south east water

PR24 Redetermination

Reply to Ofwat's Response

27 May 2025

South East Water
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1 Main themes

Ofwat does not engage with SEW's case

1.1 Ofwat's Response (the **Response**) is extensive – over 1,000 pages in total. It does not, however, engage meaningfully with our Statement of Case (**SoC**) or the challenges that we face in our appointment area. Instead, it repeats points made in the PR24 FD, mischaracterises our position, and dismisses relevant consideration of its statutory duties as mere disagreements with its exercise of regulatory discretion.[1]

1.2 It is not possible, within a 10-page limit, to address all of the material issues raised. This Reply therefore focuses on addressing main themes and points and we request that the CMA ensures adequate opportunity for us to respond to Ofwat's wider submissions within the remainder of its process, e.g. at Main Party hearings and/or as part of the RFI or Working Paper process.

1.3 Above all else, Ofwat's Response again fails to take proper account of company-specific circumstances, and the real-world operational challenges we face in ensuring water security for our customers. Our SoC set out key, company-specific context explaining why our PR24 FD would not have been financeable or deliverable. Ofwat does not address this totality, focusing instead on discrete building blocks in individual silos, and exhibiting a one-size-must-fit-all attitude in the way in which it insists we should be viewed and regulated (including misplaced comparisons with Affinity and Severn Trent). This side-steps the practical realities of running our network and addressing the challenges posed by its limited interconnectivity, the unanticipated step-change in demand, increasing frequency of extreme weather events, and resulting reduction in headroom and network capacity. We have raised our concerns with this approach with Ofwat during the PR24 process and are disappointed to see the same pattern continuing now.[2]

1.4 Ofwat's Response also mischaracterises SEW's position. For example:

Table 1: Addressing Ofwat's mischaracterisations

Ofwat Response	SEW's Position
PR19 under-delivery and retrospective decision-making: SEW has underspent its enhancement allowance during the 2020-24 period by 7% (£11 million).[3]	This is partial and misleading. Our AMP7 underspend on enhancement is driven by efficiencies on our WINEP programme, not under-delivery. We have overspent on resilience enhancement schemes during the same period and, importantly, forecast overall PR19 totex overspend of **£96.3m**. Ofwat's approach to disallowing costs based on supposed PR19 overlap is an arbitrary, asymmetric and retrospective regulatory intervention inconsistent with the principles of the PR19 price control.[4]
Costs allowances: SEW has increased its overall requested costs by £129 million since the DDR.[5]	Our SoC and previous PR24 submissions are consistent. Our enhancement cost submissions to the CMA were £4.4m less than at DDR, explained by a reduction in the request for water efficiency of £13.5m and two new PFAS requests post PR24 FD, totalling £9.1m. We have agreed that one of those PFAS requests ([redacted]) can be deprioritised and covered by the PFAS uncertainty mechanism, so our request is now £8.7m lower than at DDR. Ofwat misinterprets our case on enhancement costs: our SoC expressly requested that the CMA fund our proposed enhancement costs in full, rather than using Ofwat's contingent allowance mechanism.[6] As the £50m contingent funding is not certain, we have removed it from the funding request in our SoC. As explained in our SoC, our base cost submissions to the CMA are £54m higher than at DDR to capture the difference between the mains replacement rate assumed in our plan (0.28% p.a.) and the mains replacement rate that we are now required to deliver (0.43% p.a.). Ofwat has not provided its calculations, so its basis for the £129m gap is unclear.[7]
Deliverability: SEW stands to earn net outperformance payments of £3.2m in AMP8 simply by achieving PCL forecasts in their representations.[8]	This is misleading and incorrect. Aggregating individual ODI outcomes assumes perfect correlation across all PCs, which is statistically incorrect and overstates total potential rewards. In addition, our DDR outcomes performance forecasts were based on our proposed cost allowances and PCLs (including extreme weather exclusions). Given the significant reductions in cost allowances and excessively stretching PCLs in the PR24

1 Ofwat, April 2025, PR24 redeterminations - overview of our response to the statements of case, paragraphs A1.4-A1.5.

2 SEW, August 2024, Draft Determination Response Executive Summary (**SEW091**), page 6.

3 Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraph 3.25.

4 SEW, March 2025, Statement of Case, paragraph 4.26.

5 Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraph 4.5; PR24 redeterminations – expenditure allowances – common issues, paragraph 2.11.

6 SEW, March 2025, Statement of Case, paragraph 4.55.

7 All SEW figures quoted are pre-frontier shift and real price effects.

8 Ofwat, April 2025, PR24 redeterminations - overview of our response to the statements of case, paragraph 4.26; Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraph 3.26.

Ofwat Response	SEW's Position
	FD, KPMG's analysis shows significant negative penalty risk on ODI performance in the base case.[9]
Water supply interruptions: SEW's performance issues are due to its past investment decisions, and failure to conduct root cause analysis.[10]	Our SoC provides a detailed explanation of the unique, company-specific challenges we face[11] including, at Annex F, a root cause analysis of these challenges, consistent with previous representations made to Ofwat. See for example our Resilience Strategy which was submitted to Ofwat with our DDR.[12]
Financeability: SEW's challenges in raising equity are the result of its past financing choices and ongoing performance challenges.[13]	We have not suggested that the financeability assessment should take account of actual company circumstances. Rather, our analysis shows that the PR24 FD does not allow a notional company operating in our region to achieve the target credit rating. We also note that Ofwat does not engage with the clear and abundant evidence that increased risk in the water sector, and weakening of the quality and supportiveness of the regulatory regime, is impacting on the credit quality of the sector.[14]
SEW's recent equity raise indicates that the PR24 FD is financeable.[15]	Recent equity investments by our existing shareholders – including £200m in May 2025[16] – have been made to maintain financial resilience, in view of change in rating agency guidance and risk facing the industry, and to improve our liquidity position.[17] They reflect a difficult choice, focus on the long-term, and some residual faith in the broader UK regulatory system – but are certainly not a validation of the PR24 FD.[18]

