents to limit impact to customers. This can be achieved through both short-term and long-term resilience planning, addressing single points of failure and improving communication with third party stakeholders.

4.196 In relation to funding, at PR19, we provided cost efficient allowances of £173.6 million to Southern Water for supply and demand side enhancements to tackle the root causes of service failure and improve resilience across its network.<sup>211</sup> For PR24, we allow a further £181.74 million for supply connectors enhancement.<sup>212</sup> Moreover, in its statement of case, the company notes that it has "an ageing asset base and historically have not focused our spending on improving the resilience of our assets. This is partly down to management decisions...".<sup>213</sup> It also had the largest underspend of water enhancement during 2020-24 of £96 million in the sector.<sup>214</sup> By not prioritising asset health and managing the risk of its supply system, it has led to a less resilient supply network and an increased risk to customers experiencing interruptions to their water supply. Southern Water customers ranked having a "continuous supply of clean wholesome water" as their top priority, having an indexed score of 100.0, showcasing that customers want a quick turnaround in this metric.<sup>215</sup> Therefore, it is not in customers

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<sup>210</sup> UK Water Industry Research, Identifying the root cause of interruptions to supply, 2023. Page 10 of the report concludes that 'pipe failure is the largest reason given the (interruptions to supply) incidents across the industry'. Appendix C of the report presents company detailed results around duration of interruptions by different causes.

<sup>211</sup> [OF-OU-025] Ofwat, PR19 final determinations: Southern Water – Cost efficiency final determination appendix, October 2020, p. 6.

<sup>212</sup> [OF-OA-023] Ofwat, PR24-final-determinations-Expenditure-allowances-Enhancement-cost-modelling-appendix, December 2025, p. 151.

<sup>213</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 371.

<sup>214</sup> [OF-OU-017] Ofwat, WCPR 2023-24, October 2024, p. 34.

<sup>215</sup> The index score is measured from 0-100 with 100 being the strongest priority. See [OF-SRN-011] Southern Water, srn03-customer-acceptability, October 2023, p. 65.

interest to experience a higher rate of interruptions because of historical management decisions made by the company, and customers are entitled to a level of service resilience that their bills have funded.

4.197 We do not agree with the company's proposed PCL. A target of 9 minutes 18 seconds for 2025–26 represents an 86% increase in supply interruptions when compared to the PR19 2024–25 PCL of 5 minutes. In fact, the proposed PCL for 2025–26 is a 43% increase on the PR19 2020–21 PCL (set at 6 minutes 30 seconds). This represents a significant deterioration, effectively moving performance targets back by almost five years. When we extrapolate Southern's proposed PCL to get a 2024–25 baseline of 10 minutes and 15 seconds, this does not represent fair service to customers, especially considering that Southern Water has already achieved below 10 minutes and 15 seconds in the 2020–25 period. Southern Water should have a PCL that is sufficiently stretching so that it is incentivised to provide the service that customers expect given their allowances.

## ODI rate

### Final determination

4.198 At PR24, we set the ODI rate for water supply interruptions based on the PR19 median unit ODI rate (per minute of interruptions per customer). This was because the top-down approach to setting ODI rates resulted in a unit rate that was lower than the average PR19 ODI rate, which would have been inconsistent with our objective that the PR24 ODI rate should be at least as strong as the one set at PR19.<sup>216</sup>

## Statement of Case

4.199 Southern Water says that the rate of £0.536m is 84% higher than its rate at PR19, therefore is too strong and not aligned with customer preferences.<sup>217</sup>

4.200 Southern Water challenges the use of PR14 historical data to calculate the P10/P90 performance range, arguing that this introduces an error in the rate, due to a change in the definition of performance at PR19.<sup>218</sup> At PR14, interruptions caused by severe weather conditions could be excluded from reported performance, whereas these exclusions were removed at PR19. Southern Water claims this change accounts for the apparent deterioration in sector performance over time. Southern Water therefore argues that we should use only PR19 performance data, to be consistent with the PR24

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<sup>216</sup> [OF-OA-017], Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 84. para. 31–32.

<sup>217</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 387

<sup>218</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 388.

definition of water supply interruptions. The company estimates the ODI rate would reduce by a factor of 1.6 to £0.329m.<sup>219</sup>

## Our response

- 4.201 Southern Water's proposal has no impact on its ODI rate for water supply interruptions. As explained above, for final determinations, the ODI unit rate was set equal to the median of companies' PR19 ODI rates per minute of interruption per customer, adjusted for inflation.<sup>220,221</sup> Southern Water experiences a relatively larger increase to its ODI rate compared to the average company as its PR19 ODI unit rate for water supply interruptions was in the lower quartile.<sup>222</sup> This aligns with our approach at PR24 to set consistent rates across performance commitments.
- 4.202 Our approach to setting the ODI rate for water supply interruptions is consistent with the top-down methodology used at final determinations. For each company, we set the PR24 unit rate as the higher of (i) the median PR19 unit rate, or (ii) the unit rate calculated via the PR24 top-down approach.<sup>223</sup> For final determinations, we introduced the median PR19 ODI rate as a minimum for all common performance commitments. This was necessary to provide a sufficiently strong incentive for companies to improve their performance at PR24.<sup>224</sup>
- 4.203 Taking all this into account, we consider that it is not in the interest of customers to lower the ODI rate for water supply interruptions below the median PR19 ODI unit rate for Southern Water. This measure has a direct impact on customers and is of high priority to them. Therefore, it is essential that there remains a strong incentive for companies to improve performance.

## Risk protections

## Final determination

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<sup>219</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 388.

<sup>220</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), pp. 91-92.

<sup>221</sup> [OF-OU-074] Ofwat, PR24 final determinations: PR24-FD-OC03-ODI-rates, December 2024.

<sup>222</sup> [OF-OU-074] Ofwat, PR24 final determinations: PR24-FD-OC03-ODI-rates, December 2024.

<sup>223</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 86.

<sup>224</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 30.



4.204 At PR24, for water supply interruptions we set the collar level at -1% RoRE for all companies, except for South East Water (for which it is -2% RoRE). At final determinations, we made no changes to our approach from draft determinations.<sup>225</sup>

4.205 There is a greater range of underperformance than outperformance for this performance commitment. We therefore calibrated the level of the collar in response to the contribution of this performance commitment to the overall balance of risk. We balanced this against the importance of keeping financial incentives on a sufficiently wide range of performance. We determined that ODIs apply to a wide range of performance so to incentivise companies to avoid incidents where customers are off water supply for an extended period of time.<sup>226</sup> In this case, a 1% collar generally translates to an underperformance range of 20 minutes.<sup>227</sup> Introducing a tighter collar, while providing more protection to companies against financial risk, would weaken incentives too much at the expense of customers being off supply.

