



# **Southern Water: focussed reply to Ofwat's response to disputing companies' statements of case**

# Introduction

1. Southern Water (SRN) welcomes the opportunity to provide this focussed reply to Ofwat's response to disputing companies' statements of case ("**Ofwat's Response**"). This submission should be read alongside the Joint Reply to Ofwat's Response ("**Joint Reply**") made on behalf of all five disputing companies ("**DCs**").
2. Given the 10-page cap on our reply, we necessarily do not engage with every point made in Ofwat's Response; our agreement to any point made by Ofwat should not be inferred from the absence of commentary in this reply.
3. We have the following overarching comments on Ofwat's Response:
  - A. It contains limited new evidence, with much reliance on assertion rather than evidence. Ofwat does not accept any criticism of its FD, notwithstanding the Cunliffe review and April's NAO report. Ofwat accuses DCs of selectivity while its Response is itself selective.
  - B. Ofwat emphasises that it had considerable discretion under its statutory general duties. That discretion now vests in the CMA rather than Ofwat, and we ask the CMA to exercise that discretion in support of our case.
  - C. In multiple contexts (e.g. for total pollutions PCL and notified item thresholds), Ofwat asks the CMA to let Ofwat determine matters under a separate process without subsequent recourse to the CMA. We are concerned about the number of issues for which Ofwat proposes this approach. On most issues, Ofwat had the opportunity to determine its policy during the 3 years of its PR24 process. Further, this approach would require companies to trust Ofwat's judgement on matters which, in many cases, contributed to the decision to trigger this redetermination. Should any matters be handed back to Ofwat, it is vital that the CMA sets tramlines to govern the Ofwat process and approach (e.g. in the form of supervision of outcome or setting strategic direction) to avoid undermining the statutory protection offered by the redetermination process.
  - D. Ofwat accuses the DCs of lacking transparency as to bill impacts, emphasising the need to involve customers in the CMA process. We are acutely conscious of the impact on customer bills and have urged the CMA to take steps to mitigate this impact to the greatest extent possible. We are pleased that CC Water recognised the extent to which our investment plan involved our customer research. The vast majority of our AMP8 enhancement plan is mandated by regulatory obligation and law, and we have limited our request for funding to those items required in order to meet these obligations, together with a fair balance of risk and reward.
4. In the remainder of this submission, we address specific points raised in Ofwat's Response. In doing so, we adopt the same categorisation and order of issues used in our Statement of Case ("**SoC**").

# 1. Risk and financeability

5. This section addresses Southern Water-specific factors not covered in the Joint Reply.

Ofwat response	Southern Water reply
Ofwat states that ecological challenges we face are not unique to our area and therefore concludes there is no evidence for a less stretching PCL. Ofwat also did not comment on our heightened risk due to a larger and more complex capital programme driven by protected environments in our region. <sup>1</sup>	<ul style="list-style-type: none"> <li>Ofwat has not correctly understood our case regarding company specific characteristics included in our SoC. The KPMG report <i>Impact of exogenous risk factors on wastewater ODI performance</i> indeed states that these factors are not unique to our area. However, it demonstrates that exposure in our region is statistically significantly higher (Table 7, p. 15).</li> <li>The exposure to ecological factors is likely to have material impact on our PC performance. Statutory requirements also necessitate a more complex and capital intensive AMP8 investment programme with many novel solutions.</li> </ul>
Ofwat has already intervened at the FD to reduce the PCL stretch <sup>2</sup> and is of the view that exclusions are not required as the risks are mitigated by existing risk protections. <sup>3</sup>	<ul style="list-style-type: none"> <li>Ofwat did not assess whether the performance improvements required to meet PCLs were achievable at DD or FD. In this context, the intervention provides no assurance that, while less stretching, the PCL is reasonable given: (i) current levels of sector performance; and (ii) ecological characteristics making performance improvements more challenging.</li> <li>Ofwat did not assess whether the FD risk protections provided sufficient protection to support financeability, and therefore whether extreme events can be managed by the notional company.</li> </ul>
WINEP funding addresses issues on pollutions arising from protected environments. <sup>4</sup>	<ul style="list-style-type: none"> <li>WINEP does not directly fund the management of pollution incidents. It includes schemes to help comply with changes in discharge permits and to reduce storm overflows.</li> </ul>
It would be inappropriate to reduce the ASM thresholds as it would encourage companies to undertake inefficient totex investment to inflate RCV. <sup>5</sup>	<ul style="list-style-type: none"> <li>The capital programme is the company's largest ever and will be difficult to deliver with strong incentives against non-delivery including PCDs and statutory penalties.</li> <li>ASM remedies are needed to support financeability for the notional company<sup>6</sup>.</li> </ul>
Removing the OAM deadband would result in an imbalance in risk and reward due to upward skew in finance risk. <sup>7</sup>	<ul style="list-style-type: none"> <li>Ofwat's own inflation data show financing risk has a negative skew<sup>8</sup>.</li> <li>OAM deadband removal is required to balance risk and return by removing the negative skew in outcomes.</li> </ul>

