Business Plan 2025 to 2030

Draft determination
Representation (SES101)
28 August 2024

1. Executive summary

In this section we provide an overview of the main areas on which we are making representations to Ofwat's draft determination of our PR24 Business Plan.

For each area we set out what was included in our PR24 plan, Ofwat's position in its draft determination and a summary of our response to its draft determination.

We also provide a guide to reading our draft determination response with links to all supporting documents and appendices.

A. Summary of our draft determination representation

1. In October 2023, we submitted our Business Plan for 2025 to 2030 to Ofwat. We set out an ambitious programme of activity to deliver improved outcomes for customers, the environment and wider society. Our plan reflects the priorities of our customers and is set in the context of a 25-year strategy, with the investment needed over the next five years critical to the delivery of our longer-term ambitions.
2. Ofwat has recognised the level of ambition we have shown through its Quality and Ambition Assessment (QAA) of our plan, rewarding us with 5bps return on regulated equity, equivalent to approximately £0.4m in AMP8.
3. To deliver our PR24 plan we consider that a total cost allowance of £413.9m is required. This represents a £13.3m per year increase from our current plan (PR19), which is being driven primarily by additional capex spending to deliver our smart metering programme and refurbish our water softening plant at Kenley Water Treatment Works.
4. The draft determination of our Business Plan reduced our proposed total expenditure allowance to £324.1m. This creates a significant £89.8m shortfall in the costs needed to run our day-to-day business, achieve higher performance standards and meet new legal and regulatory requirements. We have significant concerns with the allowed expenditure in the draft determination and conclude that a significant increase in funding is required at final determination.
5. In our response to the draft determination, we maintain that £413.9m is an efficient and appropriate spending allowance for us over the 2025 to 2030 period. We have focused our response on the targeted areas summarised in this document and provide more information and evidence to Ofwat in our supporting documents to support its final determination decision on our PR24 Business Plan.
6. Our PR24 plan was prepared and submitted while our previous shareholders were conducting a strategic review of their ownership of SES Water. In January 2024, Pennon Group plc ("Pennon Group") acquired East Surrey Holdings Ltd, the holding company of SES Water. This representation submission has been prepared on a standalone basis as the licence holder for our supply area. The financing aspects of the plan reflect commitments by Pennon Group as the company's new owner.
7. Since our Business Plan submission in October 2023, our performance has continued to be strong, as evidenced in our recently published APR 2024. We have continued to

deliver good results across many performance commitments including leakage, supply interruptions and biodiversity which supports our performance trajectory into AMP8.

Outcomes and incentives

Business plan submission

8. We put forward a well-considered and balanced outcomes package with appropriate outcome delivery incentives (ODI) attached to our performance commitments. The level and pace of improvement reflected the priorities of our customers and followed challenging but deliverable trajectories through AMP8 and beyond, in line with our long-term delivery strategy (LTDS) and Water Resources Management Plan (WRMP). We set ourselves challenging performance improvements from base expenditure and identified targeted enhancement funding to deliver a step-change in key areas including leakage and customer consumption reduction.

Ofwat's draft determination

9. Ofwat aligned its Performance Commitment Levels (PCLs) with the performance targets set out in our Business Plan in five areas – Compliance Risk Index, Leakage, Discharge Permit Compliance, Serious Pollution Incidents and Mains Repairs.
10. It reduced the PCL relative to what we proposed for Water Supply Interruptions, Unplanned Outage and Biodiversity and it increased the performance stretch beyond the level we presented for Water Quality Contacts, Greenhouse Gas Emissions, Per Capita Consumption (PCC), and Business Demand.
11. The ODIs Ofwat calculated for Discharge Permit Compliance and Water Quality Contacts have resulted in a significant level of downside skew to our incentive package creating an imbalance between risk and reward. The estimated average Return on Regulated Equity (RoRE) impact of our draft determination at the P10 level of performance is -5.56%. Specifically for Discharge Permit Compliance, a single failure at any of our sites would result in a pre-tax penalty of £13.91 million (2022/23 prices).
12. Furthermore, Ofwat proposed Price Control Deliverables (PCDs) for smart metering and water softening which result in an unacceptable level of risk.

Our response to the draft determination

13. We maintain our position that the PCLs and ODI rates that we put forward in our PR24 Business Plan deliver stretching performance and reflect our customers' priorities.
14. The performance levels we will deliver in AMP8 follow a trajectory that will enable us to achieve our long-term ambitions set out in our LTDS, delivering tangible and sustained improvements in performance. We therefore request that Ofwat makes a small number of targeted changes to the PCLs and ODI rates summarised below in its final determination of our plan:
    - **(a)** Set the PCL for PCC at 11% reduction from the 2019/20 baseline in-line with our WRMP – a well evidenced and customer-based plan, and introduce an uncertainty mechanism around delivery of government policy interventions;
    - **(b)** Set the PCL for Business Demand at 5% reduction from the 2029/20 baseline in-line with our WRMP;
    - **(c)** Set the PCL for water quality contacts at 0.58 contacts per 1,000 customers and change the ODI rate to £0.812m;
    - **(d)** Calculate the ODI rate for Discharge Permit Compliance so it mirrors a more normalised approach across the industry – reflecting a post-tax RoRE in the region of 0.03% to 0.15% per site failure for all WoCs: and

(e) Review and update its proposals on PCDs for metering and softening which, in their current form, are not appropriately specified.

15. While all these changes are necessary and important, the updates to the PCLs and ODI rates for Discharge Permit Compliance and Water Quality Contacts alongside reinstatement of cost allowances are the most critical for ensuring that we will face an acceptable balance of risk and reward in the forthcoming regulatory period.

Base cost allowance

Business plan submission

16. Our PR24 plan includes £323m to continue to deliver our core wholesale services and £35.9m for our retail services. Our ambitious ‘base’ spending plan included a 1.0% efficiency challenge, while at the same time delivering improved performance outcomes from our base expenditure, including continuing to improve our already upper quartile performance in areas of high importance to customers including water supply interruptions and leakage. It included five cost adjustment claims, including pumping costs (water resources and network plus), regional wages, water softening and retail costs, totalling £80.9m that predicated our base expenditure requirements.

Ofwat’s draft determination

17. Ofwat awarded us a £285.5m base cost allowance (wholesale and retail) in its draft determination. Our wholesale base allowance was £75.2m less than our Business Plan and Ofwat has not approved the majority of our cost adjustment claims (CACs), awarding only £18.7m for water softening.

18. Ofwat has also calculated future energy costs in a way that we do not consider to be appropriate and has not applied this to our CACs.

Our response to the draft determination

19. We have significant concerns with the base cost allowance in Ofwat’s draft determination. We have identified a series of representations on how we consider Ofwat’s base cost modelling needs to change at final determination to provide us with an adequate and efficient level of allowed totex that reflects our unique circumstances and the level of outcomes performance we will deliver from base in the next AMP.

20. We are proposing revised CACs of £46.2m specifically related to:

- The topography of our operating area and the impact this has on the relative volume of power consumption and pumping costs within our business relative to others in the sector (CAC1); and
- The additional costs we incur relative to others in the sector associated with softening the water that we provide to our customers – something we have a unique legal requirement to deliver (CAC2).

21. We have identified issues with the way in which energy cost (price) adjustments (EPA) have been calculated by Ofwat in its base allowances. This effects all companies but is likely to have a greater impact on us than most others as a result of our relatively high volume of power consumption related to the topography of our network. We have calculated the impact our representations on Ofwat’s energy price adjustment and true-up mechanism would have on our base cost allowance and estimate this provides an additional £23m of allowed totex.

22. We have assumed the additional funding we consider is required from Ofwat’s base modelling (to bring our overall base allowance into alignment with the efficient expenditure we forecast in our plan) will be provided by Ofwat in its final decisions and

updates to its wholesale base cost modelling. We identify several factors that we request Ofwat also considers in finalising its base cost modelling which are in part interrelated with the energy price and pumping adjustments referenced above and also the performance ambition that we are expected to achieve from base spend.

23. Our revised base cost estimate is £356.7m (wholesale and retail) for the 2025 to 2030 period. As noted in this document and the associated representations, we strongly consider this level of base cost expenditure vital to maintain the base level of service for our customers.

Enhancement costs

Business plan submission

24. Our PR24 Business Plan includes £53.4m of targeted wholesale enhancement expenditure to deliver new legal and regulatory requirements and significantly reduce leakage and PCC, improve water quality by replacing lead pipes that supply schools and improving the resilience of our assets to climate change.

Ofwat's draft determination

25. Ofwat allocated £38.6m of enhancement expenditure in the draft determination, reducing the funding for our smart metering programme by £5.6m, leakage by £7.1m, lead replacement by £2.2m and resilience by £2.2m. A further 20% efficiency challenge was applied to several other areas, while our costs to address water quality deterioration and environmental investigations were increased.

Our response to the draft determination

26. We have reviewed Ofwat's cost assessment and benchmarking approach and considered up-to-date information from the market to provide an updated view of the enhancement expenditure we require. This has resulted in a series of representations in light of the position taken by Ofwat in the draft determination with our revised enhancement costs total £57.2m including:

   (a) £24.8m for smart metering, which is £1.4m higher than our original PR24 plan due to an underestimate of delivery costs;

   (b) £13.0m for leakage, which includes an extra £2.5m for trunk main renewal, a new regulatory requirement;

   (c) £3.8m for lead replacement in-line with our original PR24 plan; and

   (d) £4.3m for resilience in-line with our original PR24 plan.

Risk and return and financeability

Business plan submission

27. Our PR24 Business Plan incorporates various components as specified by Ofwat and is financeable on a notional and actual company basis.

28. The financeability of our plan is dependent on the application of a 7% RCV run-off rate across both the water resources and water resources network plus price controls. Although higher than Ofwat's guidance, we consider this to be appropriate to address intertemporal fairness, affordability and financeability and it is consistent with what was applied to our PR19 Business Plan.

Ofwat's draft determination

29. In its PR24 draft determination Ofwat has adopted a run-off rate of 4.50% for our water resources (WR) price control and a rate of 4.15% for the water networks plus (WNP) price control. This results in bills reducing over the shorter term in exchange for materially higher bills in the longer term. Over the 2025 to 2030 period this results in a c£60m revenue reduction.

Our response to the draft determination

30. We have reinforced our position and provided evidence and substantiation for our higher RCV run-off rate. We emphasise that our RCV run-off rate and PAYG rate need to be considered jointly by Ofwat, as both collectively impact how much current customers pay versus future customers.
31. The 7% RCV run-off rate is consistent with the natural rate when considering both historic and forecast levels of spend on capital maintenance and renewals and considering the proposed PAYG rate. Over the 15-year period from 2015/16 to 2029/30, we have spent and will spend an average of 6.6% of our RCV on capital maintenance. Looking at our plan for AMP8, we are expecting to spend an average of 7.2%. While our capital maintenance activity will naturally fluctuate from AMP to AMP, our run-off rate is aligned with our long-term average spend. We are also one of the few companies that do not recover this expenditure through PAYG and instead seek to recover it through the RCV run-off rate.
32. Our 7% RCV run-off rate is largely consistent with an aggregate rate of cost recovery for capital maintenance adopted by other water companies in the sector once the approach other companies take to the recovery of infrastructure renewals through PAYG is taken into consideration. Ofwat's draft determination proposals, on the other hand, would temporarily reduce bills in the shorter term and the expense of higher bills for future customers – violating the intergenerational fairness principle.
33. We maintain our position on the 7% RCV run-off rate as evidenced in this response, although have noted in our representation that an approach of funding infrastructure renewals expenditure through PAYG would provide similar results.
34. We are financeable on an actual and notional basis after incorporating our responses to Ofwat's draft determination, including our representations on totex, PAYG levels and RCV run-off rates, together with Ofwat's views on allowed returns, retail margins and official forecasts of inflation.
35. As with our submitted PR24 Business Plan, our financeability is dependent upon:
    - Additional operational equity from 2024/25 and into AMP8 (modelled at £35m) from our parent company, together with £10m of de-gearing equity in 2024/25;
    - Ofwat's acceptance of our totex representations;
    - Ofwat's acceptance of our RCV run-off rate representation, which proposes a rate of 7%; and
    - Effective and efficient debt raising activity via Pennon Group in AMP8, including re-financing of our index-linked bond commencing in 2027.

Governance

Business plan submission

36. We updated our dividend policy for 2025 to 2030 to align with amendments made by Ofwat to Condition P of our licence. This resulted in an average dividend yield of 4.22%

over the business plan period. In line with our dividend policy, these amounts will be assessed in terms of customer delivery and performance at each period and adjusted as deemed necessary.

37. Furthermore, our executive pay policy has taken into account feedback from Ofwat and will remain in place ensuring that poor performance overall is not rewarded and allowing for transparent reporting of the application of the policy each year in our APRs. Our executive pay policy continues to ensure that the Company's Remuneration Committee can exercise discretion and judgement by reference to overall performance delivery for customers, communities and the environment and performance against specific metrics and stakeholder feedback.

Ofwat's draft determination

38. In its QAA of our Business Plan, Ofwat confirmed that in its view, our policy on dividends did not meet its expectations. Our plan assumed a 4.22% return to shareholders, based on our actual company structure, above Ofwat's 4% guidance limit. Furthermore, it didn't specify all the conditions in Ofwat's guidance of when dividends will be paid.

39. Ofwat also highlighted that our executive pay policy only partially met its expectations as we did not provide enough detail to demonstrate that it is aligned to delivery for customers and the environment.

Our response to the draft determination

40. We have aligned our dividend yield to 4% with Ofwat's expectations that this is the maximum that is reasonable for a company with little real RCV growth.

41. We have also noted Ofwat's recommendations within the QAA to provide further details within the dividend policy on certain items, including how dividends declared or paid will take account of delivery for the environment over time. We will update and finalise our dividend policy prior to the commencement of AMP8.

42. We have noted Ofwat's comments on our executive pay policy and, while this does not have a material impact on Ofwat's draft determination proposals, we will update and finalise our executive pay policy prior to the commencement of AMP8.

B. Guide to reading our draft determination response

43. Our response to Ofwat's draft determination consists of an overarching document (this document SES101) and a series of supporting appendices to provide further evidence and technical detail.

44. We have also responded to Ofwat's summary proforma and updated the data tables and the models that support our submission.

45. The following table summarises the documents we have produced.

Document reference number (to be added)	Document title
SES101	Business Plan 2025 to 2030: Draft determination representation
SES102	Outcomes
SES103	Pumping cost adjustment claim
SES104*	Softening cost adjustment claim
SES105*	Energy prices

SES106	Leakage reduction enhancement claim
SES107*	Smart metering enhancement claim
SES108	Customer focussed lead replacement programme enhancement claim
SES109*	Resilience enhancement claim
SES110	Enhancement efficiency challenge
SES111	RCV run-off rate
SES112	Risk and return (RoRE) and financing our plan
SES113	External Assurance – PA Consulting
SES114	External Assurance – Mott MacDonald
SES115	External Assurance - NERA
SES116	Customer and Environmental Scrutiny Panel – Ofwat letter
SES117	Summary of our draft determination response
SES118	PR24 draft determination company representation proforma

** Documents published have redactions for security and commercial reasons.*

2. Outcomes and incentives

In this section we present our response to Ofwat's draft determination of our PR24 Business Plan and how it has changed the outcomes we will deliver for our customers.