1.5 Ofwat's Response continues to advance the model-driven approach which underpinned the PR24 FD – across areas including base cost models, benchmarking of bespoke enhancement cost proposals and the Outcomes package. Rather than asking what is right for our region, circumstances and customers, Ofwat focuses on a set methodology and common principles. Ofwat also states that companies should not *"blame weather, third parties or external factors"* – but this is not a matter of "*blame*".[19] Ofwat's position that companies must shoulder the burden of external risks, even where they have no ability to control them and the funding allowed is insufficient to enable effective mitigation, is inconsistent with its statutory duties and the approach in other sectors. Our request – based on our root cause analysis – is that the regulatory framework fund us adequately to address the risks posed by the relevant external factors.

Ofwat does not address submitted evidence and introduces new evidential requirements

1.6 In many areas, Ofwat's Response does not take account of evidence previously submitted, either in our SoC or during the PR24 process. In other areas, Ofwat introduces new evidence and seeks to shift the evidential requirements to establish the need for, or efficiency of, our proposals. For example: for our leakage enhancement claim, Ofwat has introduced new arguments including a comparison of PR19 and forecast unit costs;[20] and for our service reservoirs claim, Ofwat has introduced a new assertion that increasing storage at existing sites should have lower costs than developing new service reservoirs, which is demonstrably untrue.[21] Whilst we cannot provide additional evidence within the 10-page limit for this Reply, we are confident that the evidence is available to address Ofwat's new points and justify our cost submissions. We will be happy to provide this information on the CMA's request.

1.7 Meanwhile, Ofwat has also proposed that the CMA set a cut-off date limiting new information in the redeterminations to that which was available to Ofwat when setting the PR24 FD, or which has subsequently become available and could not reasonably have been provided earlier.[22] Ofwat's proposal is at odds with the CMA's published guidance and past practice in water redeterminations, and more broadly inconsistent with the statutory duties applicable to redeterminations under the Water Industry Act 1991.[23]

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9 SEW, March 2025, Statement of Case Annex H, Table ANH1.
10 Ofwat, April 2025, PR24 redeterminations – expenditure allowances – common issues, paragraph 4.92.
11 SEW, March 2025, Statement of Case, section 2; Statement of Case Annex F.
12 Submitted to the CMA as SEW097.
13 Ofwat, April 2025, PR24 redeterminations - overview of our response to the statements of case, paragraph 4.44.
14 SEW, March 2025, Statement of Case, paragraphs 6.18, 7.37.
15 Ofwat, April 2025, PR24 redeterminations – risk and return – common issues, paragraph 1.4.
16 Result of Equity Issue - 14:00:00 15 May 2025 - 53HO News article | London Stock Exchange.
17 SEW, March 2025, Statement of Case, paragraph 2.55(e).
18 SEW, March 2025, Statement of Case, paragraph 1.26; page 85.
19 Ofwat, April 2025, PR24 redeterminations - overview of our response to the statements of case, paragraph 3.3.
20 Ofwat, April 2025, PR24 redeterminations – expenditure allowances – common issues, paragraph 4.54.
21 Ofwat, April 2025, PR24 redeterminations – expenditure allowances – common issues, paragraph 4.94.
22 Ofwat, May 2025, Response to disputing companies' submissions on other companies' statements of case, page 3.
23 See: CMA, December 2024. Water References: Competition and Markets Authority Guide CMA205, paragraph 3.10, and CMA, CMA approach to water redeterminations, paragraph 58, June 2020.

On Water Supply Interruptions (WSI) Ofwat attacks a straw man and draws flawed conclusions

1.8 Our SoC provides a detailed root cause analysis of the challenges we face on WSI performance. Ofwat's Response does not engage meaningfully with this evidence, and instead attacks a straw man, arguing: *"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".*[24] Our SoC did not propose an extreme weather exclusion. As explained below, Ofwat's approach to the WSI PCL is disconnected from other parts of the price control, including its assessment of enhancement costs and its financeability assessment.

1.9 Ofwat also draws flawed conclusions:

(a) Ofwat cites average annual PCC data and argues that reductions from Covid-19 peaks in the last three years show there has not been a sustained increase in demand in SEW's area.[25] This does not engage with the submission in our SoC that the key increase is to <u>peak</u> consumption (i.e. ADPW).

(b) Ofwat states that, as SEW has been in its current form for 18 years, the company should have resolved any interconnectivity issues. As set out in our SoC, SEW has invested to improve interconnectivity in previous AMPs (despite not being fully funded by Ofwat at PR14 and PR19 for sub-zonal schemes), but the resilience challenges posed by recent increases in demand and extreme weather events since 2020 could not reasonably have been anticipated.[26]

(c) Ofwat states Figure ANF9 of SEW's SoC shows that *"40% of serious incidents still occur in regions with high sub-zonal interconnectivity"* and other strategies within management control to reduce WSI should be taken, despite failing to clearly identify them.[27] However, contrary to Ofwat's positioning, Figure ANF9 shows the strong link between interconnectivity challenges and WSI; and it does not follow from Ofwat's observation that alternative effective strategies are available.