## 2. Base costs

Ofwat response	Southern Water reply
<b>Ofwat does not accept the serious concerns of using the statistically insignificant bands 1-3 variable in its wastewater models</b>	
Ofwat acknowledges that the bands 1-3 variable is not statistically significant at the 10% significance level. However, it does not consider	<ul style="list-style-type: none"> <li>This variable is a clear outlier, being the only variable on which Ofwat relies which fails this high importance test.</li> <li>Ofwat's own model robustness tests explain that: <i>"failure of these tests and criteria would raise serious concerns about using the model"</i><sup>10</sup>.</li> </ul>

<sup>1</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, paragraph 4.116

<sup>2</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, paragraph 4.119

<sup>3</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, paragraph 4.114

<sup>4</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, paragraph 4.117

<sup>5</sup> Ofwat, April 2025, PR24 redetermination, Risk and return – common issues, paragraph 2.69

<sup>6</sup> Southern Water, March 2025, PR24 Redetermination Statement of Case, paragraph 278

<sup>7</sup> Ofwat, April 2025, PR24 redetermination, Risk and return – common issues, paragraph 2.80

<sup>8</sup> KPMG, January 2025, PR24 Final Determinations – risk analysis for a notional company, page 20, SOC-1-0001.

<sup>10</sup> Ofwat, December 2024, PR24 FD: Expenditure allowances – base cost modelling decision appendix, page 61

<p>this sufficient grounds to exclude the variable from the models<sup>9</sup></p>	<ul style="list-style-type: none"> <li>In all similar cases during the PR24 consultative process, when a potential variable failed the statistical significance test, Ofwat chose not to use the variable (e.g. "band 6" variable in wastewater<sup>11</sup>, "transience"<sup>12</sup> and "proportion of metered customers"<sup>13</sup> variables in retail).</li> </ul>
<p><b>Ofwat's new evidence of APH data quality is not sufficient to alleviate the significant concerns we raised</b></p>	
<p>Ofwat provides new evidence to support its view that APH data quality has improved since PR19 (and getting closer to 80% measured data – one of Turner and Townsend ("T&amp;T") recommendations to address APH data quality)<sup>14</sup></p>	<ul style="list-style-type: none"> <li>This new evidence is insufficient to alleviate concerns.</li> <li>T&amp;T includes multiple recommendations, but we are concerned that Ofwat has only shown progress towards one of these (and has still not met the recommended 80% figure).</li> <li>Specifically, T&amp;T recommended: <i>"Ofwat to move to more accurate estimation techniques for those pump sets where measured data is not available – based on the ranked methods in this report"</i>. There has been no progress made against this recommendation during PR24.</li> <li>Ofwat has not responded to our concerns with relying on historic APH data, given data quality issues. It is noticeable that a significant proportion 34% of this data has been manually imputed by Ofwat in the PR24 feeder models (with limited explanation or transparency). When the original externally-assured APR data is used instead, the APH variable loses statistical significance in nearly all models.</li> </ul>
<p><b>Ofwat has made three inappropriate adjustments to reduce our CAC requested amount for investing in AAD</b></p>	
<p>Ofwat provided its own estimate of the implicit allowance. Ofwat used <i>"all AAD upgrade costs"</i> instead of <i>"sludge quality enhancement costs only"</i> to estimate the implicit allowance. This increased the value from £11.5m to £32m<sup>15</sup></p>	<ul style="list-style-type: none"> <li>There is no <i>"all AAD upgrade costs"</i> category included within the Ofwat base models. These costs are included within broader cost categories.</li> <li>In the FD, Ofwat stated that we <i>"failed to account for AAD upgrades by other companies"</i>. However, the information that Ofwat relied upon was not available to companies and was only collected by Ofwat in September 2024. Our Implicit Allowance in the SoC was based on known AAD related costs from the PR24 FD models.</li> </ul>
<p>Ofwat argues that we failed to account for cost-sharing in the CAC request, and that since we could recover 50% of any overspend from customers the need for an adjustment is reduced<sup>16</sup></p>	<ul style="list-style-type: none"> <li>This is an erroneous application of the cost sharing mechanism: cost sharing is intended to address instances where actual spend exceeds the predicted efficient spend, not to justify allowances being set upfront that are insufficient for recovery of known efficient spend.</li> <li>There was no expectation within the CAC guidance that companies should account for cost sharing when demonstrating the need for adjustment; nor was the point reflected in Ofwat feedback during CAC development process.</li> </ul>
<p>Ofwat argues that we did not account for future opex savings from investing in AAD. Ofwat estimated how much our hypothetical allowance would reduce by if it increased the percentage of sludge treated through AAD to 100%. This led to its estimated opex savings of £61 million for 2030-35<sup>17</sup></p>	<ul style="list-style-type: none"> <li>Speculative opex savings in future periods are not relevant to our need for funding in PR24.</li> <li>After AAD upgrade is completed at Ham Hill and Ashford, only 36% of our total sludge will be treated through AAD, so even according to Ofwat's highly speculative method, any savings would be only a fraction of what Ofwat asserts. We have been unable to calculate this, as Ofwat has not provided the data necessary to replicate the £61m savings, despite our request for the data.</li> <li>Further, we will stop digestion (and electricity generation) at a number of sites which means we will have to pay for additional power at these sites.</li> </ul>