## Company statement of case

4.206 Southern Water challenges the -1% collar level and says that it does not create balanced incentives. Therefore, the company proposes a tighter collar of -0.5%. Further, it says we have not considered the Guaranteed Standards Scheme (GSS) where water companies are required to compensate customers which presents risks that could distort the impact of this performance commitment and believes that these risks have not been sufficiently accounted for in our final determination. Therefore, the company proposes a tighter collar of -0.5%.<sup>228</sup>

## Our response

4.207 Southern Water has not provided compelling evidence to justify introducing a tighter collar of -0.5% RoRE in place of the -1% RoRE set at final determinations. There is a wide range of likely performance outcome for this measure and tightening the collar would mean that some companies could meet the collar after a single water supply interruption. Given the importance of this performance commitment for customers, it is essential that incentives remain strong. On the other hand, tightening the collar would mean the companies would have little incentive to improve performance after they have hit -0.5% RoRE for a given year. We respond to the risks of the GSS scheme in section 1 of our response on common outcomes issues.<sup>229</sup>

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<sup>225</sup> [OF-OA-017], Ofwat, Final determinations: Delivering outcomes for customers and the environment, December 2024, p. 84.

<sup>226</sup> [OF-OA-017] Ofwat, Final determinations: Delivering outcomes for customers and the environment, December 2024, Section 9.3, p. 93.

<sup>227</sup> average minutes lost per customer where the interruption lasts more than 3 hours.

<sup>228</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p.388.

<sup>229</sup> Ofwat, PR24 redeterminations – outcomes – common issues, April 2025, pp. 15-17 (s.1).

## Leakage

### Final determination

4.208 At PR24, we did not set a collar for leakage, as it is a well-established performance commitment and performance is averaged over three years. This averaging mitigates against the impact of single-year performance shocks, where a collar may otherwise help to mitigate downside risk.<sup>230</sup> Companies also received significant enhancement allowances to reduce leakage and deliver performance improvements.

4.209 At PR24, we did not set a collar for leakage, as it is a well-established performance commitment and performance is averaged over three years. This averaging mitigates against the impact of single-year performance shocks, where a collar may otherwise help to mitigate downside risk. Companies also received significant enhancement allowances to reduce leakage and deliver performance improvements.

### Company statement of case

4.210 Southern Water says that including a cap but not a collar does not provide a fair and balanced regulatory approach for a performance commitment that it believes is influenced by external and unpredictable factors.

4.211 In light of this, Southern Water proposes introducing a -0.5% RoRE collar on leakage.

### Our response

4.212 As noted above, we did not consider a collar appropriate for leakage at PR24. However, we did consider it appropriate to set a 1% cap on this performance commitment, because of the extra outperformance payments opportunities created by having an enhanced threshold for this performance commitment. This cap allows companies to earn enhanced outperformance ODI payments, while protecting customers from significant bill increases. Based on company performance forecasts, Southern Water is expected to earn outperformance payments on leakage over the 2025–30 period.

## Customer contacts about water quality

### Risk protections

### Final determination

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<sup>230</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, pp. 126–127.

4.213 At PR24, we did not set caps and collars for the water quality contacts performance commitment, as it is a well-established metric with only a small amount of variation in performance year-to-year.<sup>231</sup>

## Company statement of case

4.214 Southern Water says that, since water quality contacts is a service-based performance commitment, it should have a collar, in line with other service-based performance commitments such as water supply interruptions. It says that if a large scale water supply incident occurs, a collar would limit underperformance associated with supply interruptions but not for customers that contact the company about water quality. It believes this is inconsistent and could subject the company to downside risk.

4.215 In light of this, the company proposes a -0.5% RoRE collar on water quality contacts performance commitment.<sup>232</sup>

## Our response

4.216 Southern Water has not provided compelling evidence to justify changing our final determination position by introducing a collar on water quality contacts. Based on the companies forecasts of performance in this area, combined with rates similar to PR19, there is little evidence to suggest that Southern Water may reach a -0.5% RoRE level for this measure.

## Compliance risk index

### Deadband

### Final determination

4.217 At PR24, we set a deadband for this performance commitment. This is because it is a risk-based compliance measure rather than an absolute one, which can be impacted by the internal pipework and fittings at customer properties.

4.218 We worked with the Drinking Water Inspectorate (DWI) to set the deadband on CRI, which follows a glidepath from each company's PR19 deadband level at 2024-25 to a

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<sup>231</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p. 103.

<sup>232</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, Chapter 6, Section 4.1, p.390.

value of 1.0 at 2029–30. This is a level that, if exceeded by a single additional failure, could result in material risk to water quality.<sup>233</sup>

## Company statement of case

4.219 Southern Water challenges the glidepath for an improving deadband from 1.83 in 2025–26 to 1.50 in 2027–28 and then to 1.00 in 2029–30. The company says that this trajectory is too stretching, particularly given that a large number of its assets are under DWI investigation. A multiplier is applied to these assets under DWI investigation, which inflates its score. Southern Water notes that the DWI's investigation notices will be in place across 2025–30, making the glidepath for the deadband too stretching. The company proposes a wider deadband, starting at 3.3 and reducing to 2.0 by 2029/30.<sup>234</sup>

## Our response

4.220 We set the CRI deadband at PR24 to reflect a level of performance to acknowledge that performance could be impacted by internal pipework and fittings in customer properties, responsibility for which is outside companies' legal obligations. This level was set through consultation with the DWI and represents a realistic level of performance that could be impacted by this exogenous factor.

4.221 To achieve an overall balance in the outcomes package whilst maintaining incentives for performance improvements, for final determinations we set criteria for considering whether changes to deadbands were justified. These criteria were:

- Whether the change would reduce net negative ODI payments (or 'negative skew') based on operational reality; and
- Whether there is a low risk of materially weakening the incentives.

4.222 For final determinations we explicitly stated that we continued to expect companies to be responsible for mitigating and managing the effects of factors outside their control.<sup>235</sup>

4.223 We do not consider that proactively widening the deadband because the company is under investigation by the Drinking Water Inspectorate for its performance meets our criteria. In particular, the number of assets under DWI investigation is a factor that Southern Water should have taken reasonable steps to mitigate and companies should not be provided relief from underperformance payments where they fail to do so.

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<sup>233</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, section 5.2, p.42.

<sup>234</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case', March 2025, Chapter 6, Section 4.1, p.390.