(d) Ofwat alleges that SEW can improve its WSI performance via operational changes.[28] Ofwat recognises that we are undertaking various operational actions,[29] but vastly overstates the impact of such measures which, in turn, underlines its failure to understand our root cause analysis and the challenges we face. The identified measures have already been factored into our analysis of expected performance.

Ofwat does not consider financeability and deliverability 'in the round'

1.10 Ofwat's Response does not critically assess the deliverability and financeability of the PR24 FD 'in the round'. As set out in our SoC, the overall 13% funding gap we face, combined with larger gaps of 50-60% in key areas for water security, significant penalties for WSI in the base case, and a material imbalance in risk and return, means that the PR24 FD is neither financeable nor deliverable, and leaves us needing 'everything to go right'. This creates unacceptable water security risks for our customers in the short and longer term.

1.11 We address key points from Ofwat's Response under each of the main building block headings below (save for asset health, frontier shift, cost of capital and financeability, which are addressed separately in the Joint Reply made on behalf of all Disputing Companies (**Joint Reply**)). **Table 2** then summarises SEW's position on a wider range of issues arising from Ofwat's Response.

2 Costs

Base costs

2.1 We have highlighted several material errors relating to Ofwat's assessment of base costs. These relate to: (a) the inability of the base cost models to accurately reflect cost pressures relating to topography, population growth and water treatment complexity; and (b) the insufficiency of the cost adjustment claims (**CACs**) and post-modelling adjustments to capture SEW-specific cost pressures.

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24 Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraph 4.226.

25 Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraphs 4.231-4.232.

26 Ofwat has also struggled to assess our network capacity enhancement schemes in the past due to the absence of resilience standards: see SEW, March 2025, Statement of Case, paragraph 2.44.

27 Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraph 4.235.

28 Ofwat, April 2025, PR24 redeterminations – response to South East Water's statement of case, paragraph 4.238.

29 See SEW, August 2024, PR24 DDR – Operational Effectiveness (**SEW096**).

2.2 Ofwat has not engaged with a number of arguments outlined in our SoC, including:[30]

(a) the rationale for using the benchmarking period rather than the full modelling period for calculating the implicit allowance for the post-modelling adjustments;

(b) the range of evidence (including bottom-up modelling and comparisons to the wastewater sector) supporting our CAC on WTW-level economies of scale;

(c) the quantitative evidence that we used to suggest that the upper quartile benchmark is overly stringent, given the quality of the models; and

(d) the statistical quality of our proposed base cost models e.g. modelling treatment complexity.

2.3 We strongly disagree with Ofwat's proposal to deprioritise the base cost models – which are a critical component of the price control accounting for c.58% of totex allowances. Several Disputing Companies have raised material objections to the base cost models and we note that some of our requested changes were investigated by the CMA at PR19 as potential remedies. As explained in our SoC, flaws in the base cost models risk underfunding efficient real-world costs and undermining our capital maintenance programmes, leading to increased risk of asset failure and ultimately increasing water security risks. This risk is exacerbated by Ofwat's application of base PCDs, which restricts our ability to target spending where it is needed most.

2.4 Econometric models are an imperfect approximation of the real world and what factors drive expenditure. Our expenditure is driven by topography (the physical vertical distance that we need to move water in order to move it from the source to the customer's tap); population growth (the more customers are added to an existing network the more it becomes 'congested' and must be run at higher cost, with water moved greater distances and expensive sources in constant use because there is no flexibility to rest them); and water treatment complexity (the more treatment processes are needed, the more cost is incurred in power, chemicals, operational supervision and equipment maintenance). A failure to properly control for these factors means that we are underfunded to deliver the base level of service to customers.

Enhancement costs

2.5 We welcome the fact that Ofwat's Response largely accepts our evidence on service reservoir costs, trunk main meters as part of our smart network case, and our Poverty Bottom resilience interconnector scheme.

2.6 In addition to the points in **Table 2**, we note that:

(a) In many areas, Ofwat changes the goalposts by asking for new evidence and raising new points. As set out above, we have the necessary evidence available and are happy to provide this on the CMA's request.

(b) Ofwat has not addressed some of the key points in our SoC and retrospectively presented its assessment in a different way, e.g. where the deep dives lead to 10% or 20% cuts in our costs, Ofwat now presents these as an uplift from the benchmark rate (e.g. WINEP investigations).

(c) Ofwat does not justify its approach in some places, e.g. the choice of the benchmark for high performers on leakage.

(d) There are a high number of factually incorrect assertions in Ofwat's Response, e.g. Ofwat states we have management control over [redacted] (for the River Medway Scheme enhancement case): the relevant Act of Parliament and associated agreement confirm we do not.

3 Outcomes

3.1 Ofwat's Response mainly focuses on our past WSI performance and does not engage with our root cause analysis – which is clearly linked to the investments we propose in our plan – and the operational activities we are undertaking. We disagree with Ofwat on the reasons for our past performance and how we can deliver improvements over the next five years. In **Table 2**, we reply to specific points made by Ofwat (including on C-Mex). We also have an active asset maintenance programme which is targeted at addressing supply interruptions relating to asset health. Based on this programme, we met our unplanned outage ODI target every year in AMP7. However, effective asset health initiatives are not able to materially influence our WSI

[30] SEW, March 2025, Statement of Case, paragraphs 4.25; 4.33; 4.14; 4.19.

ODI performance, which is instead driven by the external factors discussed in our SoC, which Ofwat does not properly take into account.