This includes targeted representations that support changes to the performance commitment levels (PCLs) Ofwat included in its draft determination for Water Quality Contacts, Business Demand and Per Capita Consumption.

It also proposes changes to the Outcome Delivery Incentives (ODIs) associated with Water Quality Contacts and Discharge Permit Compliance to address the significant downward skew in our overall incentive package, presented in the Draft Determination.

A. Introduction

1. Our PR24 business plan proposed an ambitious programme of activity to deliver improved outcomes for customers, the environment and wider society. In its draft determination, Ofwat has recognised the level of ambition we have shown through its Quality and Ambition Assessment (QAA) of our plan, rewarding us with 5bps return on regulated equity, equivalent to approximately £0.4 million in AMP8.
2. We put forward a well-considered and balanced outcomes package that focused on:
   (a) Continuing to deliver upper quartile performance in key areas including drinking water quality, customer contacts about water quality, supply interruptions, mains repairs, leakage and unplanned outage – helping to shift the industry frontier in some critical performance areas;
   (b) Significantly reducing how much water is used by household and business customers to secure our water supplies, in-line with the Government's Environmental Improvement Plan (EIP) targets and our WRMP; and
   (c) Improving the environment by reducing greenhouse gas emissions and improving biodiversity in a systematic and efficient way.
3. The outcome levels that our Business Plan targeted for 2025 to 2030 were set in the context of our long-term delivery strategy (LTDS). The level and pace of improvement reflected the priorities of our customers and followed challenging but deliverable glidepaths, with the appropriate level of funding.
4. Using a specially developed tool, we calculated the level of improvement we could deliver from base expenditure alone and identified where enhancement expenditure was required to enable a step-change in performance over a 25-year period. Our cost proposals reflected this with an appropriate allocation of base and enhancement expenditure, which reflected the unique circumstances of our company. We fully considered where we are on our performance journey and identified the interventions required to significantly improve our performance over AMP8 in a number of areas.

5. Our package of ODIs was considered in the round to ensure it represented an appropriate balance of risk and reward, with the necessary protections in place to enable us to manage uncertainty and factors affecting performance not fully within our control. Together with some targeted Price Control Deliverables (PCD) we considered that we struck the right balance between delivering for our customers and our shareholders throughout the 2025 to 2030 period.
6. The level of ambition we proposed and its alignment with our customer priorities was supported by both our independent Customer Scrutiny Panel (CSP) and our Environmental Scrutiny Panel (ESP). They have written a joint letter to Ofwat (SES116: Customer and Environmental Scrutiny Panel - Ofwat letter) confirming their support for our plan and the outcomes it will deliver for customers and the environment. The letter highlights concerns that the scale of challenge applied to funding requirements will risk the delivery of significant environmental benefits and increased resilience, which were supported by customers and that the draft determination includes limited reference to customer preferences.
7. We welcome Ofwat's recognition that our plan was ambitious and its approach to align some PCLs with the performance targets that we put forward. However, our package of outcomes and ODIs was constructed carefully to ensure it met the expectations of our customers and supported the delivery of our long-term ambition and reflected an appropriate balance between risk and reward.
8. Therefore, we do not consider that all the changes that Ofwat has proposed to our PCLs within its package of draft determination are in the best interests of our customers. We have restated the performance commitments levels between 2025 and 2030 for four ODIs where the draft determination set a target that was even more stretching level than what was included in our Business Plan.
9. Furthermore, we have put forward evidence for why the ODI rates set in Ofwat's draft determination for Water Quality Contacts and Discharge Permit Compliance are not appropriate and result in an excessive downward skew of our overall incentive package.
10. We have also highlighted why we require Ofwat to consider elements of its proposed package of PCDs, financial incentives intended to protect customers from partial or later delivery of specific base or enhancement projects. Specifically, we consider several changes are needed to the PCDs that Ofwat has proposed for softening and metering to provide a more balanced regulatory package.
11. While we accept Ofwat's proposals for PCDs in other areas of its draft determination, the extension of the use of PCDs at PR24 introduces additional risks into the regulatory regime and, as a relatively new part of the regulatory framework, there is a high degree of uncertainty associated with it how key elements of the PCD package may play out in practice. It is important, therefore, that Ofwat comprehensively assesses the impacts of its final package of PCDs on the balance of risk and return as discussed in Section 4 Risk and Return.
12. Acceptance of these targeted changes at final determination will restore the balance of our outcomes and incentives package in the round. The delivery of these challenging performance commitments is dependent on Ofwat reconsidering its base and enhancement expenditure allowances and proposals on PCDs, details of which are set out below.

B. Performance Commitments Levels

13. The table below sets out the performance commitments we made in our PR24 business plan and the performance commitment level in Ofwat's draft determination.

Table 1: Change in performance commitment levels between SES Water's PR24 plan and Ofwat's draft determination

£ outturn	Units	Source	2025/26	2026/27	2027/28	2028/29	2029/30
Where the Draft Determination PCL is set an even more stretching level relative to our PR24 Business Plan commitments.							
Water Quality Contacts	# contacts / 1000 people	Business plan	0.60	0.60	0.60	0.60	0.60
		Ofwat DD	0.50	0.50	0.50	0.50	0.50
Per Capita Consumption	% reduction from 2019/20	Business plan	-6.60%	-7.87%	-9.00%	-10.00%	-11.00%
		Ofwat DD	-6.40%	-8.40%	-10.30%	-12.00%	-13.50%
Business Demand	% reduction from 2019/20	Business plan	-4.70%	-3.38%	-3.96%	-4.55%	-5.14%
		Ofwat DD	-6.90%	-8.80%	-10.30%	-12.60%	-14.90%
Operational GHG Emissions	tonnes CO2e reduction	Business plan	1,888	2,382	2,656	2,962	3,244
		Ofwat DD	1,888	2,382	2,656	2,962	3,786
Where the Draft Determination PCL is set at the stretching levels proposed in our PR24 Business Plan commitments.							
Leakage	% reduction from 2019/20	Business plan	-15.48%	-18.25%	-21.03%	-23.81%	-26.59%
		Ofwat DD	-15.10%	-18.30%	-21.00%	-23.80%	-26.60%
Mains Repairs	# repairs / 1000 km of mains	Business plan	58	57	56	55	54
		Ofwat DD	58	57	56	55	54
Serious Pollution Incidents.	# of incidents	Business plan	0	0	0	0	0
		Ofwat DD	0	0	0	0	0
Discharge Permit Compliance	%	Business plan	100%	100%	100%	100%	100%
		Ofwat DD	100%	100%	100%	100%	100%
Compliance Risk Index	Index score	Business plan	0	0	0	0	0
		Ofwat DD	0	0	0	0	0
Where the Draft Determination PCL is set at a less stretching level relative to our PR24 Business Plan commitments.							
Water supply interruptions	Minutes per property	Business plan	00:03:50	00:03:45	00:03:40	00:03:35	00:03:30
		Ofwat DD	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00
Unplanned Outages	% of peak week production.	Business plan	1.00%	1.00%	1.00%	1.00%	1.00%
		Ofwat DD	2.14%	2.14%	2.14%	2.14%	2.14%
Biodiversity	Net change in biodiversity units / 1,000sq.km	Business plan	0.00	0.00	0.00	2.06	3.01
		Ofwat DD	0.00	0.00	0.00	0.08	0.73

Source: SES Water (PR24 Business Plan) and Ofwat (Draft Determination)

14. This table shows that the PCLs set out in Ofwat's draft determination aligns with our PR24 Business Plan for five performance commitments and that for three performance commitments, Ofwat's draft determination sets the PCL below what we proposed in our PR24 Business Plan. However, four performance commitments have been set at a level that requires us to deliver an even greater performance improvement relative to what we proposed in our PR24 Business Plan.
15. We do not consider Ofwat's changes are in the best interests of our customers and therefore propose that Ofwat align the PCLs for PCC, Business Demand, and Operational GHG Emissions with the stretching level of outcomes that we proposed to deliver in our PR24 Business Plan. For Water Quality Contacts, we propose that the PCL is set at a more ambitious level relative to the level of outcomes that we proposed to deliver in our PR24 Business Plan.
16. In the following sections we summarise our position for these four performance commitments, with further information provided in Document SES102: Outcomes.

Water quality contacts

17. We are currently in the industry upper quartile for water quality contacts. Our performance level over the first four years of AMP7 is 0.56, 0.58, 0.64 and 0.58 contacts per 1,000 customers, which is less than half of the industry average.
18. However, we are falling short of our current business plan target of 0.50 contacts per 1,000 customers. This is because since the target was set the number of channels customers can use to contact us about their water quality have increased to include social media. Furthermore, our new contact management system is recording customer contacts about water quality more accurately. Together, we anticipate that this has increased customer contacts by 0.1 per 1,000 customers.
19. The performance of 0.6 which we proposed in our PR24 Business Plan reflects both of these factors. It was calibrated based on the target of 0.5 water quality contacts which was established in PR14 but uplifted by 0.1 to account for the two new factors that are outlined above. As such, we consider that 0.6 Water Quality Contacts reflect the level of performance that we have been funded to deliver.
20. The draft determination sets a PCL of 0.50 for AMP8. Given our already strong performance, we consider a further stretch to our performance level in these circumstances is not appropriate and funding has not been allocated to deliver this.
21. Nevertheless, we want to continue achieving our upper quartile position and challenge ourselves to do better. We therefore propose a PCL of 0.58 customer contacts per 1,000 customers. This performance aligns with our outturn performance level in 2023/24 and continues to reflect industry upper quartile performance.

Per capita consumption (PCC)

22. Reducing how much water is used by our household customers is a priority for us. It is critical if we are to secure resilient and sustainable water supplies for the future, while tackling the joint challenge of population growth and climate change, while also reducing how much water we abstract from the environment.
23. Our PR24 plan is aligned with our WRMP, which has been approved by Defra[1]. It requires us to reduce PCC by 11% between 2019/20 and 2029/30, and this is reflected in the PCL we put forward in our business plan.
24. The additional 2.5% stretch included in Ofwat's draft determination represents a material challenge to what is already a highly ambitious target that is not fully within our control. It also goes beyond the interim targets set out in the Government's EIP.
25. PCC is measured using a three-year rolling average to account for variations in weather conditions and other external factors. However, Ofwat has calculated the PCL for PCC using only our normal year consumption projections. Our calculation included both normal and dry year projections, which better represent the impact that weather variability has on PCC.
26. We therefore do not consider Ofwat's approach to calculating the PCC PCL is appropriate as in dry years, household customers' demand for water can increase by up to 8%, making it significantly more challenging to reduce PCC. Therefore, both dry and normal year projections should be included in the calculation of the target.
27. The additional stretch that results from Ofwat's approach is not justifiable from a water resources management perspective, does not align with our WRMP and does not reflect

[1] References to WRMP throughout the PR24 Business Plan and this document refer to WRMP24. Our WRMP24 is currently in 'revised draft' form and we received permission from Defra to publish it on 21 August 2024. We will make some presentational changes following discussion with the Environment Agency, specifically concerning how bulk exports are referenced, but no material changes will be undertaken as we prepare to publish our final WRMP in October 2024.

weather variability appropriately. We therefore strongly believe that the 11% reduction to PCC from 2019/20 levels proposed in our business plan to be the appropriate PCL, especially given the cross-industry and multiple expert views articulated on the stretching nature of this target.

28. The enhancement expenditure we requested to deliver our smart metering and customer experience programme supports the delivery of the original 11% PCC reduction target, however, draft determination funding fell £6m short. We provide further evidence to support our enhancement case for smart metering in Document 107: Smart metering enhancement claim.
29. Furthermore, the long-term PCC target included in our WRMP, to reduce average consumption to 110 litres per person per day by 2050, assumes that a number of new government policies will be introduced over the coming years that will contribute to reducing customer water use.
30. Our AMP8 plan assumes that by 2029/30, 1.4% of the targeted PCC reduction will be delivered primarily as a result of the implementation of mandatory water labelling by government for all water using appliances in 2025. Should this not happen in-line with this timeframe then the assumed savings may not be realised.
31. In Ofwat's draft determination, companies are fully exposed to the risk that these initiatives are implemented late or not delivered at all. For example, should the government-led initiatives not occur on time and the associated incremental improvement of 1.4% not be delivered, we would be exposed to an uncontrollable penalty of £0.18 million (2022/23 prices) in 2029/30 based on the draft determination ODI rate.
32. We consider that Ofwat should develop a new mechanism to protect companies from the risk that government does not deliver in this area and consider that an ex-post review is the least disruptive approach which still accomplishes the objective of protecting companies from delivery risk that is outside of their control. We provide further details on this proposal in Document SES102: Outcomes.

Business demand

33. Like PCC our business plan target for reducing Business Demand by 5% from 2019/20 is aligned with our WRMP and the Government's EIP. The target imposed by Ofwat in its draft determination is 14.9%, which represents a threefold increase in the level of ambition for AMP8 and would result in us achieving the Government's target of a 15% reduction in non-household water use by 2050, 20 years early.
34. We do not consider there to be any justification for the increased stretch Ofwat has proposed and consider it to be undeliverable. The forecasts we used in our WRMP align with the Water Resources Planning Guidelines, co-authored by Ofwat, therefore should be relied upon for the business plan.
35. Furthermore, the increased PCL results in a significant downside risk. Performing at our assessment of the P10 level would result in an aggregate penalty of £2.24 million (2022/23 prices) while performing at the P90 level would also result in a penalty of £0.38 million (2022/23 prices) based on the ODI rate and PCL set in the draft determination. The fact that we continue to face a financial penalty even at our P90 level of performance shows the scale of the challenge that Ofwat have set with the adoption of this performance commitment level.
36. We therefore request that Ofwat aligns our PR24 plan with our WRMP in its final determination and our Business Demand reduction target for AMP is 5% from the 2019/20 baseline.

C. Outcome Delivery Incentive (ODI) rates

37. We recognise that Ofwat have adopted a top-down approach to calculate an appropriate ODI rate for each PC. If applied proportionately, we consider that this approach is sensible and provides a transparent calculation to the ODI penalties/rewards. In some specific (and limited) circumstances, this approach has not been able to account for some of our own unique situations.
38. Our analysis shows that there is a significant downside skew to our ODI package, with two ODI rates – Discharge Permit Compliance and Water Quality Contacts – having a disproportionate impact. We note that Ofwat have acknowledged that there is an issue with both of these rates in a message to water only companies (WoCs) on 20 August 2024.