<sup>235</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p. 42.



## Collar

### Final determination

4.224 At final determinations, we did not set a collar for compliance risk index as this performance commitment is well-established and relates to companies meeting their statutory compliance obligations. A collar would lower the incentive for companies to do this.<sup>236</sup>

### Company proposal

4.225 Southern Water highlight that the compliance risk index is a compliance related performance commitment, which means it relates to underperformance only. It says that this may expose the company to additional downside risk outside management control, which could be mitigated by introducing a collar.<sup>237</sup>

### Our response

4.226 The company has not provided compelling evidence to set a collar for this performance commitment. As the only performance commitment directly related to the quality of drinking water, it is important that companies are sufficiently incentivised to perform well in this area. We consider the deadband that is in place provides sufficient risk protections for this performance commitment.

## Bathing water quality

### Risk protections

### Final determination

4.227 As bathing water quality is a new performance commitment at PR24, for final determinations we set caps and collars at  $\pm 0.5\%$  of wastewater RoRE, which is in line with our approach to other new performance commitments. As we stated at final determinations, '[t]his allows sufficient incentives on performance around the PCL, while protecting customers and companies from larger performance deviations.'<sup>238</sup>

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<sup>236</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p. 41.

<sup>237</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 390.

<sup>238</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p. 142.

## Company proposal

- 4.228 Southern Water says that the value at risk associated with this performance commitment is more material for coastal companies than for inland companies. The company highlights that although four companies account for 74% of bathing water sites (South West Water, Welsh Water, Southern Water and Anglian Water), they serve only 28% of wastewater customers.<sup>239</sup> Southern Water contends that this creates an imbalance for coastal companies in their exposure to risk.
- 4.229 Because of this, Southern Water proposes that this performance commitment should be considered more akin to a bespoke commitment for companies with the most exposure. The company challenges that 'coastal impacts' have not been adjusted for in the base cost assumptions, creating asymmetric downside risk for this performance commitment.
- 4.230 Southern Water also says that pipes which are poorly connected by property developers have a negative effect on the measurement of bathing water quality, which is an exogenous factor, outside the company's control.<sup>240</sup>
- 4.231 Therefore, Southern Water proposes tightening the cap and collar on its bathing water quality performance commitment to  $\pm 0.25\%$  RoRE.<sup>241</sup>

## Our response

- 4.232 We do not consider there is compelling evidence to justify tightening the cap and collar past the  $\pm 0.5\%$  RoRE levels set at PR24.
- 4.233 We do not agree that Southern Water faces a higher risk due to having a higher number of bathing water sites. Performance commitment levels for bathing water quality are set on a company specific-basis using a bottom-up, site by site assessment based on historical performance. Companies are expected to maintain historical performance, unless they have enhancement expenditure for improvement schemes (through the WINEP), or compelling evidence to justify why deterioration is not due to their assets. In the case of additional enhancement, we expect improvements to be included in the performance commitment level. At final determinations, we accepted further evidence and justification from Southern Water on its site specific forecasts, including reasons for site deterioration. Having more coastal and/or inland bathing water sites should not

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<sup>239</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 409

<sup>240</sup> A misconnection is when the wastewater pipe has been wrongly connected to the surface water sewer pipe. So instead of going to a wastewater treatment works, it goes directly into a river or stream and causes pollution.

<sup>241</sup> [OF-OA-003] Southern Water, OFW-PR24–Southern Water Statement of Case, March 2025, pp. 409–410.

make it harder to meet performance expectations, as these are based on current performance and the funding companies receive in the 2025–30 period.<sup>242</sup>

4.234 Additionally, Southern Water has historically received significant funding to improve its coastal bathing waters. Southern Water received £31.5 million at PR14 and £20.6 million at PR19 of additional funding specifically for use in improving bathing water quality.<sup>243</sup>

<sup>244</sup> This is among the largest funding received by companies for bathing water improvements over this period.

4.235 Southern Water's 2023 base cost adjustment claim was rejected, as our analysis did not show that operating treatment works near the coast was significantly more expensive than operating in land treatment works.<sup>245</sup> Southern Water also receives wastewater network plus base allowance, which is more than it requested.

4.236 Our PR24 methodology is clear that the outcomes we specify relate to companies' functions and so they have significant control over these. External factors may also have an effect but, in many cases, companies can mitigate the impact of external factors, through how they prepare for and respond to such factors, including by working with third parties such as developers. Even though it is an issue Southern Water should be managing, it is not specific to it. We do not consider it appropriate to make exemptions for one-off, short term events such as developer misconnections.

4.237 Caps and collars are set to maintain strong incentives while protecting customers and companies from extreme levels of payments. We consider that tightening the caps and collars to  $\pm 0.25\%$  RoRE would significantly weaken the incentive for this performance commitment, which would not be in the interests of customers or the environment.

## Discharge permit compliance

### Risk protections

### Final determination

4.238 At PR24, we did not set a collar for leakage, as it is a well-established performance commitment and performance is averaged over three years. This averaging mitigates against the impact of single-year performance shocks, where a collar may otherwise

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<sup>242</sup> For a site by site forecast and further details on the reasons at each site, please see [OF-OU-033] Ofwat, PR24 final determinations: Performance commitment model – bathing water quality, December 2024, 'SRN\_Site\_Forecasts'.

<sup>243</sup> [OF-OU-110] Ofwat, Setting price controls for 2015–20 Final price control determination notice: company-specific appendix – Southern Water, December 2014, p. 177.

<sup>244</sup> [OF-OU-111] Ofwat, PR19 final determinations: Southern Water final determination, December 2019, p. 37.

<sup>245</sup> [OF-CA-117] Ofwat, Cost adjustment claim feeder model Southern Water, December 2024.

help to mitigate downside risk. Companies also received significant enhancement allowances to reduce leakage and deliver performance improvements.

4.239 For final determinations, we introduced a deadband on discharge permit compliance as a result of our in the round assessment about how we could achieve greater balance between potential outperformance and underperformance payments across the outcomes package.

4.240 Aligned to our criteria for applying a deadband (and set out in CRI section above) we said that: "For discharge permit compliance, we consider that there is sufficient reason to include a deadband because of the negative skew resulting from this being an underperformance-only performance commitment. Based on performance at PR19 so far, where a deadband of 99% compliance has been applied, companies have maintained high levels of performance." We therefore considered that a deadband would reduce negative skew while still providing a strong incentive for companies to minimise compliance failures.<sup>246</sup>

## Company statement of case

4.241 Southern Water says that there are external factors affecting discharge compliance performance, such as potential changes in the Environment Agency's definition of compliance, specifically the inclusion of the dry weather flow (DWF) limits.<sup>247</sup>

4.242 Southern Water states that calibration of the performance range we have used in the risk model does not account for these potential changes. As a result, it says a -0.5% RoRE collar should be introduced to mitigate against these factors and ensure a fairer regulatory approach.