3.2 We also disagree with Ofwat's overarching position on WSI as it is disconnected from other parts of the price control:

(a) Ofwat has allowed enhancement expenditure across several areas (e.g. service reservoir upgrades, interconnectors, WTW upgrades, etc.) based on the need to deliver a step-change improvement in resilience and reduce WSI. Ofwat has also set PCDs for many of these schemes with a delivery date at the end of the AMP, recognising the time it takes to make the necessary investment. This must be contrasted with Ofwat's statements that operational changes could lead to a short-term improvement in SEW's WSI performance from Day 1 of AMP8.

(b) Moreover, Ofwat does not consider the implications of its risk allocation on WSI as part of its notional financeability and financial resilience assessment. Ofwat assumes on the one hand that performance commitments should be calibrated based on company-specific historical performance to create the right incentives, and on the other hand that the corresponding downside risk exposure is not relevant to its financeability assessment of the notional firm. Our analysis clearly shows that supply interruptions could breach the -2% RoRE collar driven by factors outside of our control – and a downside shock of this scale on a single ODI would result in a multi-notch downgrade and seriously jeopardise our financial resilience. Setting the WSI collar at -2% is inconsistent with the financial resilience of the notional firm operating in South East Water's region.

3.3 In addition, Ofwat considers that exogenous factors beyond the company's control are irrelevant to the calibration of the WSI PCL, arguing that operational mitigations can be deployed to fully offset their impacts. This contravenes best practice on risk allocation, including relevant Cabinet Office guidance.[31]

4 Risk & Return

Allowed return on equity

4.1 Ofwat's defence of its CPIH + 5.1% allowed return on equity repeats the mistakes that compromised its work throughout PR24. In particular, Ofwat continues to treat the estimation of the risk-free rate, the expected market return and beta as separate, self-contained academic exercises and fails to 'look up from the page' and ask if its calibration of the allowed return makes sense in the round in light of everything it is currently able to see and hear about risk, returns and investability.

4.2 All the available triangulations tell us that Ofwat's PR24 FD, let alone the lower numbers that it floats in its Response, is set in fundamentally the wrong place:

(a) Returns on other asset classes – as at 27 May 2025, investors can continue to lock in returns of over 5% by buying gilts and over 6% by buying investment-grade corporate bonds.

(b) NAO and Independent Commission reports – two independent reviews of Ofwat and the water sector have in April and February 2025[32] highlighted fundamental concerns about investor appetite for new water industry investments and recognise the increase in the risk that is faced by water companies.

(c) Rating agencies – the updated rating agency methodologies, referenced in our SoC, have pulled down company credit ratings based on downgrades of the regulatory framework.

(d) Cross-checks – the multiple cross-checks that are available to the CMA, notwithstanding their limitations and imperfections, continue to point directionally towards required returns in excess of CPIH +6%. Ofwat has set a hurdle rate for attaching weight to cross-check evidence which is too high and has in consequence failed to triangulate its estimate of returns against wider market evidence.

Company-specific adjustment on cost of debt

4.3 Ofwat does not properly engage with the arguments and evidence in our SoC on the consequences of infrequent debt issuance. As in the PR24 FD, Ofwat appears to accept the basic observation that a smaller

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31 Government Commercial Function, May 2021, Risk Allocation and Pricing Approaches, paragraph 2.2.2.

32 NAO, 25 April 2025, Regulating for investment and outcomes in the water sector; Independent Water Commission, 27 February 2025, Call for Evidence.

company that issued debt relatively infrequently faced heightened risk that it would end up borrowing in years when interest rates were particularly high or particularly low relative to the mean over a longer time horizon.[33] Ofwat does not, however, satisfactorily explain why that higher variance can now be ignored when the CMA sets an allowance for our cost of debt.

4.4 Our view remains that the risk we have been exposed to – and the crystallisation of that risk in an adverse way – must be recognised somewhere within the regulatory framework. The analysis that we presented to support our SoC was undertaken on a notional company basis and was based on the risk differential between a notional frequent and infrequent issuer. It found that a 30bps uplift to the cost of embedded debt would be appropriate. We think that assessing this on a notional basis saves the CMA from undertaking a very detailed forensic examination of how, when and why we have borrowed, and all the problems of hindsight that this would entail, while also enshrining the principle that appropriate allowance needs to be made for unavoidable costs incurred on customers' behalf, driven by our historical status as an infrequent issuer of debt.

Relevance of SEW's recent equity raises

4.5 Finally, Ofwat references recent equity raised as evidence that the PR24 FD is investable – including equity raised by SEW. However, Ofwat has mischaracterised the nature of our equity issuance. The £75m equity investment by our existing shareholders in December 2024 and the additional £200m equity investment by existing shareholders in May 2025, are to reduce gearing and support financial resilience. Effectively, our shareholders have had to choose between: (a) declining to invest additional equity, risking our credit rating dropping below investment grade and thereby triggering a downward spiral which could result in write-downs; and (b) investing additional equity based on an expected return that is currently below the return available elsewhere (but placing weight on the longer-term prospects for the sector, including through this CMA redetermination process). It is rational for investors to choose option (b) where that approach minimises economic losses compared to option (a). This says nothing about the financeability and investability of the PR24 FD and SEW's ability to secure additional equity to support necessary investment.

5 Financeability and investability

5.1 The Joint Reply explains how Ofwat: (i) mischaracterises sector-wide credit rating downgrades; and (ii) gives inadequate consideration to the notional company's financial resilience under its stress tests.