Discharge permit compliance ODI rate

39. We fully support the introduction of the Discharge Permit Compliance performance commitment to hold us to account for our environmental performance.
40. However, the top-down approach to calculating the ODI penalty results in a discharge permit compliance penalty rate of £0.556m per percentage deviation against our compliance score target of 100%. As we have just four sites with discharge permit licenses, a failure at any one of these would result in an annual discharge permit compliance performance level of 75%. In comparison, a single instance of non-compliance for a large WaSC like Anglian Water would result in a drop in a performance of just 0.12%.
41. As such, a discharge failure at a single site would result in a pre-tax penalty of £13.9m which is equivalent to around 6.3% RoRE. Performance at our assumed P10 level – which assumes one site failure per year – would result in an aggregate ODI penalty of pre-tax penalty of £69.5 million (2022/23 prices) over AMP8.
42. We highlight in Document SES102: Outcomes, that the implied penalty per site failure that has been set in our draft determination is significantly above the penalty that would be paid by any other water only company (WoC) or water and sewage companies (WaSC).
43. This is clearly disproportionate, and we require Ofwat to develop this ODI so that it mirrors a more normalised approach across the industry as a whole – reflecting a post-tax RoRE in the region of 0.03% to 0.15% per site failure for all WoCs.
44. Based on our expected evolution of regulated equity over the next AMP, these RoRE rates equate to a pre-tax penalty of between £0.1 million and £0.3 million (2022/23 prices) per site failure.

Water quality contacts ODI rate

45. As described earlier, Ofwat's draft determination set a PCL of 0.5 consumer contacts per 1,000 population over AMP8 while the ODI rate was set at ±£4.9 million (2022/23 prices). The adaptation of this stretching target alongside a greater than six-fold increase in the per-contact penalty from AMP7 represents a disproportionate increase in downside risk for our business.
46. Based on the draft determination ODI rate and PCL, we calculate that we would incur a pre-tax penalty of £0.49 million (2022/23 prices) in each year of the AMP for delivering an upper quartile level of performance (0.6 water quality contacts). This is equivalent to a RoRE impact of over 0.21%.

47. Delivery of our assumed P10 performance for Water Quality Contacts (1.0 contact per 1,000 people) would result in a penalty of £12.4 million (equivalent to around 1.12% RoRE) over AMP8. We note that this P10 performance level is still below (and therefore better than) the performance level that has been set for other companies.

48. We consider that Ofwat's top-down method of setting ODI rates results in smaller companies facing disproportionately high ODI rates relative to larger companies. We would in practice receive a penalty of c.£7,000 (2022/23 prices) per contact above the performance level of 0.5 contacts per 1,000 customers which, expressed as a percentage of our regulated equity, is a far higher penalty associated with an individual water quality contact compared to larger companies within the sector.

49. The proposed ODI rate in the draft determinations is a result of the top-down approach developed by Ofwat that seeks to achieve a similar symmetric ODI penalty/reward per individual contact for most companies.

50. However, setting the same penalty rate for us and for larger WoCs and WaSCs results in a much higher level of financial risk for our business when measured as a percentage of regulated equity and we do not consider the level of financial exposure we face relative to other companies is appropriate in the context of our ongoing upper quartile performance delivery. Our strong performance leads to a narrow range of likely performance and therefore a high penalty for a small deviation from the PCL.

51. Our analysis shows that an ODI rate that is calibrated to 0.0005% RoRE per water quality contact for us would reflect an equitable approach being applied across the industry. We estimate that a penalty of 0.0005% of RoRE equates to a pre-tax ODI penalty/reward rate of approximately £1,100 per relevant individual contact. Based on the assumption that we are responsible for a total population of 738,308 people, a penalty of £1,100 per water quality contact equates to an ODI rate of £0.812 million (2022/23 prices). This is marginally above the ODI rate that we have in AMP7 and helps to reduce some of the downside risk facing our business from this performance commitment. The penalty rate – once expressed as a percentage of regulated equity – would still be above the level Ofwat has set for a number of other companies.

52. We consider Ofwat should incorporate both our proposals – to reduce the performance commitment level to 0.58 and set the ODI rate at £0.812m – in the final determination. This results in a more symmetric balance of risk and reward for this performance commitment, in the context of the upper quartile level of performance that we have been delivering.

53. The penalty that we will face from delivering our PR24 Business Plan performance commitment would fall from a pre-tax penalty of £2.47 million (2022/23 prices) to £0.08 million (2022/23 prices).

54. At the P10 performance level, our downside risk would fall from a pre-tax penalty of £12.36 million (2022/23 prices) to £1.71 million. At the P90 performance level, our upside potential falls from £3.46 million (2022/23 prices) to £0.89 million (2022/23 prices).

D. Price Control Deliverables

55. As we have noted above, while we consider the extension of PCDs at PR24 introduces a set of new financial risks into the regulatory framework, we accept Ofwat's proposals with the exception of metering and softening. In both cases, Ofwat is potentially proposing to go beyond what is necessary to protect customers.

56. On metering, we are seriously concerned about the disproportionate PCD penalties we face for events that are outside our control. In our representation responding to Ofwat's assessment of our smart metering enhancement – see Document SES107: Smart

metering enhancement claim – we raise a series of concerns with Ofwat's proposed metering PCD and request three changes to the design of the PCD:

(a) We request that the PCD non-delivery and time-incentive rates be calibrated to offset the associated ODI penalties for PCC, leakage and business demand, given the significant overlap between the two sets of incentives.

(b) We request that the PCD non-delivery rates be set on the marginal cost of installing a smart meter instead of the average cost, to avoid us having to pay back efficient expenditure we have already incurred.

(c) We request that Ofwat engages further with the sector to set the operability performance thresholds for determining whether a meter has been delivered for PCD purposes. The current thresholds appear excessively stringent in the context of technological uncertainty and risk us excessive PCD penalties disproportionate to the impact on customers.

57. On softening, the capex element of the PCD is not clear and we assume Ofwat will engage with us further once it has developed the detailed design of the PCD. As part of our response to the draft determination, we wish to confirm some key principles in relation to the design of the PCD, which we summarise below and provide more detail on in Document SES104 – Softening cost adjustment claim:

(a) We oppose any time-incentive within the design of the capex PCD, as this would unnecessarily limit our flexibility to manage our capital programme within the AMP and add no benefit to customers. To the extent that a failure to deliver our capex plans in a timely manner affects our ability to soften water for our customers, this will be reflected in the opex PCD penalty.

(b) We expect that, in line with regulatory best practice, Ofwat's treatment of capex over- and underspends will be symmetric, such that we benefit from any capex efficiency as well as being expected to absorb any cost overruns.

E. Summary

58. In summary, we strongly believe that the package of performance commitments we included in our PR24 business plan will deliver the best set of outcomes, in the round, for our customers and the environment.

59. In its final determination, we request that Ofwat:

(a) Sets the PCL for PCC at 11% reduction (from the 2019/20 baseline) and introduce an uncertainty mechanism around delivery of government policy interventions;

(b) Sets the PCL for business demand at 5% reduction (from the 2019/20 baseline);

(c) Sets the PCL for water quality contacts at 0.58 contacts per 1,000 customers with an ODI rate of £0.812m;

(d) Calculates the ODI rate for discharge permit compliance so it mirrors a more normalised approach across the industry – reflecting a post-tax RoRE in the region of 0.03% to 0.15% per site failure for all WoCs; and

(e) Reviews its proposals on PCDs for metering and softening which in their current form are not appropriately specified.

60. These targeted measures will together deliver significant performance improvements across our package of outcomes and restore the balance of risk and return for our customers and shareholders.

61. Further details on outcomes can be found in Document SES102 – Outcomes. We cover the impact on RoRE in more detail in Chapter 4 Risk and Return of this document and in Document SES112: Risk and return (RoRE) and financing our plan.

3. Costs

In this section we set out our response to the cost allowances Ofwat has included in its draft determination.

We restate our £413.9m total expenditure requirement for 2025 to 2030, to deliver the outcomes for customers, including the stretching improvements in performance we are targeting.

We have considered Ofwat's feedback and carried out further modelling of both our base and enhancement expenditure requirements. We provide an updated view of our base cost allocation which includes detailed consideration of how future energy costs should be calculated in AMP8 and further evidence to support our cost adjustment claims for pumping and water softening.

We also provide additional evidence to support our enhancement claims for leakage, smart metering, lead replacement and resilience.

Overall, we have significant concerns with the allowed expenditure in Ofwat's draft determination and conclude that a significant increase in funding is required at final determination.

A. Introduction

1. Our PR24 plan set out £413.9 million of spending over the five-year period between 2025 and 2030. This represented an increase of £13.3 million per year, compared to the 2020 to 2025 period (in 2022/23 price base). The bulk of the increase in our costs was due to an increase in capex, primarily driven by our smart metering programme and refurbishment of our water softening process at Kenley Water Supply Works, together with price increases in areas such as energy and chemical spend.
2. In its draft determination, Ofwat reduced our total expenditure allowance (totex) to £324.1m. Our wholesale base cost allowance was reduced by £75.2m, and our wholesale enhancement expenditure was reduced by £14.8m. Overall retail expenditure was reduced by £0.2m.
3. We have carefully considered Ofwat's feedback in its draft determination, the changes it has made to cost allocation and the cost models and benchmarking that it has used to reach its base and enhancement cost allowances. This has included reviewing where our unique circumstances are not reflected in Ofwat's cost models, leaving us with a shortfall in base funding. We have also taken into account new information from the market and supply chain to ensure our costs are as accurate as possible.
4. We make a series of representations on Ofwat's proposals on costs as discussed in the subsections which follow, but note that we have particularly material concerns with Ofwat's draft determination proposals on:
   - **(a)** Power – both the rejection of our pumping claim (when our unique circumstances were accepted at PR19) and Ofwat's calculation and application of the energy price adjustment in its cost modelling.

(b) Softening – Ofwat's proposed allowance does not provide sufficient funding for the efficient opex and capex that we will need to incur in the next AMP related to our softening obligations.

(c) Smart metering – Ofwat's proposal is significantly lower than our current estimate of the efficient costs required to successfully deliver this critical enhancement programme that supports the ambitious reductions in customer consumption required.

5. We have concluded that £413.9 million is what we need to spend over AMP8 and that the totex allowance in Ofwat's draft determination is not sufficient to enable us to continue to deliver a high-quality, core service to our customers, while at the same time achieving the stretching performance levels required by 2030. We have therefore put forward a revised total expenditure package summarised in the table below.

Table 2: SES Water total expenditure requirement split by price control

Allowed Costs - £m	BPv0	DD	Variance to BPv0	BPv1.1	Variance to BPv0
Water Resources	36.7	22.3	(14.4)	36.7	**0.0**
Water Network +	339.8	264.1	(75.7)	339.8	**0.0**
Total Wholesale	**376.4**	**286.4**	**(90.0)**	**376.4**	**0.0**
Retail	**37.5**	**37.7**	**0.2**	**37.5**	**0.0**
Total Price Control	**413.9**	**324.1**	**(89.8)**	**413.9**	**0.0**

Source: SES Water
Note: BPv0 represents our PR24 Business Plan submission in Oct 23, BPv1.1 shows our latest Business Plan as a response to the Draft Determination (DD).
The BP enhancement costs used in DD are lower than our final data table submission (£.6m)

Table 3: SES Water totex split by base and enhancement

Allowed Costs - £m	BPv0	DD	Variance to BPv0	BPv1.1	Variance to BPv0
Wholesale Base	323.0	247.8	(75.2)	319.3	(4.2)
Wholesale Enhancement	53.4	38.6	(14.8)	57.2	4.2
Total Wholesale	**376.4**	**286.4**	**(90.0)**	**376.4**	**0.0**
Retail Base	35.9	37.7	1.9	37.5	1.7
Retail Enhancement	1.7	0.0	(1.7)	0.0	(1.7)
Total Retail	**37.5**	**37.7**	**0.2**	**37.5**	**0.0**
Total Price Control	**413.9**	**324.1**	**(89.8)**	**413.9**	**(0.0)**

Source: SES Water
Note: The BP enhancement costs used in DD are lower than our final data table submission (£.6m). We also reallocate the £1.7m retail enhancement to base in line with Ofwat's modelling.

6. This table shows that to deliver the outcomes set out in Section 2, we require total expenditure of £413.9m over the 2025 to 2030 period, leaving us with a funding shortfall of £89.8m compared to the draft determination.

7. The majority of this shortfall can be addressed through additional allowances for base expenditure that reflect our unique operating conditions, namely our legal requirement to soften water and the topography of our area that results in higher energy requirements and costs to pump water.
8. In addition, we have recalculated that £57.2m of enhancement expenditure is needed to deliver a step-change in our performance that reflects our customers' priorities, meet new legislative requirements and address issues associated with climate change and growth.
9. We note that prior to accounting for the representations which we have made on several elements of Ofwat's cost assessment there is a £89.8m gap between Ofwat's draft determination totex allowances and the expenditure we consider is required to run our business efficiently in AMP8 and deliver on our PR24 plan outcomes which our customers' support. As a result, we consider a substantial increase in allowed funding is required in Ofwat's final determination to enable us to continue to deliver our core services and the stretching outcomes ambition in our plan.
10. Recognising the emphasis Ofwat has placed on deliverability throughout the PR24 process and reflecting on its response in the draft determination, we have continued the process of active engagement with supply chain partners, both prior to submission of our Business Plan and in the time period since. This has enabled us to remain confident in our ability to deliver both our enhancement programme – itself a similar size to PR19 – and our base activities. Specific activities have included:
    - Engaging with delivery partners on an early start of around 40% of our proposed AMP8 WINEP programme;
    - Progressing an open tender process – with significant engagement from across the supply chain – on our smart metering programme;
    - Commencing discussions with Pennon and its supply chain to augment both the capability and capacity of our own supply chain; and
    - Assessing which of the contracts we currently have in place that we wish to extend into the first few years of AMP8.
11. Collectively, this work is positioning us well for the delivery requirements of AMP8, albeit aspects are dependent on the outcome of the PR24 consultation process with Ofwat.
12. In the following sections we provide more detail on our base and enhancement costs and evidence to support the totex allowance we require between 2025 and 2030.