4.243 More broadly, Southern Water says that there are added risk factors, like stricter permits, unique ecological factors, more stringent targets for phosphorus removal relative to the rest of the sector and new sector requirements for nitrogen removal. Southern Water believes as it has a relatively high number schemes for these changes, they are disproportionately exposed to the risks, which we have not taken into account enough in our risk modelling.

## Our response

4.244 In relation to the potential future inclusion of dry weather flow (DWF) in the Environment Agency's reporting requirements, our discharge permit compliance performance commitment is defined in line with the reporting guidance from the Environment Agency's (EA) and Natural Resources Wales' (NRW) water and sewerage

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<sup>246</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p.45.

<sup>247</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p.407.



company Environmental Performance Assessment (EPA) methodology version 11, February 2024. A consultation with all companies on changes to the EPA closed in January 2025 [REDACTED]

[REDACTED].<sup>248</sup> At final determinations, we said that we would 'consider the impacts of any change in the EPA following the stakeholders' consultation of the Environment Agency and Natural Resources Wales and manage the change according to our change control process'.<sup>249</sup>

4.245 Following the publication of the updated EPA methodology, in line with our change control process we will consider resetting relevant aspects of performance commitments to maintain the level of stretch and outperformance payments in line with our intention in our final determination. We propose that our change control process should run its course and suggest to the CMA that this could be an area it deprioritises.

4.246 While Southern Water has a larger number of sites that are required to meet the new requirements for nitrogen and phosphorus removal, we consider it has been appropriately funded to meet them. For the removal of nitrogen, the company was granted 90% of the funding it proposed in its business plan. At final determination we increased its phosphorous removal funding by 6% more than it had proposed.<sup>250</sup> The company did not receive its full nitrogen removal proposal as its proposal was consistently higher than any benchmark we calculated.

4.247 There are other companies, for example Wessex, who have similar number of sites but have not proposed a collar. In addition, discharge permit compliance is subject to a 1% deadband, which will help to limit the risk faced by the company.

## C-MeX, D-MeX and BR-MeX

### Final Determination

4.248 At PR24, our goal was to set stretching yet achievable financial incentives. Our ODIs at PR24 are at least as strong as those that were in place for PR19 across all areas. In particular, we considered it appropriate to have strong incentives on C-MeX to drive a step change in customer service performance.

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<sup>249</sup> [OF-OA-017] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, December 2024, p. 67-69 (s.8).

<sup>250</sup> [OF-OU-081] Ofwat, PR24CA14 - Enhancement aggregator, December 2024, Ofwat.

- 4.249 Since 2020, C-MeX scores have declined, with an industry average falling from 81.62 in 2020-21 to 75.74 in 2023-24.<sup>251,252</sup> Furthermore, no company has received a payment from the enhanced ODI threshold for delivering frontier-shift improvements in customer service. This reinforces the need for water companies to improve the service they provide to household customers.
- 4.250 At PR19, C-MeX ODIs were based on  $\pm 12\%$  of retail revenue. In the PR24 final methodology, we stated our intention to increase the amount of retail revenue at risk to  $18\%$ ,<sup>253</sup> which equates to approximately  $0.4\%$  of appointee RoRE, based on a weighted industry average.
- 4.251 While at draft determinations we further increased incentive sizes from an equivalent of  $\pm 0.4\%$  RoRE to  $\pm 0.5\%$  appointee RoRE, for final determinations we lowered the incentive size from  $0.5\%$  appointee RoRE to  $0.4\%$  appointee RoRE.<sup>254</sup> This change is therefore in line with what we said in our PR24 methodology.
- 4.252 We calibrated the size of the C-MeX incentive against retail revenue. As stated in our final determinations, we consider it is proportionate to retail revenues and the size of incentive for other key performance commitments.<sup>255</sup>
- 4.253 Turning to D-MeX, for final determinations we lowered the starting RoRE allocation and caps and collars for D-MeX from  $0.25\%$  RoRE at draft determinations to  $0.2\%$  RoRE. This is half the size of the C-MeX incentives, which we considered to be proportionate given the relative differences in the amount of revenue companies are likely to receive from residential retail compared to a developer services.<sup>256</sup> Our analysis found an average correlation of  $0.84$  between developer services revenue and regulated equity from the period 2020-23.<sup>257</sup>
- 4.254 Finally, for BR-MeX the performance commitment at PR24 was allocated on a level of risk equivalent to a maximum  $\pm 0.2\%$  appointee RoRE. We considered it appropriate to use appointee RoRE that applies to water and wastewater, to calculate incentive payments because BR-MeX applies to both water and wastewater activities. As stated in our final determinations, 'We consider that this provided a meaningful maximum

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<sup>251</sup> [OF-SRN-001] Ofwat, C-MeX and D-MeX – 2020-21 results, Ofwat.

<sup>252</sup> [OF-SRN-002] Ofwat, C-MeX and D-MeX 2023-24 results, Ofwat.

<sup>253</sup> [OF-OU-014] Ofwat, PR24 Final Methodology Appendix 8: Outcome Delivery Incentives, December 2022, p. 49.

<sup>254</sup> [OF-SRN-003] Ofwat, PR24 draft determinations Outcomes-Measure of experience performance commitments appendix, July 2024, p. 19.

<sup>255</sup> [OF-OA-017] Ofwat, PR24 final determinations-Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 241.

<sup>256</sup> [OF-OA-017] Ofwat, PR24 final determinations-Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 250.

<sup>257</sup> [OF-SRN-003] Ofwat, PR24 draft determinations-Outcomes Measure of experience performance commitments appendix', July 2024, p. 27.

financial incentive (either as an outperformance payment or as an underperformance payment) to wholesalers to provide a better experience for retailers and customers.<sup>258</sup>

## Company statement of case

4.255 Southern Water states that the ODI rates at PR24 for C-MeX, D-MeX and BR-MeX are excessive compared to the revenues of the relevant price controls.<sup>259</sup>

4.256 Southern Water states that the value of the C-MeX incentive is double that of previous customer service measures, and that this represents an excessively high level of risk. In addition, according to the company, the proposed RoRE exposure creates excessive risk for the retail business, as it is determined by wholesale RoRE. For other performance commitments, Southern Water claims, RoRE at risk is determined by the respective price controls.