5.2 In addition, Ofwat has assumed (without evidence) that any consideration of company-specific risk factors introduces actual company poor performance or inefficiency into the notional financeability assessment. However, the analysis in our SoC clearly distinguished between our company-specific performance and risks which are either: (1) inherent to any notional company operating in our region; or (2) implied by the design and calibration of PR24 regulatory mechanisms. We showed that a notional company operating in our region is exposed to additional risk relating to: (i) water supply interruptions; (ii) leakage and PCC; (iii) degree of skew in the ODI package for a WoC; (iv) downward bias in C-MeX scores; (v) high operational gearing as a WoC; and (vi) infrequent issuance on embedded debt.

5.3 As a result, Ofwat omits relevant evidence from its financeability assessment and has not carefully considered whether downside risk exposure for a notional company in our region is excessive. A downside on WSI equivalent to -2% RoRE – the level of the WSI collar – on its own is enough to jeopardise the financial resilience of a notional company operating in our regions. Ofwat's proposed remedies to any financeability constraints fail to 'step back' and consider the implications of financeability tests for allowed returns and PR24 FD risk allocation in the round. This, in turn, undermines the important role financeability tests and risk analysis have in providing a meaningful and independent cross check of the PR24 FD.

33 KPMG, March 2025, PR24 Cost of Debt: Analysis of the Infrequent Issuer Premium (Figures 2 and 3). For Ofwat's position, see: Ofwat, May 2025, Risk and return – common issues, paragraph 7.9; Ofwat, December 2024, PR24 FD – Aligning risk and return - allowed return appendix, page 109; Ofwat, July 2024, PR24 DD: Aligning risk and return - Allowed return appendix, page 91.

Table 2: Ofwat's New Evidence and Arguments: SEW Reply

#	Ofwat Response Reference	Ofwat Response Submission	SEW Reply
Base costs			
1	Expenditure allowances – common issues, para. 2.74, 2.82 and 2.99.	Ofwat rejects some proposals due to immateriality, while also rejecting other proposals due to their material impact on allowances.	Based on this use of materiality, no company proposals would ever be accepted – regardless of the quality of the evidence supporting them. Our requested corrections to the base cost models are balanced and driven by economic principles, operational rationale and statistical evidence.
2	Expenditure allowances – common issues, para. 2.70.	Including properties in the Treated Water Distribution models would mean customers pay twice for network reinforcement due to separate base cost adjustment.	This is incorrect as the methodological issues with Ofwat's network reinforcement cost adjustment materially underfunds SEW to meet its expected activity at AMP8.
3	Expenditure allowances – common issues, para. 2.195.	Using the last five years to determine the implicit allowance for post-modelling adjustments could lead to perverse incentives.	This argument is not applied consistently across Ofwat's framework and implies that historical data from companies could not be used to inform regulatory parameters due to purported regulatory gaming. Companies were not aware of whether (or how) Ofwat would account for forward-looking cost pressures (such as mains replacement) before the PR24 DD, such that historical data could not feasibly have been tainted by regulatory gaming. Moreover, using industry-wide data limits the impact that any individual company has on the implicit allowance.
4	Expenditure allowances – common issues, para. 2.274.	Companies were funded to deliver the level of activity they outlined in their PR19 plans, given that the industry-wide challenge to companies' base expenditure requests was immaterial.	Companies make expenditure requests in light of performance targets they propose. The argument of an 'immaterial challenge' to companies' plans is misleading, as Ofwat made material challenges to companies' other proposals (e.g. in relation to performance commitments and enhancement requests). Companies challenged Ofwat throughout PR19 on a range of issues that they considered led to underfunding, including the cost–outcomes disconnect and insufficient protection against input price pressures.
5	Expenditure allowances – common issues, para. 2.293.	SEW's method for estimating implicit allowance in network reinforcement is invalid as some companies receive a negative implicit allowance in wastewater.	SEW is a WoC, so any potentially unintuitive findings in the wastewater models are irrelevant. Base cost models differ materially between the two services, as does the spend on network reinforcement. A negative implicit allowance can be a legitimate estimate of how much specific companies are funded for network reinforcement.
6	Expenditure allowances – cost adjustment claims, para. 12.16.	The size of WTWs is more operationally relevant for water resources plus (**WRP**) than for wholesale water (**WW**), so the WW models should not be used to estimate the WTW economies of scale CAC.	This is irrelevant as such an argument could be applied to any cost driver unique to a certain part of the value chain, including treatment complexity and topography. We acknowledged that WTW-level economies of scale were most relevant for WRP costs in our SoC. If the models were 'working well', we would expect the estimated coefficient on treatment works' size to be roughly half the magnitude in the WW models compared with the WRP models, which is consistent with our statistical analysis.
Enhancement costs[34]			
7	Expenditure allowances – common issues, para. 4.52, 4.57 to 4.59	**Leakage:** SEW has not provided sufficient evidence to demonstrate why its costs are efficient or why its 'hybrid' unit costs have increased since PR19. Ofwat therefore concludes the unit rates at FD are appropriate.	Ofwat's backward-looking unit cost analysis mixes and matches different activities (mains renewal and other leakage) to create an apples-and-pears comparison. No robust conclusion can be drawn from Ofwat's new analysis. This becomes even more apparent when extending the analysis to all water companies. Contrary to Ofwat's newly stated view, using the median unit cost from the sample of high-performing companies would be far less arbitrary than Ofwat's own approach of selecting, without any reason or justification, SES's unit cost as the benchmark, particularly given the wide spread of forecast data. Ofwat has retrospectively amended its FD methodology (which stated it used historical data to calculate the benchmark). 4.52 * / SEW182, 4.55 * / SEW156
8	"Response to South East Water's SoC" para. 4.24, 4.83 to 4.89	**Service reservoirs:** Ofwat states that based on evidence submitted with our SoC it would apply a 10% cost challenge for the cost difference between increasing storage vs building new service reservoirs.	We welcome Ofwat's acceptance of our benchmarking evidence. We do not agree with Ofwat's new claim that increasing storage at existing sites should have lower costs than developing new service reservoirs. We have further external evidence from ChandlerKBS that demonstrates this is not the case and are happy to provide this to the CMA on request.