B. Base costs

Introduction

13. Our PR24 Business Plan includes £360.5m in expenditure to continue to deliver our core wholesale and retail services and maintain our existing network (base cost).
14. Our base plan is ambitious – we include a 1% per annum ongoing efficiency (OE) challenge, while at the same time proposing to deliver improved performance outcomes from our base spending. This includes continuing to improve or maintain our already upper quartile performance in areas of high importance to our customers, such as water supply interruptions, water quality and leakage.
15. When comparing the base allowance we have been provided in the draft determination, we consider it insufficient to allow us to deliver the core level of service for our customers. We also consider the implication of this base allowance on the efficiency of

our plan to be implausible in the context of how our business has evolved over the current AMP and in the context of how we developed our plan for the next AMP. We find that there are a number of specific factors that are driving Ofwat's unrealistic assessment of our efficient base expenditure:

- Ofwat's proposed benchmarking of our base costs creates a disconnect between the allowed base cost in Ofwat's draft determinations and the high-quality service and performance improvements we proposed in our plan. We have innovated strongly in the digital space over the current and previous AMP, and in doing so, have delivered an upper quartile level of performance or above in key PCs including water supply interruptions and leakage. Ofwat has accepted our ambition of 'what base buys' in key performance areas but has not provided us with a representative base cost allowance to deliver this ambition;
- Ofwat has rejected our cost adjustment claim to account for the benchmark models insufficiently reflecting our unique network topography, and its impact on our pumping requirements and power consumption. We have engaged with Ofwat several times on this issue, and while we appreciate the efforts taken to improve the models' ability to reflect our unique circumstances, we find that Ofwat has not comprehensively engaged with the substance of our claim;
- We have also found issues with the way in which Ofwat has calculated its energy price adjustment for companies, which serves to underestimate the impact of recent increases in energy prices. This affects all companies but is likely to have a greater impact on us than others, due to our relatively high power consumption related to the topography of our network; and
- Finally, we welcome that Ofwat has accepted the need for our cost adjustment claim related to our requirement to soften water for our customers. In our response to the draft determination, we provide further evidence to demonstrate the efficiency of our planned expenditure which we consider provides the justification for Ofwat allowing our softening cost adjustment claim in full.

16. In this section, we go into detail on each of these issues, but first revisit how we developed our plan and tested its efficiency.

How we developed our AMP8 plan and assessed the efficiency of our base expenditure

17. Our PR24 plan's forecast base expenditure was based on a bottom-up planning exercise by the business and its respective departments. This reflected a range of assumptions of the activities that need to be undertaken and the cost of doing so including our best view of input prices at the time.
18. At the time of the plan's submission, we also undertook a benchmarking exercise to test whether our bottom-up costed plan was efficient:
    - We sought to replicate how Ofwat might undertake its modelling to develop an independent benchmark of our plan's forecast base totex;
    - We made a set of assumptions of the base cost models that Ofwat would use to model efficient base costs, and cost adjustment claims (CACs) that needed to be applied to this base cost modelling to reflect our unique circumstances that were not adequately captured in Ofwat's published base cost models; and
    - We also made several proposals for how Ofwat would need to adapt its modelling at PR24 to reflect factors such as the general increase (and future uncertainty of) energy prices in setting efficient base cost allowances for us and the rest of the sector, rolling into the next AMP.

19. Based on this modelling – the comparison of our bottom-up plan against our early assessment of Ofwat's benchmarking – we were able to conclude that our PR24 Plan base cost was efficient using an upper quartile benchmark. We documented this in one of our business plan appendices (Appendix SES005B – Explaining our costs)[2].

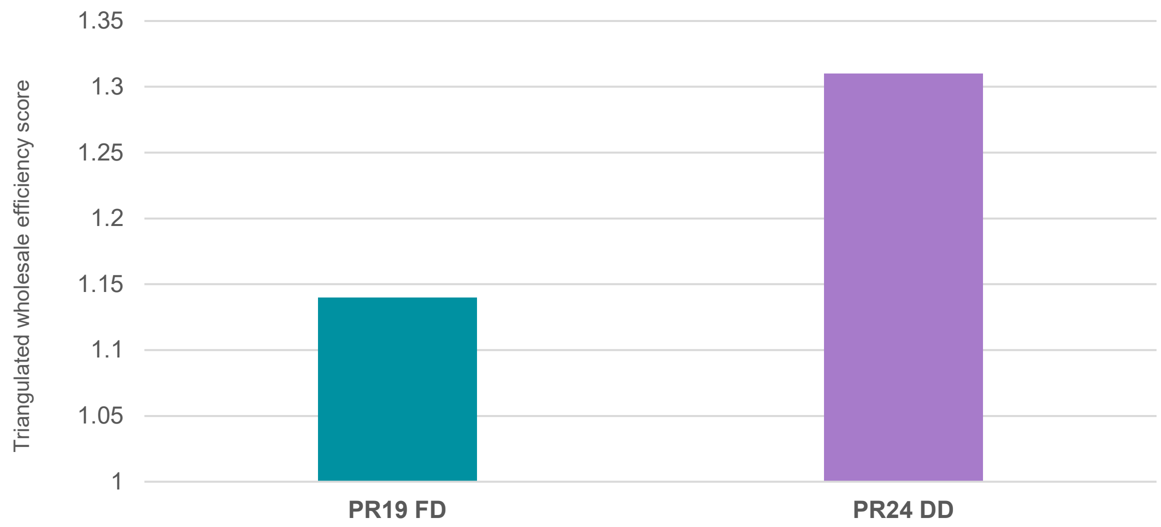
20. In its draft determination, Ofwat have made a series of modelling decisions and adjustments that lead to a level of allowed base cost that is significantly less than our plan, including the rejection of many of our base CACs. This is despite Ofwat in its PR24 QAA assessment highlighting our high level of ambition to deliver stretching performance from base expenditure.

The plausibility of Ofwat's benchmark modelling

21. When looking at Ofwat's efficiency benchmarking at PR24, and the efficiency scores that result from this benchmarking compared to our relative cost performance at PR19, we find them implausible.

22. We note that prior to any CACs being applied by Ofwat in its modelling our triangulated efficiency score[3] from the wholesale base cost modelling at PR19 was 1.14. Our equivalent score at PR24 draft determinations is 1.31 as illustrated below.

Figure 1: SES Water's triangulated efficiency score



Source: SES Water analysis of Ofwat's base cost models

23. The efficiency scores imply that our wholesale business has become 15% less efficient than the median company over the current AMP. This is despite a material proportion of our cost base being driven by power consumption, where we have been protected by recent price increases due to our hedged position. It is unrealistic that we have become less efficient than other companies who have not benefitted from such price protection.

24. We do not consider it is plausible that such a significant change in our efficiency score over a single AMP - in a relatively mature and stable infrastructure business environment - can be simply assumed as a deterioration in our base cost efficiency given the range of measures we have in place to effectively manage our cost base.

[2] https://seswater.co.uk/-/media/files/seswater/about-us/publications/pr24/appendices/ses005-explaining-our-costs.pdf

[3] An efficiency score is the ratio of the actual cost to modelled cost from Ofwat's base cost models. So, an efficiency score >1 implies an actual cost that is greater than the model's predicted cost.

25. Rather we consider it is an indication that Ofwat's base cost models at PR24 are not adequately predicting our efficient costs and a series of adjustments are required in Ofwat's modelling for final determinations to reflect our unique circumstances.

26. We consider our PR24 base plan is efficient and includes the necessary level of expenditure we require to deliver on the ambitions we have set which reflect our customers' priorities and that have their support. We propose a stretching level of performance improvement from 'what base buys' in AMP8 arising from Ofwat accepting many of the PCLs that we proposed in our business plan and the performance improvements that can be achieved from the enhancement cases proposed in our plan[4].

27. In the subsections below, we set out our representations on the adjustments that we consider are needed in Ofwat's modelling to capture the efficient allowed base spend which we require in the next AMP. This includes representations on:
    - How our ambition of 'what base buys' in key PC areas does not seem to be reflected in Ofwat's base cost allowances;
    - Ofwat's assessment of the CACs that accompanied our Business Plan submission; and
    - Ofwat's approach and assumptions for modelling an energy cost adjustment to its base cost modelling at draft determinations.

28. Finally, we provide a reconciliation between our representations on Ofwat's modelling and the base expenditure we consider is required in AMP8, including the elements of Ofwat's draft determination modelling where we accept its proposed positions.

Our representations on Ofwat's draft determinations

29. Ofwat's modelling does not reflect our upper quartile or above performance on key PCs and our ambition for performance improvements to be achieve from base.

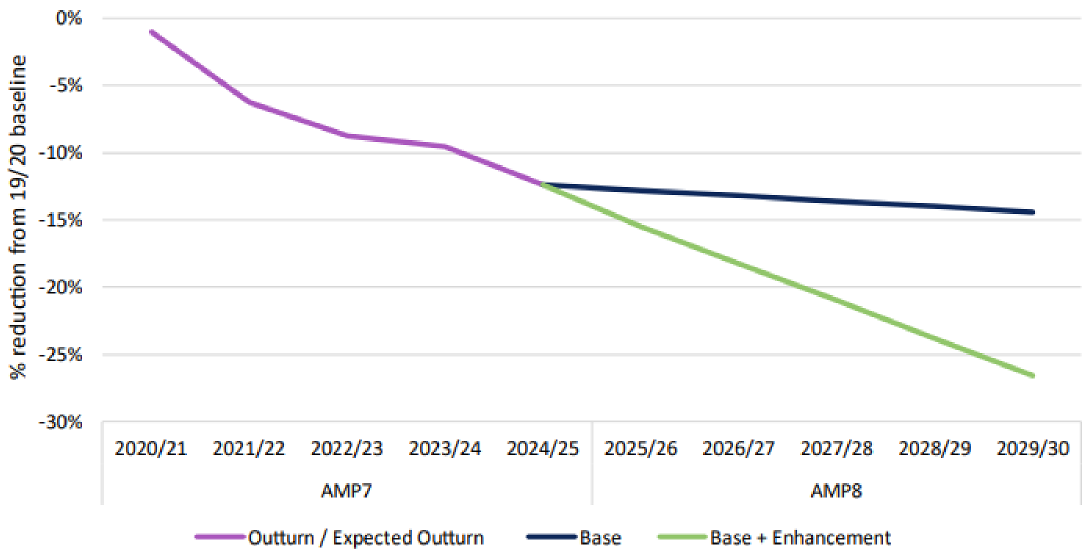
30. As we have noted above, and in the previous outcomes section of this document, we are achieving upper quartile industry performance in several key PC areas.

31. This has been driven by our investment over a series of AMPs in digitalisation and innovation (smart / intelligent network) spend which is now an integral part of our ongoing base expenditure. It is why we are able to forecast ambitious starting performance and performance improvements from base in our plan.

32. For example, in leakage, our plan identified how we are using our intelligent network (iDMA) to help us to identify and locate leaks quicker, reducing runtime and volume. This has translated into strong current performance and ability to forecast further improvements from base in the next AMP as illustrated in Figure 2 below.

[4] Which imply the residual performance improvement must come from base spend.

Figure 2: Leakage - PR24 expected performance from base and enhancement



Source: SES Water Business Plan – Chapter 6 - Outcomes

33. We noted in our plan other areas of our performance – e.g., water supply interruptions – where ongoing recurring expenditure in our smart systems and innovative asset management approach has translated into an upper quartile or above performance level on key PC areas and will drive further performance improvements from base.

34. In our plan we said the "proposed reduction in minutes per property [in water supply interruptions] can be delivered predominantly from base expenditure in the PR24 period through focusing on the ongoing embedment of our smart network and improving work practices to resolve issue even more quickly than currently"[5].

35. We are concerned that our upper quartile or above performance in these key PCs, and the level of our ambition of performance improvement delivered from base, is not adequately reflected in Ofwat's base cost allowances for its draft determinations. Our investment and recurring costs of smart and innovative systems is reflected in our actual base costs, but it is not clear it is reflected or credited in Ofwat's modelling.

36. We were able to put forward a limited number of enhancement claims to support improvements in key PCs because of the relatively ambitious outcomes we can achieve from base in AMP8 from the ongoing embedment, and recurring costs, of our smart / intelligent network. However, Ofwat's base cost modelling (as reflected in the efficiency scores referred to above) in effect disallows this expenditure and, alongside the issues we set out below in relation to our pumping CACs, are why we consider the base allowances in Ofwat's draft determinations do not reflect our efficient costs.

37. Whether Ofwat's modelling of base costs is sufficient to fund upper quartile outcomes performance cannot be observed directly from the base cost models. It is therefore a matter of judgement of what level of performance in key PC areas that are valued by customers, such as leakage and water supply interruptions, are ultimately implied by Ofwat's base cost models[6]. What we can, however, observe is that:

    (a) We are currently achieving upper quartile or above performance in key PC areas for PR24 which is driven by the recurring smart / intelligent network initiatives and systems that are reflected in our base spend.

[5] SES Water (2023): 'Chapter 6: The outcomes we will deliver', para 81.
[6] This point is made by the CMA in its final report at the PR19 appeals. See para 8.56 of Section 8 – Leakage, CMA (2021).

(b) We are able to forecast relatively ambitious performance improvements from our proposed base spend in AMP8 arising from the continued embedment of this digitalisation and innovative approach.

(c) We are in effect facing a disallowance in our allowed base spend in AMP8, via the implied efficiency score in Ofwat's base cost modelling which reduces our allowed spend below our forecast spend.

(d) Neither are we credited for the ambitious performance improvements that we had forecast to be achieved from the disallowed base cost in our PR24 plan via adjustments in Ofwat's enhancement allowances.

38. We are concerned that Ofwat's draft determinations, considered in the round, therefore result in a cost-outcomes disconnect compared with our plan.

39. The improvements in outcomes performance we would be required to achieve from base – as reflected in the PCLs and the enhancement claims proposed in our plan – go beyond what is reflected in the base cost allowance Ofwat has proposed as compared to the spend we consider is needed to deliver on that ambition. Ofwat has accepted our ambition of 'what base buys' in key PC areas but, in effect, has not provided us with a representative base cost allowance to deliver on this ambition.

40. We consider there are several ways in which Ofwat could, and should, address these issues in its final determinations and reflect its notional cost assessment modelling as opposed to giving reference to our actual spend.

41. As an example, we are aware other Pennon Group companies are proposing a symmetric CAC on leakage for companies that are upper quartile performers on leakage reduction. We support this CAC and consider it provides one example of how Ofwat can update its base cost allowances at final determinations to better reflect the industry leading performance improvements we will achieve from base.

42. An alternative approach could be for Ofwat to provide credit for the performance ambition we will achieve from base by valuing this at the enhancement spend levels that has been forgone from this performance. For example, if the improvement in leakage that we intend to deliver from base – achieved via incurring recurring costs from our smart / intelligent network and systems – is valued at the benchmarked unit cost that Ofwat has used to set enhancement allowances for leakage[7], we estimate this could justify an additional base allowance of c.£4.0m. This is prior to any account being made for benefits achieved in other PC areas we are achieving upper quartile performance or above, in particular water supply interruptions, from our smart network.

43. In principle, the 2023/24 APR data update to the base cost modelling also provides an opportunity for Ofwat to review its final model decisions (e.g., the weighting of models) to better reflect the efficient spend that we require to deliver on the performance ambition from base captured and accepted by Ofwat in our plan.