4.257 The company states that Ofwat has not considered the size of the retail revenue, developer services and non-household revenue relative to the wholesale business in the ODI rates set for the measures of experience performance commitments.

4.258 Southern Water is concerned that this creates perverse incentives given that the regulated equity at risk is a sizable proportion of the revenue of the relevant price controls. The retail business – the company argues – is a thin margin business and, if operating on its own, the level of risk would bankrupt the business in a very short period of time. The company contends that this does not reflect the economic incentives that would be present in a competitive market, given the reduced levers a water retail business has to it (i.e. it has an implicit universal service obligation to all customers and cannot tailor their services to specific customer segments in the way that competitive businesses can).

4.259 In light of this, Southern Water recommends that the ODI rates are reduced<sup>260</sup>:

- For C-MeX, this would be using the lower of 0.4% appointee RoRE or 5% of retail price control revenue;
- for D-MeX to use the lower of 0.2% appointee RoRE or 5% of developer services revenue; and
- for BR-MeX to use 0.1% appointee RoRE.

## Our response

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<sup>258</sup> [OF-OA-017] Ofwat, PR24 final determinations–Delivering–outcomes for customers and the environment, December 2024 (republished February 2025), p. 258.

<sup>259</sup> [OF-OA-003] Southern Water, 'Southern Water Statement of Case', March 2025, p. 405.

<sup>260</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 406.

- 4.260 We considered the size of the relevant revenues when setting ODIs for the measure of experience incentives and do not consider that the ODIs set out at final determinations represent an excessive level of risk exposure.
- 4.261 In relation to the C-MeX standard incentives, we note that these are symmetrical at PR24. In contrast, at PR19 underperformance payments could exceed overperformance payments, and no company received enhanced outperformance payments. Compared to PR19, at PR24 we have reduced downside risk to companies by allowing greater practical opportunity for companies to receive outperformance payments.
- 4.262 C-MeX is a performance commitment of high importance, and we consider a starting RoRE allocation of 0.4% appointee RoRE to be appropriate. This level of risk is broadly comparable to other high-importance performance commitments, such as storm overflows, which have a starting allocation of 0.6% RoRE based on wastewater regulated equity.
- 4.263 The basis for this comparison lies in the way we determine the starting RoRE allocation for calculating ODIs (as well as the associated caps and collar levels). Depending on the type of performance commitment, we use (i) water regulated equity, (ii) wastewater regulated equity or (iii) appointee regulated equity:
- For water performance commitments, we use water regulated equity;
  - for wastewater performance commitments, we use wastewater regulated equity; and
  - for cross-cutting commitments like C-MeX and D-MeX (which include retail activities) we use appointee regulated equity (i.e. the combined equity for water and wastewater).
- 4.264 Because wastewater regulated equity is typically greater than water regulated equity – due to the size of wastewater infrastructure and investment – when comparing incentive sizes it is necessary to take into account which price control type is being used. For example, 0.5% water RoRE is less than 0.5% wastewater RoRE.
- 4.265 Taking this into account, when comparing the C-MeX and D-MeX incentives size, 0.4% appointee RoRE for C-MeX is broadly equivalent in scale to a 0.6% wastewater RoRE, and therefore represents a proportionate level of risk for a performance commitment of this importance.
- 4.266 Southern Water's proposal to base C-MeX incentives on 5% of retail revenue would result in a significantly lower financial incentive for customer service at PR24 than was in place at PR19. We consider this to be inappropriate for a performance commitment of high importance, where – as stated in our final determinations – a step change in company performance is required.<sup>261</sup> Southern Water's proposal would be the equivalent

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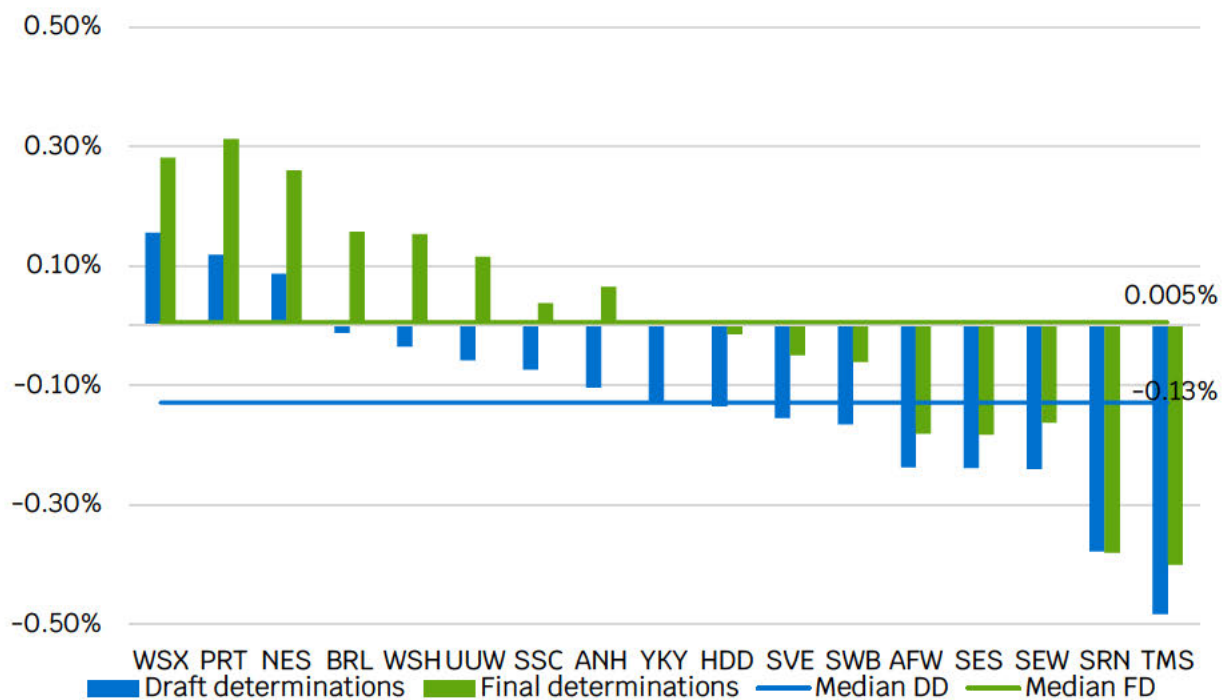
<sup>261</sup> [OF-OA-017] Ofwat, PR24 final determinations–Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 241.



of 0.09% of appointee RoRE and 0.13% of wastewater RoRE, which is significantly weaker than the incentives applied to other performance commitments at PR19.