<sup>9</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, page 43

<sup>11</sup> Ofwat, April 2023, Econometric base cost models for PR24, page 38

<sup>12</sup> Ofwat, April 2023, Econometric base cost models for PR24, page 64

<sup>13</sup> Ofwat, April 2023, Econometric base cost models for PR24, page 62

<sup>14</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, page 34

<sup>15</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, page 47

<sup>16</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, page 47

<sup>17</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, page 47

Ofwat's reasons for TMS' accepted Beckton scheme not being comparable to our AAD CAC	
Ofwat says that TMS' allowances for Beckton and SRN cost adjustment claim are not comparable due to differences in (i) risk to operational resilience (as 17% of TMS' bioresources are treated at Beckton and only 12% of SRN are treated at SRN sites) and (ii) ability to fund the investment through the base expenditure allowance <sup>18</sup>	<ul style="list-style-type: none"> <li>• We face similar resilience issues. Assets are approaching end of life and there are no other treatment options in Kent.</li> <li>• The level of risk Ofwat set out for us and TMS, based on percent of bioresources treated, is very similar.</li> <li>• Risk in operational resilience is not part of the CAC acceptance framework.</li> <li>• We are less able to fund through base expenditure as it represents a much larger proportion of our base allowance: cost of TMS scheme less Ofwat-assumed implicit allowance is £99.8m (15% of their base allowance); the cost of our scheme less Ofwat-assumed implicit allowance is £80.8m (30% of our base allowance).</li> </ul>
Ofwat's findings of an immaterial impact from the pre-modelling regional wage adjustment are driven through its choice of assumptions	
For our Regional labour CAC, Ofwat concludes that its own analysis of a pre-modelling adjustment shows an immaterial impact, and uses this as a basis for rejecting the claim as this is its chosen route for making an adjustment <sup>19</sup>	<ul style="list-style-type: none"> <li>• We have been unable to replicate Ofwat's analysis as it assesses the impact of pre-modelling adjustments against incorrect FD allowances. Ofwat has not provided us with the data, despite our submission of a query. It appears that for Water, Ofwat's analysis is based on an incomplete dataset (with only 207 observations as opposed to 221 always used at FD) which our analysis shows would lead to a material impact on the results.</li> <li>• Ofwat's conclusions are dependent on its choice of assumptions to develop its wage indices. Ofwat's analysis shows that the SOC-based index it has chosen to rely on does not appropriately recognise the higher costs faced in the SE England.</li> <li>• Ofwat appears to have calculated its forecast index using only the most recent five years of data. Our results are based on the full historic modelling period and are less affected by the impact of Covid-19 in 2020 and 2021.</li> <li>• Ofwat has used an 80% locally sourced share of labour compared to our 88% assumption which is consistent with Ofgem's assumption.</li> </ul>
Ofwat challenge issues arising from the inclusion of the coastal population variable which were addressed by SRN previously in the PR24 process	
Coastal population variable: Ofwat challenges our econometric modelling results as being sensitive to the exclusion of SRN, and considers some impacts on other companies (SWW, TMS) to be counterintuitive <sup>20</sup>	<ul style="list-style-type: none"> <li>• The issues presented in Ofwat's assessment are not new. We responded to these challenges earlier in the PR24 process and Ofwat made no further challenge.</li> <li>• We responded to the claim that the coastal variable is sensitive to the inclusion of SRN in our DD response<sup>21</sup> and presented log transformation analysis to counter this.</li> <li>• At Business Plan submission in October 2023, we explained how interactions with the load variable explain counter-intuitive results for some other companies<sup>22</sup>.</li> </ul>
Ofwat's updated unit cost analysis still suffers from methodological flaws. When corrected for these, the unit costs for our coastal sites are indeed higher than inland sites	
Ofwat accepted the challenges raised in our SoC that its single year unit cost analysis is limited. It has now extended its analysis for all data collected since 2016/17, but states that this still supports its original conclusions. Ofwat acknow-	<ul style="list-style-type: none"> <li>• Ofwat has acknowledged that its approach leads to a misclassification of a significant proportion of our sites.</li> <li>• Ofwat is wrong to downplay the impact of misclassification. In our SoC we identified four sites as being classified incorrectly by Ofwat. When these are corrected Ofwat's findings for us change significantly.</li> <li>• Whereas Ofwat found that our inland unit costs were £10 higher than coastal sites, after correcting the classification, the inland sites had a</li> </ul>

<sup>18</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, pages 49-50

<sup>19</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, page 56

<sup>20</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, page 64

<sup>21</sup> Southern Water, August 2024, SRN-DDR-015: Coastal Population Cost Adjustment Claim, pages 16-21

<sup>22</sup> Southern Water, October 2023, SRN20 Coastal Population Cost Adjustment Claim, pages 14-16