44. For the reasons we set out above, what level of performance is ultimately implied by Ofwat's base cost models cannot be observed directly. The level of adjustment that might be required to address the issues we have set out above is ultimately a judgement and is interlinked with the base allowance provide by Ofwat's final modelling.

45. We have estimated this could justify an adjustment of £4m but it could plausibility account for a more sizable proportion, alongside other data and base modelling issues, of the final adjustment ultimately needed in Ofwat's final determinations to bring our base allowance into alignment with our plan's base expenditure.

[7] Noting that we have various representations on how Ofwat has approached the calculation of this unit cost.

46. We would welcome further engagement with Ofwat on this issue as we consider it is critical to our ability to deliver on our outcomes ambition in the next AMP.

Our representations on Ofwat's assessment of our wholesale and retail cost adjustment claims.

47. Our PR24 plan included five cost adjustment claims that predicated our base expenditure requirements. The table below shows the status of these claims in our PR24 plan, Ofwat's draft determination and our representations.

Table 4: SES Water's cost adjustment claims (£m, 22/23 prices)

	SES BP submission	Ofwat DD of SES BP	SES representation
Pumping / power [8]	42.0	-	17.1
Softening	29.1	18.7	29.1
Regional wages	5.7	-	-
Retail scale	4.1	-	-
Total	**80.9**	**18.7**	**46.2**

Source: SES Water analysis

48. We consider that Ofwat's draft determination cost modelling provides a sufficient expenditure allowance to operate our retail functions efficiently and so have not pursued our claim. Similarly, we have decided not to challenge our previous claim for higher regional wages in the Southeast. As a result, neither of these adjustments are included in our revised representation CACs, as reflected in the table above.

49. We have reviewed our claims for power, maintenance and investment associated with our unique pumping requirements across both the water resources and the water network+ price controls. Our revised claim is £17.1 million which is solely related to the additional volume of power we consume as a result of the topography of our network relative to others in the sector. The price component of our original pumping claim is now reflected in our representation on energy costs, as discussed below.

50. We have also reviewed both the opex and capex requirements associated with our water softening operation between 2025 and 2030. We maintain our position that a £29.1 million cost adjustment is required to enable us to continue to operate an effective softening operation. As set out below, we consider there are several inconsistencies in the approach Ofwat has taken to assess our softening related opex and the proposed adjustment does not reflect our efficient costs. Furthermore, we have carried out additional cost assessment and benchmarking of our capex alongside further consideration of options and have concluded that our original capex calculation to refurbish the softening plant at Kenley water treatment works is appropriate.

51. Overall, we would reiterate that these CACs are vital to our ability to continue to run our core business effectively and provide a safe and resilient service to our customers now and in the future, while also improving performance. As we set out in the subsections below, and the supporting representation appendices, our CACs are evidenced and reflect adjustments that Ofwat has previously recognised are needed either in its PR19 or PR24 draft determination cost assessments.

[8] This included two separate CACs, one for water resources and one for water network plus.

Power / pumping cost adjustment claim

52. We commissioned an independent review of Ofwat's assessment of our PR24 plan pumping claim by NERA, which is included in Appendix SES103 – Pumping cost adjustment claim.

53. NERA conclude that we use more energy and spend more on power to abstract and supply water to our customers relative to the majority of the industry. This is because we need to pump relatively more water due to the topography of our supply area and the mix of water resources that we rely upon.

54. NERA further conclude that the base cost models that Ofwat has used to set the proposed wholesale expenditure allowances in its draft determinations fail to fully and properly account for these characteristics. They also identify several issues with Ofwat's assessment of our pumping claim in the draft determinations and show that Ofwat's reasoning for the rejection of our cost adjustment claim is unfounded:

- For water resources plus (WRP) (which includes water resources, raw water transport and water treatment) NERA conclude that by "*failing to include a driver that controls for companies differing pumping requirements, Ofwat's models do not control for variations in companies' pumping costs in WRP*"; and
- For Ofwat's treated water distribution (TWD) and wholesale water (WW) models, NERA conclude that we "*face unique circumstances that necessitate a cost adjustment*" and that several of Ofwat's base cost model specifications undermine "*its models' ability to control for the specific characteristics of SES Water that cause it to have unusually high power costs*."

55. Appendix SES103 – Pumping cost adjustment claim considers some of the operational issues around maintenance costs that Ofwat reference in its assessment as part of the reason for rejecting our pumping CAC and why the issues Ofwat raise are unfounded[9].

56. NERA conclude that a cost adjustment allowance of £17.1 million for our WW power costs is needed over AMP8. Based on the findings of NERA's report, and the operational points we raise on Ofwat's assessment of our CAC, we continue to conclude it is appropriate for Ofwat to make a company-specific cost adjustment for our additional pumping costs as its base cost models do not adequately control for them.

57. We have therefore reduced the size of our pumping claim to £17.1 million to align with the conclusions in NERA's independent report. Consistent with the cost adjustment accepted by Ofwat at final determinations for PR19 this reflects solely the relatively high volume of power we consumer due to the topography of our supply area and the mix of water resources that we rely upon to supply our customers.

58. While we have used £17.1 million as our representation figure for our revised CAC, there are reasons, however, to believe this is could be an understatement of the adjustment that is needed to Ofwat's modelling. NERA in their report reference the concerns that Ofwat raise with Average Pumping Head (APH) data and conclude that while "*Ofwat considers APH data quality has improved at PR24, any remaining data quality concern is likely to cause attenuation bias, thus understating the quantified relationship between APH and costs, thereby disadvantaging companies like SES Water that have relatively high APH.*"

59. Our revised CAC representation is based on the best data available at the current time for sizing a targeted, empirically justified, adjustment to Ofwat's base cost modelling. But as NERA conclude "*these data quality issues compound the need to make company-specific adjustments for companies whose high pumping requirements are not properly*

[9] In particular, the issues that Ofwat have raised around the counteracting impacts on maintenance costs of reservoirs and pumping.

represented by the boosters per length of main variable". Overall, we consider this indicates that Ofwat should be being conservative in the adjustment that it makes to its base cost modelling related to our pumping requirements in light of:

- The data issues noted above;
- The case NERA make in their report for how our higher pumping requirement is not adequately reflected in Ofwat's base cost modelling; and
- The issue we raise above that Ofwat's base models at PR24 seem to be less effective in capturing our efficient costs than at PR19.

60. Finally, we note our original pumping claim also included adjustments for price effects related to the higher price of power that we expect to incur in AMP8. These effects were included in our claim at business plan submission given uncertainties in how Ofwat would treat this energy price effect in its base cost modelling.

61. In light of the approach that Ofwat has taken to apply an energy price adjustment in its draft determinations, we have removed these price effects from our pumping cost adjustment claim. Instead, we set out how we consider Ofwat should account for these price effects in our representations on Ofwat's energy cost adjustment (see below).

Softening cost adjustment claim

62. We have long-standing statutory obligations to partially soften the naturally hard groundwater in our supply area. These obligations date from 1862 (the Caterham Spring Water Company Act) and 1903 (Sutton District Waterworks Act as amended in 1983). This requirement extends to five large groundwater water treatment works (WTWs) – Cheam, Elmer, Godstone, Kenley and Woodmansterne. In an average year these sites provide around 81% of the water supplied to our customers.

63. Ofwat has recognised that this unique requirement and has provided us with a cost adjustment in successive price reviews, funding us to soften water in-line with our statutory obligation. The amount of cost adjustment has varied across price reviews, primarily due to the amount of capex required to maintain our softening plants.

64. Our PR24 softening claim totals £29.1 million and includes:

- Opex costs of £15.11 million; and
- Capex costs of £13.96 million, the majority of which is to refurbish the softening plant at Kenley WTW.

65. Ofwat's draft determination provided a £10.89 million cost adjustment for opex, which is in-line with what we were awarded in AMP7 but does not reflect the increased costs we will incur over AMP8. We consider Ofwat has taken an inconsistent approach in the assessment of the opex elements of our softening CAC, in comparison to the approach it has taken to the assessment of base modelled costs, in that it has not adequately reflected the price effects impacting these unmodelled costs.

66. For the capex element of our claim, Ofwat awarded £7.84 million for the Kenley refurbishment. It challenged that we have not provided enough evidence to show whether alternative options instead of the replacement of filters at Kenley WTW have been considered and has given us a 20% cost efficiency challenge on the delivery of the project. We have therefore provided additional evidence around optioneering and benchmark pricing to demonstrate efficient use of capex.

67. Appendix SES104: Softening cost adjustment claim, provides our detailed representation on our softening cost adjustment claim and the evidence we consider demonstrates why Ofwat should allow the adjustment we proposed in our Business Plan in full.

Our representations on Ofwat's base energy price adjustment

68. We fully support the principles behind Ofwat's energy cost adjustment to ensure that future energy costs are appropriately accounted for in Ofwat's base cost modelling and support the energy true-up proposed by Ofwat. However, there are several substantive issues with how the energy cost adjustment has been calculated that need to be addressed in the final determination.
69. The first issue relates to the counterintuitive result of the energy price adjustment having a net negative effect over AMP8.
70. This is due to an inconsistency between the index used to uplift energy prices to 2022-23 and the index used to apply a Real Price Effects adjustment from 2022-23 onwards. While the former is a hedged index the latter is an unhedged forecast, and, owing to the way the two indices have been combined, Ofwat's resultant forecast exaggerates the expected reduction in energy prices over AMP8.
71. While this ought to correct itself through the ex-post true up, it leaves a material funding gap ('cash flow risk') that will need to be financed by company balance sheets until the end-of-period reconciliation. To reflect our representations on this issue, we have updated Ofwat's modelling of base costs to reflect the price forecast we used in our own modelling at the time of business plan submission.
72. The second issue relates to the application of the energy price adjustment to the benchmark modelled costs only and not to any of the cost adjustments.
73. In its assessment of the CACs we have submitted, such as our claims related to water softening and the additional pumping costs due to the topography of our area, Ofwat has declared that it has applied an energy price adjustment to the associated costs. However, it does not appear to be the case from our analysis of Ofwat's modelling.
74. The decision to exclude such costs from the energy price adjustment appears arbitrary and inconsistent with the principles underpinning the adjustment. The energy price adjustment is intended to ensure that our cost allowances reflect our exposure to recent increases in energy prices. By not applying it to key elements of our cost base, Ofwat is undermining its purpose.
75. We consider that the energy cost adjustment related to water softening is best applied within the opex element of softening claim itself (summarised above). This is because our estimates of energy costs are all set with reference to our outturn costs in 2017/18 and so, assume a different base price than is reflected in the more general energy price adjustment. For this reason, we consider it is appropriate for Ofwat to capture the required adjustment to power prices directly in our softening claim.
76. For our pumping related claim, we are in principle indifferent as to whether the price adjustment is applied within the claim itself or as part of the general price adjustment. However, for the reasons we have set out above, we have removed the energy price effects from our original pumping claim, so it is focused solely on the volume effects on our power consumption arising from our higher pumping requirements. As a result, Ofwat need to account for this price effect within the general energy cost adjustment it has applied to our modelled cost allowance.
77. The effect of this is captured in our representation on Ofwat's wider energy cost adjustment in Appendix SES105 – Energy prices. This appendix provides our detailed representation on Ofwat's energy price adjustment. It is critical to note that as well as the mechanics of this calculation, Ofwat also need to account for this price effect in both its modelled base costs and the pumping cost adjustment element of the allowance.
78. Furthermore, Ofwat has not applied the energy price adjustment to the base costs it has allocated to meter replacement and net zero. We consider these are best applied

through the general energy price adjustment within Ofwat's energy price adjustment model, given they are sector-wide cost adjustments.

Summary

79. Overall, we have significant concerns with the proposals for allowed base expenditure in Ofwat's draft determination and conclude a significant increase in funding is required at Ofwat's final determination.
80. We have identified a series of representations on how we consider Ofwat's base cost modelling needs to change at final determination to provide us with an adequate and efficient level of allowed totex that reflects our unique circumstances and the level of outcomes performance we will deliver from base in the next AMP.
81. The table below summarises our PR24 plan base costs, the assumptions we made in our original benchmarking of our plan (vs. the plan's base costs), Ofwat's draft determination and our representation assumptions on Ofwat's modelling.

Table 5: SES Water's base cost comparison (£m, 22/23 prices)

Item	Ref	Price control	SES BP assumptions	Ofwat Draft Determination	SES representation
SES Water PR24 plan base cost			360.5	360.5	360.5
Ofwat base cost modelling:					
Base wholesale models[1]	BAW	WR / WN+	228.4	215.9	231.8 [2]
Energy price adj.	EPA	WR / WN+	21.9	(1.3)	22.1
Pumping CAC	CAC1	WR / WN+	42.0	-	17.1
Softening CAC	CAC2	WN+	29.1	18.7	29.1
Regional wage CAC	CAC3	WN+	5.7	-	-
Frontier Shift [3]	FS	WR / WN+	(4.4)	(8.9)	(4.3)
Net zero adj.	BAN		-	0.4	0.4
Meter adj.	BAM		-	23.0	23.0
Base retail models [4]	BAR	Retail	33.4	37.7	37.5
Retail scale	CAC4	Retail	4.1	-	-
Total allowed base – wholesale + retail			**360.5**	**285.5**	**356.7**
Variance vs. SES PR24 Plan base totex			**-**	**(75.0)**	**(4.2)**

Source: SES Water analysis of Ofwat base cost models
Note 1 – Base allowance from Ofwat triangulated wholesale water models plus unmodelled costs
Note 2 – This is the base model totex – including adjustments for performance-cost trade-offs – we estimate is needed in Ofwat's final determination base cost modelling after other adjustments in this table are accounted for.
Note 3 – Ongoing efficiency net of Real Price Effects
Note 4 – Base allowance from Ofwat triangulated retail models

82. We are proposing revised CACs of £46.2 million specifically related to:

- The topography of our operating area and the impact this has on the relative volume of power consumption and pumping costs within our business relative to others in the sector (CAC1); and
- The additional costs we incur relative to others in the sector associated with softening the water that we provide to our customers – something we have a unique legal requirement to deliver (CAC2).

83. As we noted above, we have revised our pumping claim and it is solely related to the additional volume of power we consume as a result of the topography of our network relative to others in the sector. The price component of our original pumping claim is now reflected in our representation on energy costs, as discussed below.

84. The retail scale (CAC4) and regional wages (CAC4) adjustment claims that we included in our original business plan submission are not part of our revised representation claims despite Ofwat's rejection of them at its draft determination. As discussed above:

- Viewed in the round, we consider that Ofwat's draft determination retail cost model
- ling provides a sufficient expenditure allowance to operate our retail functions efficiently in the next AMP. We have as a result, decided not to pursue this claim.
- We have decided not to challenge our previous claim for higher regional wages in the South East.