[34] Green highlighting for enhancement lines provides the key references to areas where Ofwat has made claims that we have already addressed in our SoC (note that * refers to Ofwat's Response document on common expenditure allowance issues and † refers to Ofwat's specific response to our SoC). The second number (starting with SEW) references the paragraph in Annex G of our SoC.

#	Ofwat Response Reference	Ofwat Response Submission	SEW Reply
9	"Response to South East Water's SoC" para. 4.21, 4.66 to 4.82	**[redacted]:** Ofwat now requests new evidence such as a specific engineering feasibility study, the return period of the 2022 peak demand, and continues to question the need for [redacted] in the context of the AMP8 upgrade.	The requested additional evidence is available (except for a formal feasibility study, as we had a fully mobilised engineering team on site who developed the AMP8 options and preferred solution) and can be provided to the CMA on request. Ofwat seeks to bypass CMA scrutiny in the redetermination process by arguing that our proposed AMP8 investment at [redacted] could be assessed under the contingent allowance; we explain in our SoC why the contingent allowance mechanism is an inadequate solution (paragraphs 4.47 to 4.55). 4.72 † / SEW17
10	"Response to South East Water's SoC" para. 4.26, 4.74 to 4.82	**[redacted] River Medway:** Ofwat argues that we have "*management control*" over [redacted] and it would therefore be in customers' interests not to allow us the full contribution.	[redacted] is fully owned and operated by [redacted] and SEW has no control of costs. We can provide additional evidence to demonstrate this, based on the relevant Act of Parliament and associated supply agreement. 4.95 † / SEW275
11	"Response to South East Water's SoC" para. 4.22, 4.39 to 4.65	**Smart network:** Ofwat considers the smart network upgrade should be covered by base, highlighting other companies' schemes. It states we have not provided an evidenced case for the upgrade or justification for why this should be funded through enhancement costs. Ofwat accepts our request for meters on trunk mains.	We welcome Ofwat's acceptance of our proposed meters for trunk mains. For the remainder of the programme, Ofwat wrongly claims that an allowance is included in base: examples cited from other companies within base are only elements of a smart network and aren't comparable. Ofwat is also incorrect to state that we did not set out the benefits of the investment and does not address our previously submitted evidence in this regard. By Ofwat's own admission, the resilience investment delivers a step-change in our performance. Ofwat also introduces new, irrelevant points such as: the reasons for re-allocating costs; a misleading description of the option analysis we undertook; and a reference to our WSI performance in 2019/20. Ofwat states that our smart network proposals could be assessed under the contingent allowance; but we explain in our SoC why the contingent allowance mechanism is not an adequate solution (paragraphs 4.47 to 4.55). 4.49 † / SEW399, 4.45 † / SEW397, 4.63 † / SEW385-393.
12	Expenditure allowances – common issues, para. 4.109, 4.125 to 4.127	**WINEP investigations:** SEW has provided no evidence justifying its unit costs and has not demonstrated that its outturn costs were higher than is standard for water investigations in 2020-24.	We have additional evidence from AtkinsRéalis supporting our cost efficiency which can be provided to the CMA on request. 4.108-4.109 * / SEW371, 375; 4.124 * / SEW372
13	Expenditure allowances – common issues, para. 4.74, 4.79 and 4.82	**Water efficiency initiatives:** Ofwat states SEW's costs are higher than other water companies', and than costs in the previous period. It criticises the evidence SEW relies on as based on "*limited and outdated data*" and therefore believes it is not sufficient to justify its costs.	We have further available evidence supporting our choice of activities and demonstrating our costs are efficient (both top-down and bottom-up), including showing that our unit cost per activity is aligned with Ofwat's 2024 Artesia report.[35] Ofwat continues to wrongly assert that differences in unit costs represent differences in cost efficiency despite these being driven by the mix of activities. Ofwat's new evidence on PR19 outturn unit cost compared to PR24 is also irrelevant as the need for demand reduction is driven by our WRMP and the increase in demand reduction required, and therefore the PR24 programme will contain a different mix of activities compared to the PR19 programme. 4.74 * / SEW297&311, 4.79 * / 304, 4.82 * / SEW308
14	"Response to South East Water's SoC" para. 4.21, 4.156 to 4.173	**Resilience interconnectors:** Except for the [redacted] scheme, Ofwat maintains its cost challenge due to PR19 overlap and base overlap, and has requested a specific risk quantification for one scheme.	On PR19 overlap, customers will not pay twice for the same scheme and Ofwat mischaracterises its own PR19 price control: companies were required to deliver outcomes, not specific schemes. Ofwat's base overlap is not justified as we have available evidence that the need for investment is driven by a step change. 4.120 † / SEW106-107, 4.121 † / SEW88
15	"Response to South East Water's SoC" para. 4.150-4.151.	**Lead:** Ofwat claims that the DWI's undertaking was issued independently of knowledge of a significant enhancement request, or that customers would support this through enhancement.	Ofwat's claims about DWI's intentions regarding the undertaking contradict DWI's third party submission[36] which clearly states that the DWI applied the undertakings to *"safeguard the planned investments in lead mitigation which will still benefit the protection of public health"*. 4.152 † / SEW52-53, 4.154 † / SEW49-51