<p>ledges that its simpler definition of coastal sites may result in misclassification, but given it achieves 90% accuracy on our sites, considers it representative<sup>23</sup></p>	<p>unit cost of £219, compared to £261 for coastal sites (a 19% premium).</p> <ul style="list-style-type: none"> <li>• The broad-brush classification used by Ofwat is likely to misclassify other companies' sites. Ofwat has not sought to understand the extent of this issue. Ofwat's findings cannot be used as basis to counter our better-evidenced analysis.</li> <li>• Ofwat's (flawed) analysis still shows an industry-wide premium of 23% for coastal sites across the eight-year period. This increases to 26% when our sites are correctly classified.</li> </ul>
<p>Ofwat explains that for its coastal sites analysis, it does not consider industry wide averages to be appropriate and illustrates this by referencing TMS's large sites impacting the weighted average. Ofwat argues that <i>"the cost impact of operating near the coast seems immaterial when other factors such as economies of scale are accounted for."</i><sup>24</sup></p>	<ul style="list-style-type: none"> <li>• Economies of scale are important to understand the full cost impact on our coastal sites. Our coastal sites are on average approximately double the size of inland sites. Therefore, the bottom-up estimates of the coastal premium from the unit cost analysis underestimate the cost differential, as it is masked by the scale of our coastal sites.</li> <li>• This economies of scale issue is also apparent across the industry. When we compare the unit costs at a comparable band size (in line with analysis shown in Table 21 of our SoC for 2023-24<sup>25</sup>), it is clear that Ofwat's conclusions about higher costs for inland sites for four companies from 2016-17 onwards are inappropriate.</li> <li>• We also undertook econometric analysis which accounts for economies of scale and other relevant factors. This shows that cost impact of operating near the coast is certainly material when other variables like economies of scale (through WATS variable) are accounted for.</li> <li>• Ofwat has replicated our scatterplot which shows that costs for coastal sites are higher at all scale levels, showing the materiality of this issue.</li> </ul>
<p><b>We are seeking a company-specific energy adjustment</b></p>	
<p>Ofwat notes that if it used the entire historical modelling period, most companies' calculated power cost shares would have decreased and the corresponding adjustment would have been lower.<sup>26</sup></p>	<ul style="list-style-type: none"> <li>• We are not seeking symmetrical change on the power cost share to reduce other companies' allowances. In our SoC we set out a company specific issue which needs a company-specific adjustment.</li> </ul>

### 3. Enhancement costs

Ofwat response	Southern Water reply
<p><b>Supply interconnectors</b></p> <ul style="list-style-type: none"> <li>• Ofwat considers <i>"small sample size is a practical limitation rather than a modelling flaw"</i>.<sup>27</sup></li> <li>• On the exclusion of additional drivers, Ofwat states <i>"We did not find these additional variables to be statistically significant once we take account of length and WAFU"</i>.<sup>28</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Ofwat is wrong to suggest that a small sample size is not a modelling flaw. A small data sample does not provide a robust basis for setting cost allowances, and needs cross checking against site specific data.</li> <li>• Ofwat's decision to exclude additional drivers proposed by us in the model would also be flawed if (as implied by Ofwat's response) Ofwat tested the statistical significance of these additional drivers in a model that included variables for length and WAFU. The correct way to demonstrate its models are the best approach would be to test the significance of the additional drivers in a separate model.</li> <li>• It was not appropriate for Ofwat to place so much reliance on ANH's outturn data as part of its historical costs model. 93% of the value of schemes within Ofwat's historical model relates to ANH's interconnectors. Ofwat's response refers to <i>"Anglian Water's internal</i></li> </ul>

<sup>23</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, pages 66-67

<sup>24</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, pages 66-68

<sup>25</sup> Southern Water, March 2025, PR24 Redetermination Statement of Case, pages 174-175