85. We have, however, identified issues with the way in which energy cost (price) adjustments (EPA) have been calculated by Ofwat in its base allowances. This effects all companies but is likely to have a greater impact on us than most others as a result of our relatively high volume of power consumption related to the topography of our network. We have calculated the impact our representations on Ofwat's energy price adjustment and true-up mechanism would have on our base cost allowance and estimate this provides an additional £23m of allowed totex[10].

86. Finally, we have assumed the additional funding we consider is required from Ofwat's base modelling to bring our overall base allowance into alignment with the efficient expenditure we forecast in our plan[11] will be provided by Ofwat in its final decisions and updates to its wholesale base cost modelling.

87. We have noted above our concerns with the triangulated wholesale efficiency score that is implied by Ofwat's draft determination base cost models compared to our position of relative efficiency to others in the sector at PR19. We request that Ofwat carefully consider this key cost modelling result in its final determinations, its overall plausibility as a required efficiency challenge (when viewed in comparison to Ofwat's modelling at PR19) and the practical implications for our customers.

88. We have noted the risk that there may be a range of factors that impact our efficient costs that are still not adequately reflected in Ofwat's base models to meet our base cost needs to run the business.

89. For example, Ofwat's proposed benchmarking of our base costs potentially creates a risk of disconnect with the high-quality service and performance improvements we proposed to deliver from base in our plan. We have innovated strongly over the current and previous AMP, and in doing so, have delivered an upper quartile level of performance or above in key PCs including water supply interruptions and leakage. Ofwat has accepted our ambition of 'what base buys' in key performance areas but has not provided us with a representative base cost allowance to deliver on this.

90. We have estimated this could justify an adjustment of £4.0m but it could plausibility account for a more sizable proportion, alongside other data and base modelling issues, of the final adjustment ultimately needed in Ofwat's final determinations to bring our base allowance into alignment with our plan's base expenditure.

91. We continue to believe our PR24 plan base costs are efficient and have set above why we consider Ofwat's base cost modelling in its draft determination does not adequately capture the efficient allowed spend we require in the next AMP. There are several factors that Ofwat's final base cost modelling – including the update for 2023/24 data and the recalculation of the energy price adjustment – need to address in the round to meet our base cost requirements to run our business.

92. In its final determination we request that Ofwat:

    (a) Allow our revised pumping / power CAC (£17.1 million) in full.

    (b) Allow our original softening CAC (£29.1 million) in full.

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[10] This will be subject to the true-up as Ofwat has proposed in its draft determinations.
[11] After accounting for the other adjustments that we note above are required to Ofwat's base cost assessment.

(c) Make targeted adjustments to the energy cost adjustment in its modelling including:

  (i) Updating the price index it has uses to set its ex-ante base cost allowance (i.e. prior to the end of period true up mechanism)

  (ii) Ensuring its energy price adjustment is applied to our modelled base costs and our revised pumping / power CAC[12].

(d) Reflect our ultimate base funding requirement and upper quartile or above performance (on key PCs such as leakage and water interruptions) by providing additional base allowances of £15.5 million via:

  (i) Final decisions that it reaches in weighting and specification of the models used to set our base cost allowance; and/or

  (ii) Targeted adjustments to reflect our industry leading performance (such as, but not limited to, the proposal by other Pennon Group companies on leakage CAC).

C. Enhancement expenditure

93. Our PR24 plan included £53.4m of wholesale enhancement investment to enable us to make a step-change in our performance in a number of areas, meet new legal requirements and address the impacts of climate change and population growth.

94. Ofwat has reduced our total enhancement expenditure allowance to £38.6m. We have reviewed all our enhancement expenditure claims, taking account of Ofwat's feedback, new requirements and the latest market information on costs.

95. In the table below we show how much enhancement expenditure was included in our PR24 business plan, changes made by Ofwat in its draft determination and the revised costs included in our representation.

Table 6: SES Water Enhancement Expenditure Allowances

Enhancement area	SES Water PR24 plan (£m)	Ofwat's DD of our PR24 plan (£m)	SES Water representation to Ofwat's DD (£m)
Environmental improvement	5.0	5.5	5.0
Resilience	4.3	1.6	4.3
Drinking water quality (UV)	5.2	8.2	5.2
Leakage	10.5	3.4	13.0
Metering	23.4	17.8	24.8
Drinking water quality (Lead)	3.8	1.6	3.8
Cyber and open data	0.5	0.3	0.5
SEMD and resilience interconnectors	2.2	1.3	2.2
Total (pre-RPE and OE)	**54.9**	**40.1**	**58.8**
RPE and OE	(1.6)	(1.5)	(1.6)
Total (post RPE and OE)	**53.4**	**38.6**	**57.2**

[12] As noted above, we consider that a specific adjustment for price effects should be applied in our softening CAC given these are specific costs related to SES Water.

Source: SES Water adapted from Ofwat's enhancement cost allocation table

96. As shown in the table above, the most significant changes to our enhancement claims are a £7.1m reduction in leakage and a £5.6m reduction for smart metering. These are critical components of our long-term plan to secure resilient and sustainable water supplies in the face of population growth and climate change and reflect the investment needed if we are to move from our current position to achieve the ambitious targets set by government in its Environmental Improvement Plan and meet our customers' expectations.

97. We do not consider that Ofwat's cost benchmarking accurately reflects our position for leakage and smart metering, and we have provided further evidence to justify £24.8 million of enhancement expenditure for smart metering and £13.0 million for leakage reduction. This is critical if we are to deliver our WRMP, which has been signed-off by the Government and is aligned with the Water Resources South East regional plan that has set out the long-term solution to securing the region's water supplies.

98. Furthermore, our customer-focussed lead replacement scheme that targets schools and other public premises frequented by people most at risk from lead exposure has not been fully accounted for by Ofwat, resulting in a funding shortfall of £2 million. We have provided further evidence to explain our investment proposals and costs associated with this programme that was developed in response to our customers' priorities.

99. In total our revised enhancement expenditure requirement is £57.2 million over the 2025 to 2030 period.

Leakage

100. We have one of the lowest leakage levels in the industry. We are committed to reducing leakage by more than 50% over the next 25 years, in-line with our customers' expectations and continuing to lead the industry in this area, sharing our learnings with others. By the end of AMP8, we are targeting a 26.6% reduction in leakage from the 2019/20 baseline.

101. Our PR24 leakage enhancement claim totalled £10.5 million. It included £4.2 million of funding to step-up our activity to find and fix leaks, enhance our smart network and improve how we manage the pressure in our network to reduce water losses. We projected that this would reduce leakage by 3Ml/d by 2024/25 enabling us to achieve our ambitious leakage target.

102. In addition, we included £6.3 million of funding to embed our innovative DMA asset health and asset condition assessment across our network. This survey work will not deliver leakage reductions in AMP8, but the results will be used from AMP9 onwards to undertake additional network optimisation, target our mains renewal programme and model deterioration of mains (and therefore optimise investment and therefore cost in future AMPs), all of which are central to our ongoing strategy to deliver sustainable reductions to leakage in the most cost-effective and fair way for current and future customers.

103. In its cost assessment and benchmarking of leakage activity across the industry, Ofwat has calculated £1.11m/Ml/d to be an efficient cost for leakage activity. In its assessment of our leakage enhancement costs Ofwat has included the £6.3 million of costs for the DMA asset health and assert condition assessment in its calculation. However, this will not reduce leakage in AMP8 so we consider it should be omitted from the cost assessment. Doing this reduces our leakage costs from £3.5m/Ml/d to £1.4m/Ml/d, putting our costs much closer to the industry median and reflecting the true cost of reducing leakage in AMP8.

104. We consider that our DMA asset health should still be funded by enhancement expenditure as it is an enabler of future leakage reduction and a critical investment on our LTDS core pathway. It will also contribute to providing the industry with evidence for calculating the appropriate rate of mains replacement in the future.

105. We have included an additional £2.5 million enhancement funding as part of our draft determination response following Ofwat's directive to phase out the BABE approach for leakage quantification on trunk mains by the end of AMP8 and adopt upstream flow monitoring zones (uFMZs). We had originally planned to complete this transition by the end of AMP9. Consequently, our AMP8 efforts focused on areas with existing infrastructure or delivered through other projects e.g. iDMA. However, to accelerate this process and ensure full compliance with Ofwat's requirements, we will now install 49 new electromagnetic flow meters at strategic points in our upstream network during AMP8.

106. Our representation enhancement case for leakage therefore stands at £13.0 million, full details of our leakage enhancement case can be found in Document SES106 – Leakage enhancement claim.

Smart metering

107. The rollout of smart metering is the largest enhancement programme we will deliver over AMP8. It is driven by the urgent need to reduce household and business consumption in line with our WRMP to secure resilient and sustainable water supplies for the future.

108. In our PR24 plan we included £23.4m of enhancement expenditure to deliver the first five years of our seven-year smart metering programme, accelerated to meet the expectations of government and regulators. In its draft determination, Ofwat funded us £17.8 million, 20% lower than our calculation of the efficient costs required.

109. Since submission of our original plan, we have carried out further detailed market engagement on the cost of purchasing, installing, operating and maintaining meters. We now consider that our original submission was an underestimate, and that the enhancement expenditure required is £24.8m over AMP8, £1.4m higher than our original projection.

110. We consider that the information we have received from metering providers to be a more reliable and accurate view of the unit costs associated with rolling out smart meters than Ofwat's cost assessment and benchmarking. We have therefore increased our smart metering claim accordingly and it now totals £24.8m.

111. Further detail of our smart metering claim can be found in Document SES107 – Smart metering enhancement claim. This also highlights a number of inconsistencies in Ofwat's approach to benchmarking smart metering costs, not least the lack of consideration given to the higher level of demand reduction we are aiming to achieve from smart metering compared to other companies.

112. Finally, our representation highlights the overlaps between the price control deliverables (PCDs) for the metering programme and the associated outcome delivery incentives (ODIs) for Per Capita Consumption, Business Demand and Leakage reductions. The cumulative impact of these incentives creates significant downside risk that is disproportionate to the outcome that Ofwat is attempting to incentivise, and we request that Ofwat reviews its approach.

Lead replacement

113. Our Business Plan includes an enhancement case for additional expenditure associated with the replacement of lead pipes that supply water to customers who are at most risk from lead exposure. Our proposed risk-based approach, targeting investment on educational premises, goes considerably beyond our statutory duties, and is the product of extensive engagement with customers and stakeholders who supported us increasing investment in this area to help improve water quality.

114. However, our forecast lead replacement enhancement expenditure has been misinterpreted in the PR24 draft determination and as a result, Ofwat's modelling incorrectly allocates a significant element of our lead replacement base costs and volumes to our enhancement expenditure. In addition, we have concerns over Ofwat's proposed approach to benchmarking the costs of our lead replacement enhancement expenditure, including its assessment of our schools' programme, which fails to recognise the different (and higher) costs associated with these works. The impact of the draft determination is that we have been left underfunded to deliver our lead replacement programme.

115. We consider these issues to be easily resolvable and we provide supporting information to clarify the proposed expenditure associated with our lead replacement programme, as well as suggestions on how Ofwat should remedy the errors identified in its approach to assessing this in its draft determination. We restate that the total enhancement expenditure requirement to deliver our customer-focussed lead programme is £3.8m. Further details can be found in Document SES108 - Customer focussed lead replacement programme enhancement claim.

Resilience

116. In the draft determination, Ofwat has awarded elements of funding set out in our resilience enhancement case and contributed a further industry wide award of £1.6 million for enhancements related to climate resilience. We believe that several items included in our enhancement case may have been interpreted as climate-related activities e.g. run to waste facilities and smart production. However, this is not the case, and we therefore consider we have been underfunded for several enhancement actions that are vital to improve the resilience of our treatment works and processes for the benefit of our customers and the environment.

117. We have included £4.3m for specific investment to improve our resilience in our plan. Further details can be found in Document SES109 - Resilience enhancement claim[13].

Shallow-dive efficiency challenge

118. For some enhancement proposals, Ofwat has benchmarked the efficiency of our cost estimates against other companies' estimates and have determined the overall efficiency gap to be 26%. This percentage has been used as the basis for determining a 'shallow dive' efficiency adjustment, which is applied to enhancement costs that were not benchmarked. We further note that Ofwat has imposed a cap on this shallow dive efficiency adjustment limiting it to a maximum of 20%.

119. We recognise that the approach Ofwat has taken is a common lever within the regulatory toolkit. This is to encourage companies to submit efficient costs within their business plans and to ensure that Ofwat can determine efficient costs for cost lines that cannot be benchmarked. However, in using this lever, Ofwat is making two very strong assumptions:

[13] Total value of Resilience enhancement claim (Doc SES109) is £6.87m and also includes SEMD, resilience interconnectors and cyber enhancement.

(a) Firstly, that the benchmarked

(b) led costs for the enhancement lines are subject to little uncertainty (i.e. they have strong internal validity); and,

(c) Secondly, that the efficiency of benchmarked cost estimates is reflective of the efficiency of non-benchmarked cost estimates (i.e. they have strong external validity).

120. We demonstrate in Document SES110 – Enhancement efficiency challenge, that the benchmark models for enhancements have limited internal validity, and as acknowledged by Ofwat itself, less internal validity than the base cost benchmark models. We also demonstrate that the benchmark models have limited external validity, as acknowledged by Ofwat in its PR19 determination.

121. As such, we request that Ofwat avoids an overly simplistic application of the shallow dive efficiency challenge and instead, use a lower cap than the current proposed 20% cap. We anticipate that the magnitude of this efficiency challenge will naturally decrease following our representations that provide further evidence of the efficiency of our enhancement cost estimates. Despite this expectation, we believe that a lower cap of 10% on the shallow dive efficiency adjustment would be more appropriate, in line with the cap used by Ofwat in PR19.

D. Managing regulatory uncertainty

PFAS

122. Ahead of our PR24 submission, we developed a PFAS strategy in line with DWI guidance issued in 2022. At the time of submission, we had no concerns that any of our waters would require additional treatment in AMP8, however we noted that we were in the early stages of gathering water quality data under all climatic conditions, and our assessment was relevant to the regulatory guidance levels at the time. Given our position relative to the water quality guidance and the allowance for ongoing analytical funding in our 2023/24 base costs, no specific funding for PFAS was included in our PR24 Business Plan.

123. The DWI confirmed its support of our PFAS strategy in November 2023 and requested that we submit an Undertaking for PFAS covering the planned work in AMP8, which we agreed in June 2024. This committed us to ongoing monitoring, catchment categorisation and the development of risk reduction strategies proportionate to the tier allocation for each source, which would be funded through base or through our WINEP investigations where there is alignment between sources.

124. On 21 August 2024, the DWI issued revised guidance for PFAS[14] that requires the consideration of combined concentrations of PFAS at each source alongside the assessment of individual PFAS chemicals. The impact of this change to the regulatory guidance must be fully assessed and may lead to a reassessment of source risk, requiring a re-prioritised approach to PFAS reduction.