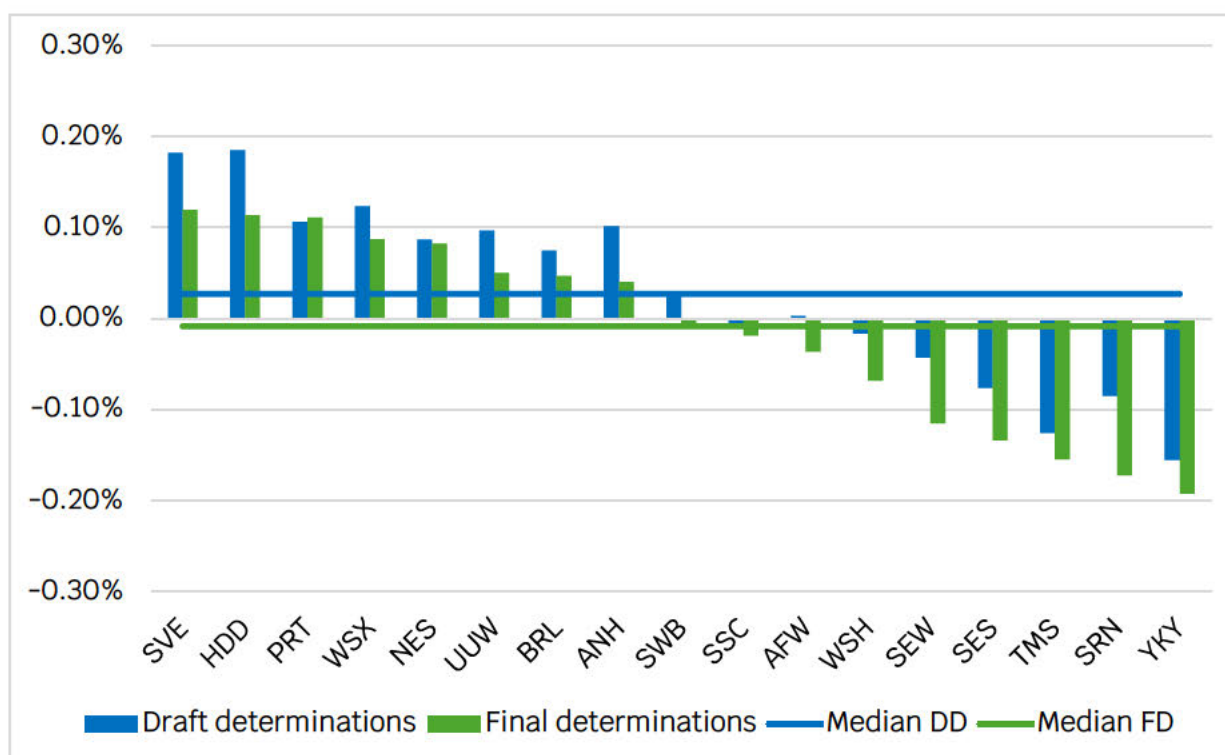
4.267 As shown in the figures below, our final determinations have resulted in a more balanced expected risk for companies from C-MeX and D-MeX compared to draft determinations.

**Figure 4.5 Expected C-MeX payments with modelled scores (based on average of 2020–24 performance)<sup>262</sup>**



<sup>262</sup> [OF-SRN-004] Ofwat, C-MeX and D-MeX Final Report, September 2024, p. 5

**Figure 4.6 Expected D-MeX payments with modelled scores (based on average of 2020–24 performance)<sup>263</sup>**



4.268 In response to the points raised by Southern Water on D-MeX, we have slightly increased the incentives at PR24 compared to PR19, from approximately 0.17% RoRE to 0.2% RoRE. This increase is justified to ensure companies maintain focus on D-MeX, particularly in light of the higher incentives applied to C-MeX at PR24.

4.269 At PR19, Southern Water's maximum exposure on D-MeX reached -0.20% RoRE in 2021–22, which was based on 12% developer services revenue.<sup>264</sup> We do not consider it appropriate to reduce the D-MeX incentives to 5% developer services revenue, as proposed by Southern Water.

4.270 The D-MeX incentive is half the size of C-MeX incentive, which we consider appropriate given the size of the relative revenues involved.

4.271 Finally, the BR-MeX incentive size is aligned to the size of D-MeX (and of business customer experience in Wales). This is important to encourage sufficient focus on this performance commitment, supporting the functioning of the business retail market. Ofwat's review of incumbent support for effective markets, along with previous market

<sup>263</sup> [OF-SRN-004] Ofwat, C-Mex and D-Mex Final Report, September 2024, p. 8

<sup>264</sup> [OF-OU-014] Ofwat, PR24 Final Methodology Appendix 8: Outcome Delivery Incentives, December 2022, p. 53.

monitoring, found that water companies need to do more to support the business retail market.<sup>265, 266</sup>

4.272 Therefore, in the context of business retail revenues, we consider a 0.2% RoRE to be appropriate.

## C-MeX performance commitment level

### Final Determination

4.273 For our final determinations, we said "in setting the baseline, we would compare C-MeX performance to a cross-sector benchmark to address concerns about C-MeX not being stretching enough and performance declining in PR19 as well as achieving a step change in customer service".<sup>267</sup>

4.274 We therefore set the performance commitment level by using as a cross-sector benchmark the UK Customer Satisfaction Index (UKCSI) all-sector average. Compared to draft determinations, for final determinations we reduced the UKCSI all-sector average by 5 points for 2025–2028, and we reduced it by 4 points for 2028–30. We used a downward adjustment of 5 because that was the long term difference between the UKCSI all-sector average and the UKCSI utilities sector average.

4.275 Therefore we reduced the PCL for our final determinations compared to draft determinations from 0.5% RoRE to 0.4% RoRE, to take into account the specific factors common to utilities organisations, such as having less frequent direct customer contact than other organisations and providing essential services.