<sup>26</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, pages 77

<sup>27</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 4.32

<sup>28</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 4.18

<ul style="list-style-type: none"> <li>Ofwat insists ANH's interconnector outturn data is appropriate basis for setting cost allowances.</li> <li>Ofwat states its modelling approach allows for factors impacting our scheme costs</li> </ul>	<p><i>interconnection programme, where as of February 2024 it forecast delivery of less than half the agreed capacity by the original date in 2025, and is not planning to deliver some schemes at all".<sup>29</sup> It is wrong for Ofwat to weight by 50% what are forecast outturn costs of those schemes that ANH has not completed, calling them "historical" costs when outturn costs may yet vary.</i></p> <ul style="list-style-type: none"> <li>Ofwat fails to quantify the extent to which its model explains the additional complexity we face in our Andover Link Main project.</li> </ul>
<p><b>IED</b></p> <ul style="list-style-type: none"> <li>Ofwat's argues that it selected the best of the cost drivers that it tested.<sup>30</sup></li> <li>As a new cross check, Ofwat calculated a unit cost per site of £8.5 million for us stating this is higher than the PR19 redetermination allowance for Northumbrian Water of £7.08m (2022-23 prices).<sup>31</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat may consider that it selected the best cost drivers it tested. However, this does not justify or offset use of an otherwise weak model.</li> <li>We disagree that Ofwat's new cross-check validates its modelling approach. Ofwat's FD allowance per site for SRN is third lowest behind Welsh Water and Yorkshire. Yorkshire was allowed preferential cost sharing at CMA PR19 for AMP7 expenditure on IED. Applying the median unit cost allowance per site across all companies of £12.0m to our 16 sites, Ofwat would have allowed us £192m, which is £20m more than we requested and £50m more than the allowance provided under the FD.</li> </ul>
<p><b>Flow monitoring at STWs</b></p> <ul style="list-style-type: none"> <li>Ofwat mischaracterises SRN as the only company that could not follow the CWW20 line guidance.<sup>32</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat is wrong to claim that we could not follow the CWW20 line guidance. The problem arises because there is a missing category in the guidance for many of our schemes and differences between the Ofwat and EA guidance.<sup>33</sup></li> </ul>
<p><b>Mains renewal</b></p> <ul style="list-style-type: none"> <li><b>Condition Assessment</b> Ofwat accepts that "<i>specific lengths of pipes can be expected to move in between condition grades</i>".<sup>34</sup></li> <li><b>Unit Cost:</b> Ofwat claims that it is our asset management decision to replace both the main and the communication pipes. It confirms its unit cost and adjustment is for the replacement of the mains pipes only to reduce bursts<sup>35</sup></li> </ul>	<ul style="list-style-type: none"> <li><b>Condition Assessment:</b> Ofwat's position reflects our SoC which notes that specific mains can move between cohorts thus appearing to improve their condition but with no renewal activity taking place. Using the data from these cohorts to require additional mains renewal is carried out with no additional funding is inappropriate and unreliable.<sup>36</sup></li> <li><b>Unit Cost:</b> Ofwat has failed to engage with the purpose of our mains renewal programme which is leakage reduction through enhancement investment, the full benefit of which is only delivered if both main and communications pipe are replaced. This is a more costly scope than a programme aimed purely at reducing bursts.<sup>37</sup> Ofwat also fails to recognise regional wage differences for mains replacement which is a labour intensive task.</li> </ul>
<p><b>Water Treatment works transition funding</b></p> <ul style="list-style-type: none"> <li>Ofwat lists improvements required in previous periods. It includes evidence from PR19 business plan that we planned to deliver DWI improvements through £41m in base allowances.</li> <li>Ofwat claims investment does not meet the criteria for transitional funding. It says we pushed DWI</li> </ul>	<ul style="list-style-type: none"> <li>In AMP7 we invested £199m base capex at the five sites, making improvements to meet the DWI Notices. Ofwat's FD decision means cost sharing (at 63.55%) should apply to this which is materially more than the forecast spend at PR19 and the long-term implicit allowance for the five sites. This is unreasonable.</li> <li>Ofwat is wrong to suggest that our proposed transition funding is to cover work required in previous periods. A carefully choreographed and phased delivery programme to meet all DWI notices is needed to mitigate risks to customer supplies whilst construction continues on live operational sites. In relation to Weir Wood, we undertook a significant amount of work to address the relevant contamination issues until the point it was no longer economical to do so. Ofwat would have been unlikely to support completely rebuilding a site if an</li> </ul>

<sup>29</sup> Ofwat, April 2024, PR24 redeterminations, Overview of our response, paragraph 4.19

<sup>30</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 5.100

<sup>31</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 5.115

<sup>32</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 5.144

<sup>33</sup> Southern Water, March 2025, Statement of Case, Chapter 3, paragraph 189

<sup>34</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 2.261

<sup>35</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – common issues, para 2.227

<sup>36</sup> Southern Water, March 2025, Statement of Case, Chapter 3 para 296

<sup>37</sup> Southern Water, March 2025, Statement of Case, Chapter 3 para 305

deadlines from AMP7 and we are not advancing spend on an AMP8 deliverable. <sup>38</sup>	apparently alternative cheaper solution was available when we decided on our initial strategy.
<b>Water supply scheme: Smock Alley</b> <ul style="list-style-type: none"> <li>Ofwat refers to the WRMP process and implies our WRMP costs should be accurate and well developed</li> <li>Ofwat fails to respond to our SoC Table 21 which shows the additional elements identified and the explanation that multiple alternative options were considered during the initial delivery phase<sup>39</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat's position in its Response suggests that it does not expect cost changes between the WRMP options appraisal process and detailed design and delivery. This is unrealistic and not grounded in the engineering reality of scheme appraisal and delivery.</li> <li>By way of example, for WRMP19 (where the Smock Alley scheme was initially selected) companies were asked to score scope and cost confidence of WRMP options, illustrating that the WRMP process recognises costs used for options appraisal decision making are not all to a high level of confidence.</li> <li>Ofwat's stance is that there is no limit to what a company should spend over and above its enhancement cost allowance due to changes in scope which companies become aware of outside the 5-yearly business planning cycle.</li> <li>Ofwat has not considered the potential impact on the risk exposure for companies of such expectations, here for a fourfold increase in cost.</li> </ul>