125. With the rapidly changing regulatory landscape for PFAS and the uncertainty this brings to the future investment needed to mitigate the risk to water quality, we expect there to be an agreed process to account for any costs incurred that have not been funded in our Business Plan to address PFAS risk when we are required to do so by the DWI, as part of an agreed statutory instrument.

[14] DWI Information Letter 03/2024, 21 August 2024 – Revised guidance specific to per- and polyfluoroalkyl substances (PFAS), https://dwi-content.s3.eu-west-2.amazonaws.com/wp-content/uploads/2024/08/21170803/Information-Letter-03_2024_revised-PFAS-guidance.pdf

4. Risk and return

In this section we show that our plan remains financeable in line with our response to the draft determination. We have highlighted the updated financial modelling assumptions following receipt of the draft determination and, consistent with our PR24 Business Plan submission, we continue to note the need for additional equity to underpin the plan.

We provide our updated representation with respect to RCV run-off rate challenges provided by Ofwat.

A. Introduction

1. We are financeable on an actual and notional basis after incorporating our responses to Ofwat's draft determination, including our representations on totex, PAYG levels and RCV run-off rates, together with Ofwat's views on allowed returns, retail margins and official forecasts of inflation.
2. As with our submitted PR24 Business Plan, our financeability is dependent upon:
   - Additional equity from 2024/25 and into AMP8 (modelled at £35m);
   - Ofwat's acceptance of our totex representations;
   - Ofwat's acceptance of our RCV run-off rate representation, which proposes a rate of 7%; and
   - Effective and efficient debt raising activity via Pennon Group in AMP8, including re-financing of our index-linked bond commencing in 2027.
3. Following our acquisition by Pennon Group and the expected de-gearing noted by Pennon Group at that point in time, we have included a £10m equity injection in our financial modelling for 2024/25. This is for commencement of de-gearing in line with Pennon Group's financial policy and is separate from the £35 million modelled equity noted above.
4. On this basis we will be financially resilient throughout the period to 2033 as evidenced by our updated stress-testing of various Ofwat and company-specific scenarios. As with our PR24 Business Plan submission, the Company, in extreme and downside scenarios, may need to retain financial resilience through a combination of suspending dividends or seeking additional equity.
5. Our forecast financial metrics – updated in line with our response to Ofwat's draft determination – continue to indicate the Company achieving, on average across AMP8, a credit rating of a strong Baa2 under Moody's assessment criteria, with some years achieving a marginal Baa1 rating. Absent changes in our credit rating regime following our acquisition by Pennon Group plc, maintaining a Baa2, and achieving a Baa1 credit rating will require the Company to deliver through AMP8: solid operational and regulatory performance, totex spend in line with final allowances from Ofwat, continued equity injections as detailed in our financing plan for 2024 to 2026, and with the absence of any severe adverse macro-economic factors.

6. We have aligned our dividend yield to 4% per Ofwat's guidance as the maximum to be reasonably modelled for a company with lower RCV growth. We consider that our dividend and executive pay policies, as previously submitted, conform to Ofwat's Final Methodology and pronouncements from Ofwat on enhancing dividend and pay policies but have noted Ofwat's recommended improvements to these policies and will address as part of finalisation of the policies prior to the commencement of AMP8.
7. Our assessment of the risk associated with delivery of our business plan based on Ofwat's draft determination identified a significant asymmetric RoRE range skewed to the downside primarily. This was due in large part to the significant adverse financial impact associated with certain ODIs proposed by Ofwat (most notably ODIs for discharge permit compliance and water quality contacts commitments). This downside risk can be mitigated to some degree through the totex and PC/ODIs representations in the Outcomes section of this response document but remains asymmetrically skewed to the downside.
8. This chapter provides an update of the financing and risk and return matters relevant to our response to the draft determination

B. Financial modelling updated assumptions

9. While our financial structure and strategy at present remains consistent with that described in PR24 Business Plan (Chapter 8: Financing our plan – aligning risk & return), the following updated assumptions are incorporated into this response. We also expect further discussions with Ofwat on the revenue feeder models post our draft determination response.
10. In line with the draft determination, our business plan response and the associated financial models adopt Ofwat's weighted average cost of capital of 3.66% (CPIH, real) and we have removed the small company premium post-acquisition by Pennon Group. We acknowledge the work undertaken by KPMG on the industry cost of debt. (Note, we have in our final data quality reviews identified an immaterial difference in the WACC used in the notional model, this will be updated through the Q&A process with Ofwat)
11. Given the funding surplus in our defined benefit pension scheme (at £8.6 million at 31 March 2024), as noted in our APR 2024, no pension deficit payments are expected to be required for 2025-30, with the scheme closed to further members. We do not expect to access this surplus during AMP8. Our defined contribution scheme is expected to continue to be funded at rates similar to AMP7.
12. Based upon the assumed levels of revenue and totex spend, tax has been calculated at the standard rate of 25% with an assumption for deferred tax based on the movement in the defined benefit pension scheme and capital allowances driven by the Company's capital investment programme. We have assumed that capital expenditure continues to be 100% allowable for capital allowances and all interest restrictions remain in place, consistent with AMP7.
13. To maintain financial resilience during AMP 8 and beyond (as noted in the financial resilience section of this chapter), further equity support will be required. This is primarily to ensure gearing is maintained at appropriate levels to ensure we have sufficient headroom under our covenants and ensure financial resilience. The modelled debt and equity injections for AMP 8 are provided in the table below.

Table 7: Equity injections from 2024/25 to 2029/2030

£m (nominal)	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	Total
New debt additions	0	0	15	17	7	8	47
Equity injections	20	20	5	0	0	0	45

Source: SES analysis

14. The table shows that within our AMP8 modelling, an equity injection in aggregate of £45 million has been assumed as a base case.

C. Financeability

Financeability – on an actual basis

15. Our financial modelling for 2025 to 2030 takes account of all the various components of this response to the draft determination – including totex representations, updated official forecasts of inflation, Ofwat specified levels of allowed return and retail margin, our updated RCV run-off and PAYG levels – and demonstrates that we can generate cash flows sufficient to meet our financing needs.
16. In line with Ofwat's draft determination, we have assessed financeability on an actual basis taking account of the expected end-of-AMP7 RCV adjustments as at 31 March 2025.
17. As with our PR24 Business Plan submission, the Board's assessment of financeability is performed through consideration of key financial metrics. While those financial metrics that Ofwat have noted in the final methodology have been considered, for our Company the main financeability metrics are those that ensure our compliance with the financial covenants associated with our index-linked bond (in particular bond gearing limit of 75% at the start of each AMP and 80% during the AMP itself).
18. As noted later in this chapter, we have incorporated RCV run-off rates and PAYG ratios in line with our draft determination representations.
19. With the equity associated with de-gearing and operational purposes and noting the other updated financial assumptions in Section B above, the Company continues to be compliant with our bond covenants through the business plan period up to 2033, in line with the 10-year horizon in our annual long-term viability statements. The annual bond ratios are noted in the table below.

Table 8: SES Water annual bond ratios

Bond Ratios	2025/26	2026/27	2027/28	2028/29	2029/30
ICR >1.3x	1.40	1.42	1.43	1.40	1.41
Gearing <80%	71.0%	71.6%	73.8%	74.7%	75.3%

Source: SES Water

Financeability – on a notional basis

20. Our Business Plan incorporating the representations to the draft determination complies with the obligations of the above financial covenants, which apply to our actual financial structure.

21. Through compliance on these metrics – we are also financeable on a notional basis, whose structure is different in two key areas:

- Assumed gearing – of less than 55% throughout the AMP; and
- Composition of external debt and the interest assumed to be payable on that debt – that Ofwat's notional structure adopts interest rates materially lower than the interest rate actually payable on our historic borrowings

22. Based upon the notional model where gearing ranges from 70% to 73%, with an average gearing of 72% across the AMP, this results in favourable interest and credit metrics and proves the Company to be financeable on a notional basis.

RCV run-off rates and PAYG ratios

23. As noted in our PR24 Business Plan submission our proposed RCV run-off rates (at 7.0%) were the highest in the sector and above Ofwat's guidance. A separate representation is provided in Appendix 111- RCV run-off rates, which reinforces our position and provides evidence and substantiation for our higher RCV run-off rate. We highlight that our RCV run-off rate and PAYG rate need to be considered jointly, as both collectively impact how much current customers pay versus future customers.

24. Our proposed RCV run-off rate is consistent with the natural rate when considering both historic and forecast levels of spend on capital maintenance and renewals and considering the proposed PAYG rate. The draft determination would temporarily reduce bills in the shorter term and the expense of higher bills for future customers – violating the intergenerational fairness principle.

25. We maintain our position on the 7% RCV run-off rate, although we note in our representation that funding infrastructure renewals expenditure through PAYG would provide similar results.

D. Financial resilience

26. As noted above we have set out the key financial ratios for the Company under its index-linked bond covenants and assuming we perform in line with its business plan for the actual capital structure. The adherence to those ratios drive our conclusions on financeability and our targeted credit ratio on an actual basis and – due to the strict nature of the bond covenants – also implicitly build in a level of financial resilience.

27. Similar to the work performed for our PR24 Business Plan submission and utilising the updated totex and financial modelling assumptions noted above as part of our draft determination's response, we have considered our ability to finance our operations and planned investments under a range of potential downside scenarios. We have again performed such stress testing up to 2033 looking at both Ofwat prescribed scenarios and our own company specific scenarios. We have assessed resilience in terms of headroom available for us (under our bond gearing covenant) to incur additional borrowing if needed to address liquidity matters arising from such scenarios, supplemented by ongoing support from our parent company if needed for downside risk.

Stress testing – Ofwat and Company specific scenarios

28. We have tested our resilience (defined by the availability of headroom against gearing) across the various stress scenarios. In the majority of cases we have sufficient

headroom to be financially resilient against these scenarios, with the exception of a 10% totex overspend, the combined scenario of a totex overspend and financial penalties. In the extreme and downside scenarios, in order to deliver the planned customer service, the Company may need to retain financial resilience through a combination of suspending dividends or seeking additional equity.

29. In addition to the Ofwat scenarios we have also tested our plan against our own company specific scenarios aligned to our October business plan submission. With the exception of the inflation scenario and the combined scenario, all scenarios were met.

E. Our assessment of risk and RoRE ranges

30. We have reviewed the overall package of incentives (ODIs), cost allowances and uncertainty mechanisms contained within Ofwat's draft determinations and concluded that it currently presents a significant imbalance between the level of risk we are exposed to and our potential for reward.

31. Our main concern is the significant negative skew between risk and reward, primarily driven by some of the penalty rates proposed within Ofwat's ODI package, as well as the wholesale cost allowance we have been provided. We are also concerned that Ofwat's draft determinations, even in a central case, would not allow us to be able to earn our allowed return due to the unrealistic wholesale cost allowance.

32. We have made separate representations on the main issues that are driving our assessment of the balance of risk and reward in Document SES112 – Risk and return (RoRE) and financing our plan, and summarise them below:

   (a) Ofwat's proposed ODI penalty rate for Discharge Permit Compliance is disproportionate for WoCs and for us in particular, as it has been set with WaSCs in mind. As discussed in section 2, we believe there is an opportunity to develop this ODI so that it mirrors a more normalised approach across the industry as a whole – reflecting a post-tax RoRE in the region of 0.03% to 0.15% per site failure.

   (b) The performance commitment level for Water Quality Contacts requires us to deliver performance levels that exceed the upper quartile, while the ODI penalty rate means that every customer contact above this stretching target would incur a penalty of approximately £7,000. Again, we have proposed as part of our representations a change to both the performance commitment level and ODI rate to bring the outcomes package back into balance.

   (c) Our wholesale base allowance in the draft determinations is £74m lower than what we consider is required to run a base level of service. Much of this is driven by:

      (i) Ofwat's rejection of our cost adjustment claim related to our higher power consumption, owing to our pumping requirements given our network topography, where we do not consider that Ofwat has engaged in the substance of our claim;

      (ii) The design of Owat's energy price adjustment, which counter-intuitively implies that energy prices will be lower in AMP8 than they have been over the period 2011-12 to 2022-23; and

      (iii) Ofwat's efficiency challenge on softening, where we acknowledge the need for and have provided further substantiation of the size of our claim, and several of our enhancement cases.

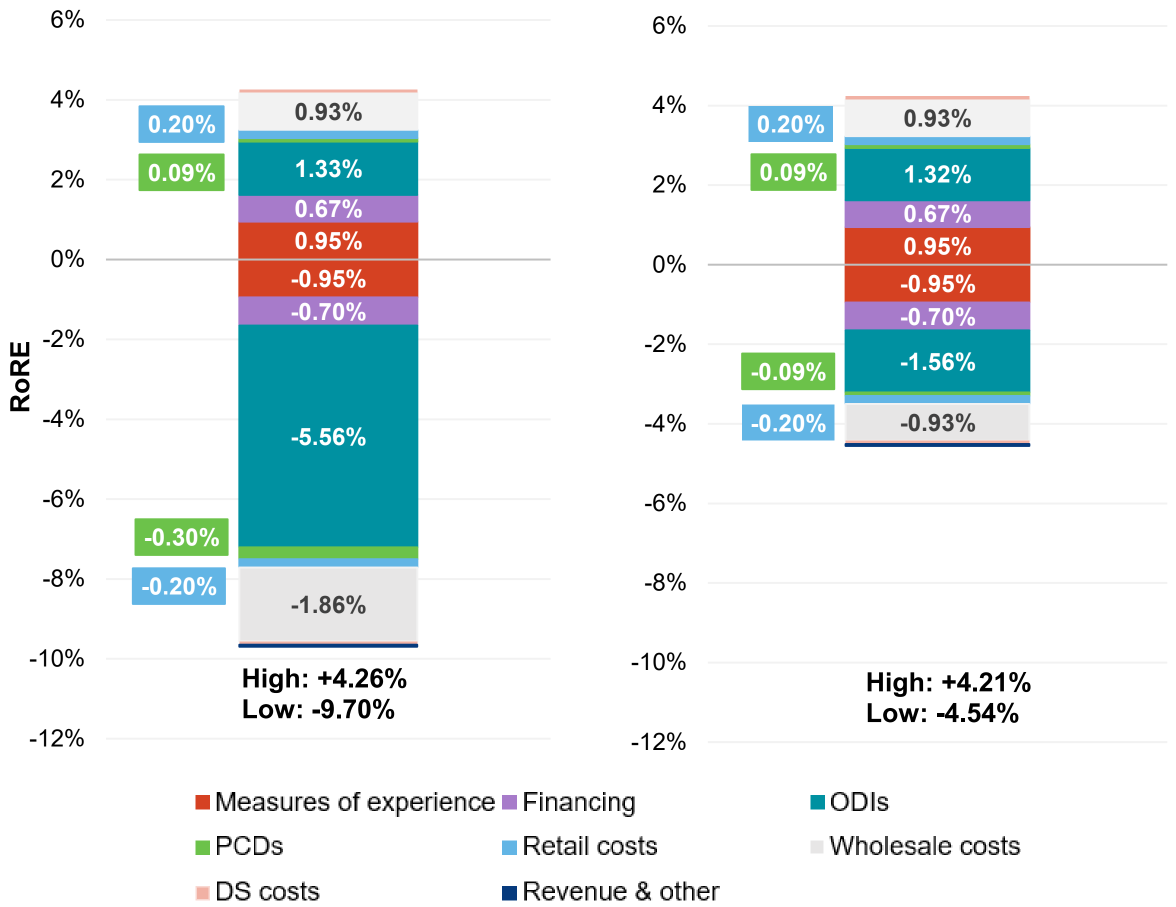
   While these factors primarily contribute to our view that the actual expected wholesale cost performance is skewed to the downside for our business as result of Ofwat's overly stretching efficiency targets in its draft determination cost assessment they also increase our assessment of the likelihood of overspending in the P1 case.