4.276 We reduced the adjustment in years 4 and 5 to encourage continuous improvement and because "we maintain the ambition for water companies to perform at levels consistent with the wider UK economy".<sup>268</sup>

## Company statement of case

4.277 Southern Water states that the long-term trend between the sector median and UKCSI all sector average is declining, and that this trend should be accounted for in setting the PCL. The disputing company also contends that the current downward adjustments

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<sup>265</sup> [OF-SRN-005] Ofwat, Review of incumbent company support for effective markets, Ofwat, August 2020

<sup>266</sup> [OF-SRN-006] Ofwat, Business retail market update 2023–24, October 2024

<sup>267</sup> [OF-OA-017] Ofwat, PR24 final determinations–Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 236

<sup>268</sup> [OF-OA-017] Ofwat, PR24 final determinations–Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 238

of 5 (for 2025–28) and 4 (for 2028–30) do not go far enough, and would result in an unbalanced risk profile under C-MeX.<sup>269</sup>

4.278 Southern Water proposes recalibrating the C-MeX PCL using larger downward adjustments: 6 points for 2025–28 and 7 points for 2028–30. The company says that this would better reflect deterioration in sector performance, which it attributes to uncontrollable factors affecting customer experience – such as increasingly negative public sentiment toward the water industry– and would result in a more balanced incentive.

4.279 The company supports its proposal with a logarithmic forecast of C-MeX performance for 2025–30, based on the downward trend observed in 2020–25. It says that this forecast justifies the proposed downward adjustment of 6 and 7 points to ensure a balanced incentive.<sup>270</sup>

## Our response

4.280 The downward adjustment of 5 set out in our final determinations is based on 'the long term difference between the UKCSI all-sector average and the UKCSI utilities sector average'.<sup>271</sup> This adjustment addresses Southern Water's concern that water companies are likely to receive negatively biased scores.

4.281 Southern Water's proposed adjustments do not take into account performance improvements from PR19 to PR24, or expected improvements across the PR24 period. Its analysis is based on a logarithmic forecast that assumes the downward performance trend observed in PR19 will continue unchanged through 2029–30. This approach implies consistent performance deterioration across all companies throughout the PR24 period, without providing a clear rationale for that assumption. On the other hand, given the changes to the ODI rates and to the performance commitment definition (with more focus on contact customers), we consider it unjustified to assume that the PR19 performance trend will persist. In fact, we expect that these changes will have a positive impact on companies' performance.

4.282 The company also proposes a larger downward adjustment in 2028–30 (7 points, compared to 6 in 2025–28), citing performance deteriorations in 2020–25. However, it does not explain why a larger downward adjustment is needed in 2028–30 compared to other years. In contrast, our final determinations apply a smaller downward adjustment in 2028–30 (4 points, compared to 5) to support continuous improvement over time.

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<sup>269</sup> [OF-OA- 003] Southern Water, Southern Water Statement of Case, March 2025, p. 402

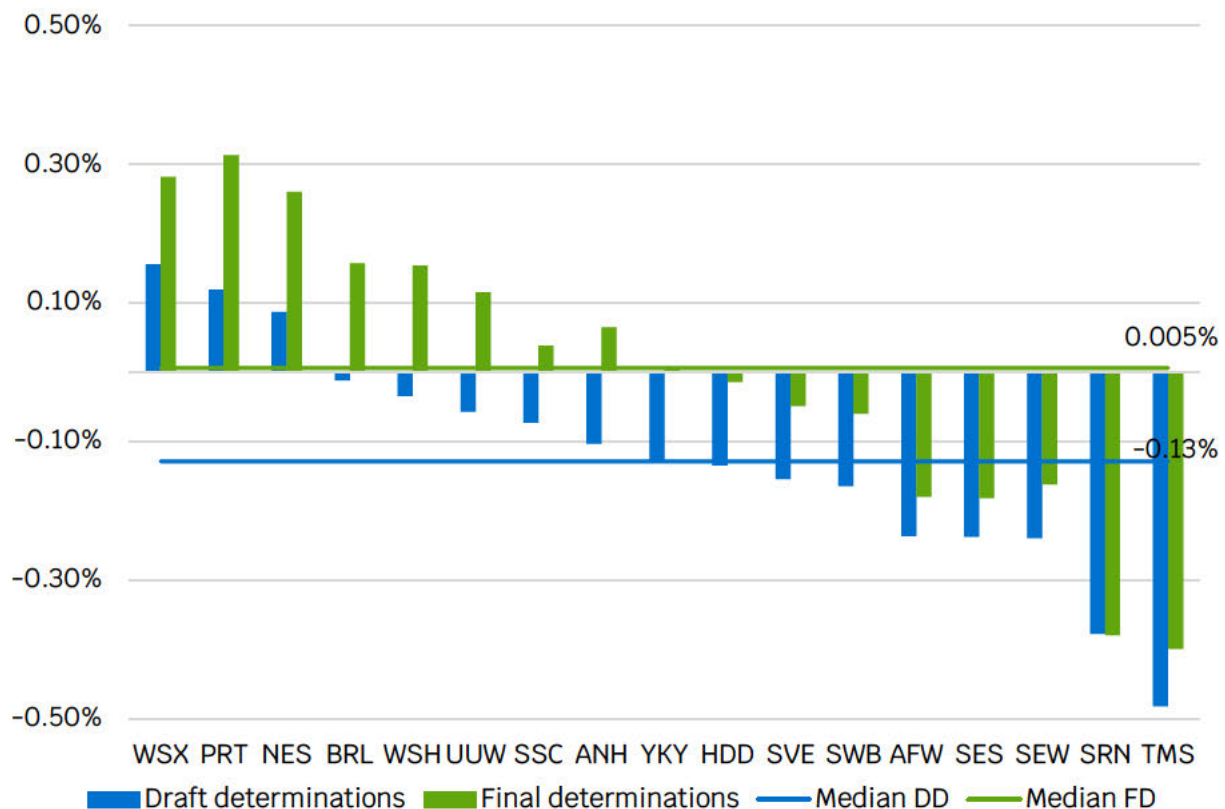
<sup>270</sup> [OF-OA-003] Southern Water, Southern Water Statement of Case, March 2025, p. 403

<sup>271</sup> [OF-OA-017] Ofwat, PR24 final determinations–Delivering outcomes for customers and the environment, December 2024 (republished February 2025), p. 238.



4.283 Our analysis of expected payments, based on outturn performance, indicates that using adjustments of 5 and 4 results in an approximately balanced level of risk at an industry level.<sup>272</sup> We therefore consider the C-MeX PCL to be achievable yet stretching. Southern Water is a poor performer on C-MeX, so its expected payments are negative. This forecast is based on actual PR19 data applied to the PR24 definition, without any additional assumptions. This is illustrated in Figure 4.7 (C-MeX expected payments), though we acknowledge that it is challenging to predict accurately the expected payments.

**Figure 4.7: Expected C-MeX payments with modelled scores (based on average of 2020-24 performance)<sup>273</sup>**



<sup>272</sup> [OF-SRN-007] Ofwat, C-MeX expected RoRE payments mode, December 2024.