## 4. Treatment of uncertainty through mechanisms

Ofwat response	Southern Water reply
<b>DPC:</b> <ul style="list-style-type: none"> <li>Ofwat points to its separate powers to designate as per licence condition U.<sup>40</sup></li> </ul>	<ul style="list-style-type: none"> <li>While Condition U is the mechanism by which DPC is delivered, the initial decision to go down the DPC route (and therefore exclude it from in-house delivery by the water company) is part of the price control decision that is subject to redetermination.</li> </ul>
<b>Undefined parameters:</b> <ul style="list-style-type: none"> <li>Ofwat proposes for notified items to be deprioritised from the CMA process. It sets out the expectation it will consult on licence changes in July.<sup>41</sup></li> </ul>	<ul style="list-style-type: none"> <li>We are supportive of notified items being deprioritised from the re-determination, providing that Ofwat does indeed consult and make the required changes ahead of the CMA's final determinations. If Ofwat does not do this, then notified items (the threshold and process) need to be addressed in the CMA's redetermination.</li> </ul>
<b>Omitted mechanism:</b> <sup>42</sup> <ul style="list-style-type: none"> <li>Ofwat states that we did not provide good knowledge of our boundary box assets.</li> </ul>	<p>We have a good level of understanding of the cost of boundary box replacement. This is apparent from our unit costs being closely aligned to Anglian Water's. The uncertainty relates to the volume of boxes that require replacement. We have undertaken a pilot survey, and assessed information from other companies.</p>

## 5. Price control deliverables

Ofwat response	Southern Water reply
<b>Ofwat discretion in PCD framework:</b> <ul style="list-style-type: none"> <li>Ofwat disagrees with SRN's proposal that a non-delivery PCD would only be engaged where a company has failed to commence or cancelled delivery of a specified output. It states that where companies are 'slightly late' in delivering an output it will withhold a claw-back and apply late delivery</li> </ul>	<ul style="list-style-type: none"> <li>The application of the claw-back mechanism is entirely at Ofwat's discretion and can be flexed when it wishes. This was also made clear by Ofwat's comments at its initial presentation to the CMA on 8 May.</li> <li>It is wholly unreasonable for companies to face such regulatory uncertainty on the application of non-delivery PCDs.</li> </ul>

<sup>38</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, paragraph 4.52-4.57

<sup>39</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, paragraph 4.87

<sup>40</sup> Ofwat, April 2025, PR24 redetermination, Expenditure allowances – cost adjustment claims, pages 51-52

<sup>41</sup> Ofwat, April 2025, PR24 redetermination, Overview of Ofwat's responses to the statements of case, page 34-35

<sup>42</sup> Ofwat, April 2025, PR24 redetermination, Response to Southern Water's statement of case, pages 33-36



penalties but where a company is 'significantly late' it reserves the right to apply a claw-back. <sup>43</sup>	
<b>Delivery delays agreed with other regulators:</b> <ul style="list-style-type: none"> <li>Ofwat dismisses SRN'S concern that the PCD framework could lead to misalignment between delivery dates set under the PCD framework and those agreed with other relevant quality regulators. Ofwat states that it is for its "<i>fellow regulators to determine the appropriateness of agreeing to delays to scheme delivery to meet their own requirements</i>".<sup>44</sup></li> </ul>	<ul style="list-style-type: none"> <li>We do not find Ofwat's position to be rational. In its recent April 2025 'Regulating for investment and outcomes in the water sector' Report, the National Audit Office (NAO) recommended that to improve future planning and price reviews, the "<i>EA, Ofwat and DWI should align deadlines and limit inconsistencies in planning timelines and assumptions</i>".<sup>45</sup></li> </ul>
<b>Storm overflows PCD:</b> <ul style="list-style-type: none"> <li>Ofwat dismisses SRN'S concern about the lack of a clear and established methodology for calculating and measuring the delivery of equivalent storage outputs for non-storage solutions and states that it has provided a hydraulic model methodology as part of the FD.<sup>46</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat's methodology fails to account for the difficulties in adopting a single hydraulic model across all overflows and does not reflect the reality of spill frequency and overflow monitoring. A large discrepancy between Event Duration Monitor data and model data can still exist.</li> </ul>

## 6. PCs and ODIs

6. Ofwat has failed to achieve an overall balance between risk and reward under the PR24 framework and to engage in the granular issues raised by SRN in respect of specific PCs and ODIs. In particular, Ofwat has failed to properly engage with key evidence we provided regarding the risk of exogenous impacts as well as other key third party evidence.<sup>47</sup> It also fails to take account of company specific and regional factors.
7. We address further specific concerns in the table below:

Ofwat response	Southern Water reply
<b>WSI – PCL:</b> <ul style="list-style-type: none"> <li>Ofwat rejects our SoC proposal and states that companies should bear the risk of external factors beyond its control.<sup>48</sup> It also acknowledges that that only four companies have met the WSI PCL in 2023-24.<sup>49</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat provides limited rationale for why the methodology underpinning this PCL diverges from the approaches applied to other PCs which make use of recent outturn performance<sup>50</sup> – despite acknowledging current underperformance against this PCL.</li> <li>Ofwat has already recognised that setting a forward-looking performance challenge based on a PR19 ambition means the sector would likely immediately underperform from the start of AMP8.<sup>51</sup></li> </ul>
<b>CRI – deadband / collar:</b> <ul style="list-style-type: none"> <li>Ofwat rejects our collar proposal and considers that the deadband in place provides sufficient risk protections.<sup>52</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat fails to acknowledge that our CRI score will remain inflated and unamendable through the assessment score multiplier until 2030 because of DWI investigation notices.<sup>53</sup></li> </ul>

<sup>43</sup> Ofwat, April 2025, PR24 redeterminations, Expenditure allowances – common issues, paragraphs 7.20 and 7.26.