Ofwat's acceptance of our representation cases on costs would bring the package back into balance.

(d) Ofwat's proposals on PCDs introduce an additional source of skew into the RoRE risk ranges. As discussed in section 2, we are particularly concerned with Ofwat's proposals on the metering PCD and the cumulative effect of the PCD incentives associated with the smart meter rollout programme and the ODIs for the PCC and Leakage reduction targets.

33. In the figure below, we present our assessment of the RoRE risk range under Ofwat's draft determinations and the range if our representations are adopted.

Figure 3: SES Water assessment of PR24 RoRE risk ranges (P10/P90) for Ofwat's draft determination proposals (left) and after applying SES Water's representation cases (right)



Source: SES Water analysis
Note 1 – assumes a notional capital structure
Note 2 – P10 and P90 ranges in figure left and figure right adopt our assessment of the P10 and P90 performance levels at business plan submission (PCD and wholesale costs have been updated)

34. Should our representations on these issues be accepted, the residual balance between risk and reward (as illustrated in the RoRE range on right in Figure 3) will remain slightly negatively skewed but will present an overall package that we consider to be more balanced and acceptable.

5. Customer bills

In this section we explain the impact our revised proposals will have on customer bills from 2025 to 2030.

A. Customer bills

1. In our PR24 Business Plan, bills were forecast to increase by 10% by 2030 compared to 2024/25. Ofwat's draft determination of our plan resulted in a bill reduction of around 20%, with bills falling to £190.76 by 2029/30. As highlighted in the letter from our CSP and ESP, the significant reduction in bills that results from combined decisions in the draft determination is not what customers asked for.
2. In our revised plan, bills are forecast to rise by 10.6% by 2030 compared to 2024/25 with an average bill of £247.32 over AMP8. The bill profiles are shown in the table below.

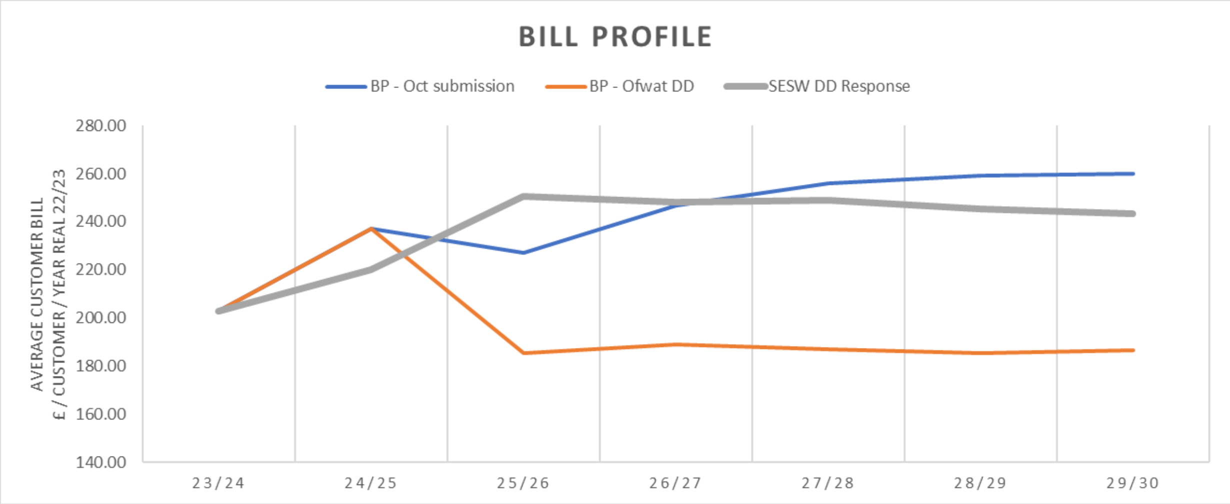
Table 9: SES Water bill forecast

£ (22/23 CPiH)	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	Avg AMP8
Business Plan*	202.97	236.98	227.29	246.72	255.93	259.12	260.14	249.84
Ofwat draft determination	202.97	236.98	189.40	192.99	191.25	189.37	190.76	190.75
DD Response**	202.97	219.95	250.70	248.24	249.01	245.44	243.23	247.32

** Average bills were modified post Oct submission as a result of Ofwat Query*
*** AMP8 average bill profile excludes PR19 revenue reconciliation adjustments – pending finalisation with Ofwat*
Source: SES Water

3. The table shows an increase in the first year of the AMP from £219.95 in 2024/25 to £250.70 in 2025/26. The bills from 2026/27 largely remain flat with a slight decline by the end of the AMP to £247.32. The bill profiles are shown in the figure below with our Business Plan including a 7% RCV run-off as noted in our representation case.

Figure 4: SES Water bill profile



Source: SES Water

4. Whilst we have modelled our revenue with an increase at the beginning of the AMP, followed by a steady tariff over the remainder of the AMP, we have also considered the impact of bill smoothing to provide a lower but constant bill increase across the AMP. This smoothed revenue profile puts pressure on our financeability and bond covenants, but we will duly consider this once we have received the outcome of the final determination.

Social tariff

5. We will continue to offer a 50% reduction on customer bills through our Water Support tariff which will enable us to support 25,000 customers on our social tariff throughout AMP8, with the overall value of the discount increasing as bills rise. This equates to just over 8% of forecast household customers in 2030. We believe we will still have one of the highest percentages of households receiving financial support in the sector despite the relative affluence of our supply area.
6. As in PR19, there will be support from shareholders as needed to supplement any social tariff shortfalls but that will be finalised and determined when we see the final determination package in the round.

6. Governance

In this section we set out the governance and additional assurance our Board has carried out on our draft determination response.

We also include a Board Assurance Statement for our response to Ofwat's draft determination.

A. Introduction

1. The governance and assurance chapter of our PR24 Business Plan outlines how the adoption of our well-established internal processes and assurance framework supported the Board in providing strategic leadership and direction to the preparation of our business plan and LTDS, submitted in October 2023.
2. A comprehensive review and assessment of Ofwat's draft determination has been completed by a team led by our Group Chief Financial Officer (CFO) and comprising executive leadership team (ELT) members, a dedicated Project Manager, our Regulation Manager (economic modelling expert) and other senior leaders in the key areas of planned PR24 investment, supported by external expert advisors from Cambridge Economic Policy Associates (CEPA), National Economic Research Associates (NERA) and Berkley Research Group (BRG).
3. Since the submission of our Business Plan and LTDS, the strategic review of the Company has concluded and ownership of the Company transferred to Pennon Group, subject to the outcome of a review by the CMA, in January 2024. The transfer of ownership to Pennon Group was confirmed in June 2024. At the time of submitting this representation, SES Water operates under the governance of the SES Water Board.
4. This representation has been proposed for SES Water as the standalone licence holder for our supply area, except that financing aspects reflect commitments from Pennon.
5. In the absence of any prescribed overarching expectations from Ofwat in respect of assurance for representations, the Board, as with our original submission, have supported the development and application of a proportionate governance and assurance framework for our draft determination representation submission.
6. Each area for agreed representation has been assessed and owned by an Executive team member, with support in documenting the case from either senior leader specialists and/or external advisors, as detailed above. In all cases there has then been at least one further expert review, two in areas that are more complex to assess and present, and external assurance has been obtained for the financial models and results that confirm the financeability of the Company, the amended data tables (financial and non-financial) and the appropriate compilation of the Ofwat proforma and associated representation documents.
7. The assurance applied is summarised in Table 10 below.

Table 10: Assurance completed on SES Water draft determination response

DD Representation area	Evidence needed	Expert review and/or /assurance
CAC Softening (capex)	Provide evidence to support the proposed scheme including optioneering and cost assessment /benchmarking and assurance of costs	NERA and BRG reviews
CAC Softening (opex)	Evidence increase in Opex – volume and price effects	NERA and BRG reviews
CAC power (networks)	Establish whether inclusion of APH in cost models is adequate or whether we still have case for additional CAC	CEPA and BRG reviews
CAC power (water resources)	Provide evidence of need – material impacts on running the business if cost adjustment received in PR19 is removed	CEPA and BRG reviews
Enhancement – leakage	Cost benchmarking does not accurately reflect SES scope of work.	NERA and BRG reviews
Enhancement - smart metering	Demonstrate why costs are efficient, and impact on WRMP targets	BRG review
Enhancement - lead	Evidence why costs are (2x) higher than industry average	CEPA and BRG reviews
Financing – RCV run-off rates	Build on RCV run-off paper already submitted to Ofwat.	NERA assurance
Governance – Dividends	Address Ofwat concern over Dividend policy	Internal review
Governance – Exec pay	Address Ofwat concern with exec pay policy	Internal review
PCs, ODI & PCDs – overall	To be considered in overall review of document	NERA review
ODI & PCs – WQ contacts	Target is not consistent with Ofwat's assessment	NERA review
ODI & PCs – discharge permits	Identify investment changes required to deliver reduced targets, and challenge back on ODI reward/penalty payment methodology (Discharge permits, etc.)	NERA review
RORE	Review and represent back where required on package on RORE	NERA and BRG reviews
Financial models and results	Updated models and financeability assessment	CEPA review; NERA assurance
Financial data tables	Updated tables (and change log/commentary if needed)	NERA assurance
Non-financial tables	Updated tables (and change log/commentary if needed)	Motts assurance
Ofwat pro-forma template	Template has been fully completed with appropriate sign-posting to DD documents, and documents are available	PA Consulting

DD Representation area	Evidence needed	Expert review and/or /assurance
Board Assurance	Statement in support of DD representation governance and assurance	PA Consulting

Source: SES Water

8. The following external reports are available that support our assurance process:
   - SES113 - External Assurance PA Consulting;
   - SES114 - External Assurance Mott MacDonald; and
   - SES115 – External Assurance NERA.
9. The areas for representation are supported by the Board, confirmed in the Board Assurance Statement below.

B. Board Assurance Statement

10. This statement has been produced in support of SES Water's PR24 draft determination representation. The SES Water Board of Directors ('the Board') confirms that it both owns and is accountable for the overall business planning process and is confident that this representation supports a high quality and ambitious business plan that is consistent with ensuring that our Business Plan delivers value for customers, communities and the environment at PR24, and in the longer term, aligned with our long-term delivery strategy.
11. As a Board, we recognise the importance of good governance and assurance to ensure that our stakeholders can have confidence in our future plans and our ability to deliver them.
12. The Company's Board has been integral to the governance surrounding the development and submission of the draft determination representation. The assurance of the representation has been directly overseen by the senior independent non-executive director. The representation, encompassing responses to Ofwat's proforma, updated data tables and compilation of supporting information, has been developed following well established Company systems and processes with associated internal assurance checks and the application of external assurance where required.
13. As a Board, we have provided direction and challenged management through the process of reviewing the draft determination and considering areas for representation. We sought supporting assurance, and are satisfied that:

    (a) The data and information that underpins the justification for our representation is both accurate and consistent;

    (b) The representation supports a high quality, stretching and ambitious plan that aligns to the Company's stated purpose to harness the potential of water to enhance nature and improve lives;

    (c) The Company will maintain adequate levels of financial resilience in 2025-2030 and beyond;

    (d) The representation continues to support a plan that achieves value for money and balances the delivery of business as usual, planned improvements to service levels and the resultant impact on bills, both in the short term and phased over the longer term;

    (e) The Business Plan for 2025-2030 is deliverable with the resources proposed. Ongoing engagement with supply chain partners, both prior to submission of our

Business Plan and in the time period since, has enabled us to remain confident in our ability to deliver both our enhancement programme – itself of a similar size to PR19 – and our base activities;

(f) The Business Plan for 2025-2030 will support the Company’s long-term vision to transform performance through digital innovation and smart technology, to build the trust of our customers so that they value water and the service we provide, and to enhance the environment and provide local communities with wider benefits from our business activities;

(g) The representation is made in support of the ambition of a plan that is reflective of the expectations and priorities of our customers, stakeholders, regulators and government, delivering operational, financial and corporate resilience, both in the period to 2030 and in the longer term.

14. Our representation challenges some of Ofwat’s draft assessments to ensure that the final determination supports the priorities of our customers and communities that we serve and enables the continued delivery of industry leading performance in key areas of service.

15. In providing our representation the Board had specific regard to:

    - The continued applicability of the PR24 Business Plan submission in October 2023;
    - The expertise and processes deployed by the Company’s Executive team and the various external advisors to support the preparation of this submission;
    - The satisfactory conclusion of NERA’s review of the Company’s financial modelling in support of this submission;
    - The conclusion of PA’s assurance review, covering the completeness of our responses to Ofwat’s proforma and the external assurance of new information included in this submission;
    - Commitments of equity and other financial support from Pennon to ensure the Company’s ongoing financeability;
    - Confirmation from Executive management on the deliverability of the Company’s plans; and
    - The ongoing support for our plan from our independent Customer Scrutiny Panel (CSP) and Environmental Scrutiny Panel (ESP), as evidenced in the letter sent to Ofwat on 12 August 2024 in response to the draft determination, which followed the CSP and ESP Chairs’ direct engagement with the Board.

16. The SES Water Board of Directors confirm that at its meeting on 22 August 2024, the full Board reviewed the Company’s PR24 draft determination representation and approved its submission to Ofwat. We are satisfied that the representation is needed to reaffirm the approach and funding needed in support of the delivery of a plan that reflects our customers’ priorities and our long-term delivery strategy.

17. Signed on 28 August 2024 by:

Dave Shemmans, Chair

Murray Legg, Senior independent non-executive

Jon Woods, Independent non-executive

Rebecca Wiles, Independent non-executive

David Sproul, Pennon Group, Chair

Susan Davy, Pennon Group, Chief Executive Officer

Andrew Garard, Pennon Group, Group Counsel and Company Secretary

Ian Cain, Chief Executive Officer

Paul Kerr, Chief Financial Officer