35 Artesia for Ofwat, 2024, Least cost compilation of water efficiency measures.

36 DWI, April 2025, PR24 Water price determinations third party submission, page 4.

#	Ofwat Response Reference	Ofwat Response Submission	SEW Reply
16	Expenditure allowances – common issues, para. 4.145 to 4.146, 4.154 to 4.156.	**Net zero:** Ofwat claims that opex savings cover capex for WTW, and the base cost adjustment for EV covers infrastructure upgrades. It also questions why emissions from production and transportation of liquid oxygen are not included in our analysis.	For ozone schemes we have already shown that the opex savings do not cover the capex over a reasonable time period. We can also show the cost adjustment for EV infrastructure upgrades does not cover the capex. AtkinsRéalis have advised that emissions from production and transportation of liquid oxygen are scope 3 emissions and therefore should not be included. 4.145 * / SEW334, 4.151 * / 338, 4.152 * / SEW339
17	"Response to South East Water's SoC" Para. 4.185 to 4.186, 4.187 Expenditure allowances – common issues, para. 4.137 and Figure 2727	**Raw water deterioration:** Ofwat recommends that both [redacted] and [redacted] are deferred to the 'PFAS reopener', states it cannot comment on costs for 5 catchment studies due to lack of evidence, and continues to consider a 10% cost challenge appropriate for [redacted].	We accept Ofwat's proposal to use the 'PFAS re-opener' for [redacted] and [redacted]. We have evidence available to support the costs relating to the five additional catchment studies, which has now been provided to the CMA and Ofwat. We disagree with Ofwat's conclusions on the new analysis for [redacted] as it shows that it is efficient compared to its nearest comparators in Ofwat's chart (Figure 2727). 4.136-4.137 * / SEW141, 9.31-9.32 * / SEW141
18	"Response to South East Water's SoC" para. 4.204	**Drinking water protected areas:** Ofwat retains the request of detailed cost sheets.	The detailed breakdowns that Ofwat requests are available and can be provided on request. 4.204 † / SEW322
19	"Response to South East Water's SoC" para. 4.21, 4.156 to 4.173	**SEMD:** Ofwat maintains that the submitted evidence does not demonstrate cost efficiency for all components of the scheme.	We have evidence available to respond to Ofwat's specific points on cost efficiency for components of the SEMD scheme, including benchmarking evidence demonstrating that our SEMD opex is efficient.
Outcomes			
20	"Response to South East Water's SoC" para. 4.233	**WSI:** Ofwat argues that our operational headroom fell below 0% only three times across the modelled horizon (2017-2024) and therefore is not a significant driver of risk.	Ofwat has misunderstood our headroom analysis. Regional averages mask sub-zonal deficits, and our statistical analysis shows that serious supply interruptions occur when headroom falls below the critical 5% threshold, well before reaching 0% level. As our SoC showed (Annex F), our headroom has a high correlation of 0.72 with occurrence of serious supply interruption incidents. The analysis shows that it fell below 5% around 400 times.
21	"Response to South East Water's SoC" para. 4.237	**WSI:** Ofwat claims our "non-delivery" of PR19 schemes has impacted our performance.	Under Ofwat's totex and outcomes regime, we have optimised our whole PR19 programme and are forecast to overspend our totex allowance by **£96.3m**. Ofwat has picked a small number of specific schemes that are not representative of our programme. These schemes would not have been in place until 2024 in any event so would not have had an impact on recent performance.
22	"Response to South East Water's SoC" para. 4.227; 4.239	**WSI:** Ofwat notes Affinity Water is a neighbouring company which is able to achieve upper quartile WSI performance, and that Severn Trent has improved performance over time.	Ofwat's comparisons with Affinity Water and Severn Trent overlook fundamental operational and structural differences between companies, and within companies' networks, e.g. neither of these companies needed to introduce TUBs in AMP7. The fragmented, geographically dispersed supply zones and significantly lower network interconnectivity in our Kent and Sussex regions (among other things) make the comparison wholly inappropriate.
23	"Response to South East Water's SoC" para. 4.235	**WSI:** Ofwat disputes the role of limited interconnectivity in driving poor performance, noting that 40% of serious incidents occurred in areas with relatively high sub-zonal interconnectivity.	First, this confirms that 60% of incidents occurred in areas with limited interconnectivity. Second, Ofwat fails to account for how interruptions are driven by multiple factors, (again not engaging with the wider water security picture) which interact with each other including operational headroom, network interconnectivity, and geography and which drive WSI risk exposure in our Kent and Sussex regions. For this reason, our water security investment proposals are not limited to interconnectivity improvements: each part of the "source to tap" system is important for improving water security (see Figure 2.2 in our SoC).
24	"Response to South East Water's SoC" para. 4.226	**WSI:** Ofwat claims we have responded poorly to severe weather events.	Ofwat's claim does not take into account evidence showing that more severe extreme weather occurred in AMP7 than had previously been anticipated (e.g. AtkinsRéalis' hot spells climate projection analysis, cited in our submission on other Disputing Companies' SoCs). Ofwat also fails to attach any weight to the 'lessons learned' exercises we have carried out in response to extreme weather incidents and our continuous work to improve.
25	"Response to South East Water's SoC" para. 4.214	**C-MeX:** Ofwat argues a company-specific PCL would be inappropriate.	Companies will still target the same levels of customer service; it is just the measurement of the PCL that will be adjusted to reflect regional biases.
26	"Response to Anglian's SoC", para. 7.59	**Leakage:** The CMA should consider if any amendments are needed to our AMP8 leakage PCL given we also had the PR19 clawback mechanism.	We agree that the CMA should consider whether a similar adjustment is necessary for SEW and update the enhancement cost allowance model for AMP8 to take into account SEW's 2024/25 leakage position.