<sup>44</sup> Ofwat, April 2025, PR24 redeterminations, Expenditure allowances – common issues, paragraph 7.24.

<sup>45</sup> National Audit Office, '[Regulating for investment and outcomes in the water sector](#)', 25 April 2025, paragraph 25(e).

<sup>46</sup> Ofwat, April 2025, PR24 redeterminations, Expenditure allowances – common issues, paragraphs 7.148 – 7.153, 5.158 – 7.161.

<sup>47</sup> For example, see [Utility Week Intelligence and Marsh McLennan, April 2025, UK utilities risk report 2025](#).

<sup>48</sup> Ofwat, April 2025, PR24 redeterminations, Response to Southern Water's statement of case, page 77.

<sup>49</sup> Ofwat, April 2025, PR24 redeterminations, Response to Southern Water's statement of case, page 79.

<sup>50</sup> See Southern Water, March 2025, Statement of Case, pages 386 – 388; South East Water, March 2025, Statement of Case, pages 68 – 72; and Anglian Water, March 2025, Statement of Case, pages 149 – 150. Each provides evidence of Ofwat's failures to use recent industry outturn data and that exclusions are clear sector issues.

<sup>51</sup> Ofwat, December 2024, PR24 Final Determinations: Delivering outcomes for customers and the environment, page 19.

<sup>52</sup> Ofwat, April 2025, PR24 redeterminations, Response to Southern Water's statement of case, pages 85 – 86.

<sup>53</sup> See Southern Water, March 2025, Statement of Case, pages 389 – 390 and DWI, August 2018, Compliance risk index, SOC-6-0027.

<b>Total Pollutions – PCL:</b> <ul style="list-style-type: none"> <li>Ofwat states that it may reset aspects of the Total Pollutions PC subject to the outcome of the EA's consultation into EPA reporting requirements under its change control process.<sup>54</sup></li> <li>Ofwat states that SRN does not provide compelling evidence to support a less stretching PCL and incentive rate.</li> </ul>	<ul style="list-style-type: none"> <li>The FD change control process does not guarantee that Ofwat consult on modifications to reflect EPA changes.</li> <li>Ofwat has provided little evidence as to why it rejects using recent outturn performance (23/24) to develop PCL and reject our arguments around exclusions.</li> <li>The remedy for the correct ODI rate in our SoC was targeted at a specific error in the calculation. Ofwat have not recognised this error, as the definition has changed over time and using PR19 data is more reflective of the current PR24 definition.</li> </ul>
<b>C-Mex – PCL:</b> <ul style="list-style-type: none"> <li>Ofwat rejects our concern regarding the decline in the long-term trend between the sector median and UKCSI all sector average and states that (i) its downward adjustment of 5 addresses our concern; and (ii) our proposed adjustments do not take into account expected performance improvement across PR24.<sup>55</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat fails to acknowledge the continued deterioration in the UKCSI water sector average performance vs the all-sector average, as shown in the latest UKCSI report from January 2025.<sup>56</sup> The next report will be published in July 2025 and should be taken into account in the CMA's redetermination.</li> <li>Ofwat fail to take into account that the revenue at risk is disproportionate compared to the scale of the respective retail activity and is not reflective of a competitive market outcome. Ofwat reference maximum D-Mex exposure reached -0.2% RoRE in PR19 which was based on 12% developer service revenue. It fails to consider the current incentive is almost triple this at 33% of developer service revenue and significantly more than other PR24 PCs.</li> </ul>
<b>Storm Overflows</b> <ul style="list-style-type: none"> <li>Ofwat states if we provide additional evidence on WINEP delivery then the CMA could consider this PCL adjustment.<sup>57</sup></li> </ul>	<ul style="list-style-type: none"> <li>Our storm overflow program in the WINEP is concentrated on shellfish areas as opposed to spill reductions; this proves that high spill overflows are the focus of our 2030 and 2035 deadlines.</li> </ul>

## 7. Weighted Average Cost of Capital (WACC)

8. This section addresses Southern Water-specific factors not covered in Joint Reply.

Ofwat response	Southern Water reply
<b>Ofwat is wrong to view its FD as investable</b>	
Ofwat's regulatory decisions had no role in the rating downgrades of the sector. <sup>58</sup>	<ul style="list-style-type: none"> <li>Investors, rating agencies and the NAO have all stated that the regulatory framework has worsened investor perception of the sector. It is not clear how much rating agencies need to downgrade the sector before Ofwat accepts there is a problem with the framework.</li> <li>Only a few companies who have outperformed (for now) have avoided downgrades, due to the deteriorating regulatory framework.</li> </ul>
The requirement for new equity could mostly be met by restricting dividends. <sup>59</sup>	<ul style="list-style-type: none"> <li>It is not clear if this is correct, particularly in the context of Ofwat's reduction to notional gearing from 60% to 55%.</li> <li>This will only further the investor concern that equity investment into water companies has essentially become an investment into capital appreciation i.e. an assumption of dividends at some point in the future, which in turn relies on trust in the future regulatory framework.</li> </ul>

<sup>54</sup> Ofwat, April 2025, PR24 redeterminations, Response to Southern Water's statement of case, pages 56 – 60.