<sup>273</sup> [OF-SRN-004] Ofwat, 'C-MeX and D-Mex Final Report', September 2024, p. 5.

4.284 Southern Water has not provided evidence to support its claim that performance deterioration is due to uncontrollable external factors. In particular, as shown in Table 4.15 below, scores for the contact component of the C-MeX survey – which reflects how companies respond to direct contacts from customers (such as billing queries or operational issues) have declined in line with the non-contact component. This suggests that performance issues are not in actuality driven by negative public sentiment.

4.285 In conclusion, we consider the C-MeX PCL is set at an achievable yet stretching level based on PR19 performance. On the other hand, Southern Water has not demonstrated why having a less stretching PCL across the PR24 period – based on a deteriorating performance trend – would be in customers' interests.

**Table 4.15: Change in customer survey scores<sup>274</sup>**

	2020-21	2021-22	2022-23	2023-24
Customer Experience survey scores	83.9	81.2	79.9	77.92
Customer Service survey scores	79.4	78	76.3	73.56

<sup>274</sup> [OF-SRN-004] Ofwat, C-MeX and D-MeX Final Report, September 2024, p. 4.

## Aligning risk and return

4.286 We consider the issues raised by Southern Water around risk and return should be considered thematically. Therefore, the issues outlined in table 4.16 are all addressed in the 'name of the Risk and Return document'.

**Table 4.16: Navigation of key issues in risk and return**

Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
WACC	Chapter 7	PR24 redeterminations – risk and return – common issues.  Section – Balance of Risk.
Return on equity – market tests	ES, Section 7.1, para 56 onwards Chapter 7, para 5 Chapter 7, section 3.2 Chapter 7, section 4	PR24 redeterminations – risk and return – common issues.  Section – Allowed Return on Equity.
Return on equity – Parameters	ES, Section 7.1, para 59 onwards Chapter 7, para 8 Chapter 7, section 3.2 onwards	PR24 redeterminations – risk and return – common issues.  Section – Total Market Return.
Cost of debt	ES, Section 7.1, para 60 onwards Chapter 7, para 9 onwards Chapter 7, section 3.4	PR24 redeterminations – risk and return – common issues.  Section – Embedded Cost of Debt.
Notional gearing	ES, Section 7.1, para 63 Chapter 7, para 12 onwards Chapter 7, section 3.5	PR24 redeterminations – risk and return – common issues.  Section – Retail Margin Adjustment.
Impact/affordability	ES, section 8.1, para 75 onwards Chapter 8, section 1.2	PR24 redeterminations – risk and return – common issues.  Section – Overall balance.
Outturn adjustment mechanism (OAM)	Chapter 1, Section 8.1	PR24 redeterminations – risk and return – common issues.  Section – Outturn Adjustment Mechanism
Aggregate sharing mechanism (ODI and totex)	Chapter 1, Section 8.2	PR24 redeterminations – risk and return – common issues.  Section – Aggregate Sharing Mechanisms.
DDCM	Chapter 5, section 6.4	PR24 redeterminations – expenditure allowances – common issues.



Point in Southern Water's statement of case	Statement of case (SoC) reference	For Ofwat's response see
		Section - PCDs overlap with other incentives.
Retail price control – bad debt	Annex 3, para 1	PR24 redeterminations – risk and return – common issues.  Section - Retail Margin Adjustment.

## Affordability

4.287 Table 4.17 shows Southern Water's final determination bill increase over the 2025–30 and Ofwat's calculation of the possible bill impact in 2029–30 from Southern Water's statement of case.

**Table 4.17: Southern Water's bill increases for AMP8 (£)**

	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	5yr avg.
Final determination <sup>275</sup>	420	606	609	613	630	642	620
Statement of case	420						

4.288 In Southern Water's statement of case, we have not been able to find information on the bill impact as a result of the requested redetermination in the company's statement of case.

4.290 Therefore, we have calculated that the likely bill in 2029–30 is likely to be a range from depending on the factors set out above.

<sup>275</sup> Final determination bill values for Southern in this table excludes the impact of the schemes within the DM.

<sup>276</sup>



## 5. Areas for deprioritisation

- 5.1 In its statement of case, Southern Water indicates that there are a number of areas of our final determination that are not being challenged.<sup>277</sup> The company states it is not challenging any aspect of our retail price control (with a caveat about potential recalculation of the bad debt element), our quality and ambition assessment (QAA), the majority of aspects of our base costs models, almost £4.0 billion of the enhancement expenditure allowances included in our final determination; and all PCs and ODIs not otherwise included in the company's statement of case.
- 5.2 In response to the CMA's request, we have suggested in our PR24 redeterminations – overview of our response to the statements of case document that the CMA could deprioritise redetermination of a number of the PR24 price review building blocks.<sup>278</sup> We include QAA, the retail price control, base costs models and the PCLs and ODIs for the total pollution incidents PC.
- 5.3 As such, we do not agree with some of the suggestions made by Southern Water for deprioritisation from the CMA redetermination process. We reflect that both the PR24 price review process itself and the redetermination process undertaken by the CMA feature significant asymmetries, as discussed in the PR24 redeterminations – overview of our response to the statements of case including a likelihood that companies have not proposed areas for redetermination where the potential outcome could lead to a less 'favourable' outcome.

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<sup>277</sup> [OF-OA-003] Southern Water, Southern Water PR24 Redetermination Statement of Case, March 2025, Annex 3, p. 544.

<sup>278</sup> Ofwat, PR24 Redeterminations – overview of our response to the statements of case, April 2025, section 5.

## A1 Appendix 1: Key financial metrics

A1.1 The main body of this document sets out the key interventions that we made to Southern Water's business plan. This appendix provides further detail of the calculation of the final determination where we made a number of interventions to Southern Water's business plan and/or draft determination representation position. Further detail on the interventions are set out in our documentation.

**Table A1.1: Key financial metrics**

	Draft determination	Company view (August 2024 representation)	Final determination
Average bill (2025-30) £	569.32	747.17	627.18
Average bill growth (%)	47	83	57
Allowed return (%)	3.72	4.49	4.03
RCV Growth (%)	32	58.7	43.9
Dividend yield (%)	2	2	4.1
ACICR simple (ratio)	1.67	1.61	1.71
ACICR weighted (ratio)	1.66	1.55	1.70
FFO/net debt simple (%)	10.0	9.6	10.7
FFO/Net debt weighted (%)	10.0	9.3	10.6
Run off rate (%)	4.18	4.49	4.36
Post financeability revenue adj (£m)	158.3	130.7	119.7

**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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