#	Ofwat Response Reference	Ofwat Response Submission	SEW Reply
Risk and return			
27	"Risk and return - common issues" para. 4.21 to 4.22	SEW's higher gearing and lower credit rating impact its cost of debt performance and it is wrong to pass the effect of these financing choices to customers.	KPMG demonstrates that infrequent issuers of debt – like SEW – are exposed to increased point in time risk compared to frequent issuers of debt. We estimated the CSA on a notional company basis and this estimate is not contingent on our past financing choices. Notwithstanding this, Ofwat is wrong to assert without evidence that our credit rating has contributed to our cost of debt performance. A number of our instruments were wrapped and achieved AAA-ratings at issue. KPMG has shown that our cost of debt performance cannot be ascribed solely to our gearing (see paragraphs 5.5.11 to 5.5.16 and Appendix 2 of the Infrequent Issuer report, **SEW.KPMGB**).
28	"Risk and return - common issues" para. 7.12	Affinity Water, a company that is similar in size to SEW, has the lowest embedded debt costs in the sector.	Ofwat has not engaged with the points made by KPMG in section 5.5 of its Infrequent Issuer report. The fact that a company with similar characteristics to SEW enters AMP8 with abnormally low costs corroborates our view that smaller, infrequent issuers have historically faced much greater variance in possible interest rates.
29	"Risk and return - common issues" para. 7.19	Sharing of embedded debt costs would dilute incentives and expose customers to the cost of high-risk financial structures.	Ofwat mischaracterises our request of the CMA. We are not proposing a formal cost-/risk-sharing mechanism. Rather, we ask the CMA to consider whether the outturn consequence of our infrequent issuer characteristic should be borne solely by shareholders. To estimate the amount that could be borne by customers, KPMG priced the risk differential between a notional frequent and infrequent issuer as 30bps.
30	"Risk and return - common issues" para. 7.20	KPMG argues that differences in standard deviation of RoRE affects 'forward-looking' beta.	This is a mischaracterisation. Ofwat has previously objected to the position that the KPMG analysis shows that infrequent issuance risk is systematic and requires compensation. However, KPMG's work shows that the identified risk does have a systematic component. For the avoidance of doubt, now that we are becoming a larger, more frequent issuer, we are not saying that SEW's forward-looking beta is higher than other water company betas, nor that our risk profile is different. We are asking the CMA to ensure that the greater risk we have faced historically is recognised when calibrating the debt allowance.
31	"Risk and return - common issues" para. 7.24	SEW constrained its ability to issue more frequently through the choices made by management.	Ofwat has provided no evidential basis for this statement. Frequency of issuance is determined first and foremost by the starting RCV, the profile of RCV growth and the frequency with which debt requirements grew/grow to a benchmark size. Management cannot control the size of a company's underlying financing requirement.
Financeability and investability			
32	"Risk and return - common issues" para. 2.77	Moody's expect positive median performance, which would reduce RoRE for the sector without the OAM deadband.	Moody's analysis is based on our DDR, which does not represent a forecast of expected performance and cannot be compared to the median company's expected performance based on the PR24 FD. This analysis is not relevant for assessing the appropriateness of the deadband as it does not reflect an expected outcome.
33	"Risk and return - common issues" para. 2.80	The deadband is needed to preserve the negative skew on ODIs to maintain a balanced package by offsetting positive skew in financing.	This is based on Ofwat's flawed risk analysis. After correcting for the flaws identified in Ofwat's risk analysis, the OAM deadband would need to be removed to support the price control as a fair bet given the significantly negative expected performance.
34	"Risk and return - common issues" para. 2.69	Low retained risk on wholesale totex could lead to companies undertaking inefficient investment providing no value to inflate RCV and valuations.	This concern is not relevant for PR24 where we are delivering our largest ever capital programme. Much of the programme is driven by statutory requirements and, if not delivered, could drive fines and penalties. Companies will not have spare bandwidth to undertake inefficient projects.
35	"Response to South East Water's SoC" para. 3.32 to 3.33	Ofwat took SEW's DDR RoRE estimate and added improvements from the FD to recalculate RoRE. Ofwat estimates that SEW's RoRE P50 should be +0.1% with positive skew from -4.8% to 5.1%.	Ofwat's analysis is outdated and fails to capture the risk exposure arising from the PR24 FD: (1) the DDR baseline assumes risk mitigations which were not applied at PR24 FD, such as an extreme weather exclusion for the WSI ODI; (2) key drivers of risk such as WSI have not been accounted for and would drive expected losses; (3) the increased totex allowances reduced P50 exposure but increased delivery risk; and (4) PR24 FD analysis includes updated data which has been disregarded. As such, Ofwat's findings of positive skew and P50 RoRE are wrong.
36	"Risk and return - common issues" para. 10.21 to 10.34	SEW's historical capital structuring decisions impact its financeability and contribute to its inability to target the notional rating as set by Ofwat.	In setting out our financeability concerns, we have provided detailed evidence which shows financeability constraints for a notional company operating in our region. This analysis does not relate to our actual capital structure and indicates constraints on a notional basis.

south east water