<sup>55</sup> Ofwat, April 2025, PR24 redeterminations, Response to Southern Water's statement of case, page 97.

<sup>56</sup> Southern Water, March 2025, Statement of Case, pages 401 – 404; South East Water, March 2025, Statement of Case, pages 74 – 76; and [The Institute of Customer Service, January 2025, UK Customer Satisfaction Index](#).

<sup>57</sup> Ofwat, April 2025, PR24 redeterminations, Response to Southern Water's statement of case, page 72.

<sup>58</sup> Ofwat, April 2025, PR24 redeterminations, Overview of our response, para 4.43

<sup>59</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 9.24

	<ul style="list-style-type: none"> <li>The consequence of no net dividends is a higher CoE, especially as investor trust in the regulatory framework is at an all-time low as demonstrated by e.g. rating downgrades of the framework.</li> </ul>
<b>Ofwat has dismissed our request for a cost of embedded debt sharing factor</b>	
<ul style="list-style-type: none"> <li>We have asked for a company-specific adjustment (CSA) on the cost of embedded debt.<sup>60</sup></li> </ul>	<ul style="list-style-type: none"> <li>We have not asked for a CSA; we have asked for a sector-wide sharing factor. Our request has the effect of narrowing the distribution of out/under-funding positions across the sector.</li> <li>Ofwat does not disagree with our specification of a sharing factor: "... if such a policy were adopted, at very least, it should apply symmetrically to all companies including to share outperformance"<sup>61</sup>. Our sharing factor is applied to the sector and is based on symmetric sharing across companies (rather than with customers).</li> <li>Ofwat recognised the benefits of cost of debt sharing at PR19.</li> </ul>
<ul style="list-style-type: none"> <li>Our cost based on trailing averages of the benchmark index is lower than the allowed cost of embedded debt.<sup>62</sup></li> </ul>	<ul style="list-style-type: none"> <li>This misses the key point for why a sharing factor is required: companies do not issue 20Y benchmark debt every day over 15/20Y. For perspective, we have 23 active pure debt instruments which have been issued over 22Y.</li> <li>We have point in time risk as interest rates are fully outside of our control and our ability to control timing of issuance is constrained. Our performance is also affected by regulatory policy over time which is fully outside of our control.</li> </ul>
<b>Ofwat has dismissed our request for a company-specific share of new debt</b>	
<ul style="list-style-type: none"> <li>This request was not raised during the PR24 process.<sup>63</sup></li> </ul>	<ul style="list-style-type: none"> <li>This is not correct as we requested this in our BP: <i>"For our view on an appropriate Southern Water cost of capital, we have used...as the ratio of embedded to new debt considering the scale of our enhancement programme and corresponding RCV growth"</i><sup>64</sup>.</li> </ul>
<ul style="list-style-type: none"> <li>Awarding a company-specific share of new debt is complex<sup>65</sup> and the impact of it is not material across the sector.<sup>66</sup></li> </ul>	<ul style="list-style-type: none"> <li>We have asked only to reflect our company-specific RCV growth rate. This is not at all complex to implement and Ofwat has all the necessary data for this in its financial models.</li> <li>In our case, it is material as we have the largest capital programme across the sector in terms of RCV growth.</li> </ul>
<ul style="list-style-type: none"> <li>Awarding a company-specific share of new debt increases customer exposure to each company's financing choices.<sup>67</sup></li> </ul>	<ul style="list-style-type: none"> <li>Our RCV growth is completely outside of our control as it is driven by mandatory requirements.</li> </ul>
<b>Ofwat has dismissed our request to maintain notional gearing at 60%</b>	
<ul style="list-style-type: none"> <li>High inflation observed in AMP7 supports deleveraging of the notional company.<sup>68</sup></li> </ul>	<ul style="list-style-type: none"> <li>Ofwat has now recognised that totex overspend across the sector was driven by high inflation and pressure on input prices<sup>69</sup>. Thus, the notional company could not have used high inflation to reduce gearing as it funded totex overspend.</li> </ul>

<sup>60</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 4.18

<sup>61</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 7.19

<sup>62</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 4.20

<sup>63</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 4.71

<sup>64</sup> Southern Water, October 2023, SRN64 Cost of Capital Technical Annex, page 9

<sup>65</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 4.72

<sup>66</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 4.71

<sup>67</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 4.72

<sup>68</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 3.14

<sup>69</sup> Ofwat, April 2025, PR24 redeterminations, Common issues on risk and return, para 2.16