Rt Hon Alistair Carmichael MP
Chair
Environment, Food and Rural Affairs Committee

By email: efracom@parliament.uk

Date: 5th June 2025

Dear Chair,

Re: Reforming the Water Sector inquiry

Thank you for your letter of 13 May, asking for further information on matters which have arisen during your Committee's inquiry into reform of the water sector. I welcome the opportunity to help to further inform the Committee's thinking after appearing in front of you in January. Southern Water is committed to improving its service to customers and environmental performance, and we agree with the Government that regulatory reform is needed to help the industry improve.

My team have prepared comprehensive responses to your queries below. I hope that my response, and those of other water companies who appeared in front of you, will support you reaching well-evidenced and sustainable recommendations, which will support ongoing consideration of the much-needed reform of our sector.

Remuneration model

We understand that executive pay is a subject of concern in the sector. We publish our Annual Report every year which provides complete transparency regarding our executive pay and bonus structure.

Southern Water's Remuneration Committee is made up of at least three Non-executive Directors. The majority must be independent NEDs and the Chair must be one of the independent NEDs. An update to the company's Remuneration Policy for Executive Directors is being finalised and will be published in the company's next Annual Report. The new Policy will consider the latest rules and guidance, including Ofwat's Performance Related Pay Prohibition Rule, which is expected to be published shortly. The current version of the Policy can be accessed in the company's existing Annual Report.

Dividend policies

No dividends have been paid to our external shareholders since 2017. Furthermore, there is no plan to pay any external dividend until after 2030. Our shareholders would only receive dividends when stretching customer and environmental performance targets are met. I have included our latest dividend policy as an appendix, which will be published with our 2024-25 Annual Report. I have also included our previous policy, which was in place from 2020-2025.

Advertising fees

Southern Water does not advertise to its customers. We are, however, required by our regulators to provide customers with service-related information about:

- water supply or pollution incidents
- how to save water
- how to prevent pollutions and blockages

- investments/improvements we're making in their area that will directly benefit them or the environment, and
- how to get support either with paying their bills or priority services.

We must provide regular updates to our regulators showing them that we have used every possible channel to communicate these critical messages. This is particularly important in the run up to a potential drought, when we may use means of communication such as print, radio or TV ads to raise awareness of the importance of saving water to reach a wider audience. Any campaigns we do run are regionally targeted in 'hotspot' areas to reduce unnecessary spend and reach those audiences directly impacted by the service issues outlined above.

Legal fees

Southern Water does not routinely take legal action against any regulator. When cases go to Court, it is normally the result of prosecution proceedings being issued against us by the Environment Agency (EA) or Drinking Water Inspectorate (DWI). When that happens, we have no option but to incur legal costs dealing with the (usually lengthy) court process. However, it is important to note that the costs we incur in relation to these court proceedings, as well as for compensation for loss of service and guaranteed standards payments, are not borne by bill-paying customers. We are required to disclose and make adjustments for these disallowable items in our Annual Performance Report to Ofwat each year.

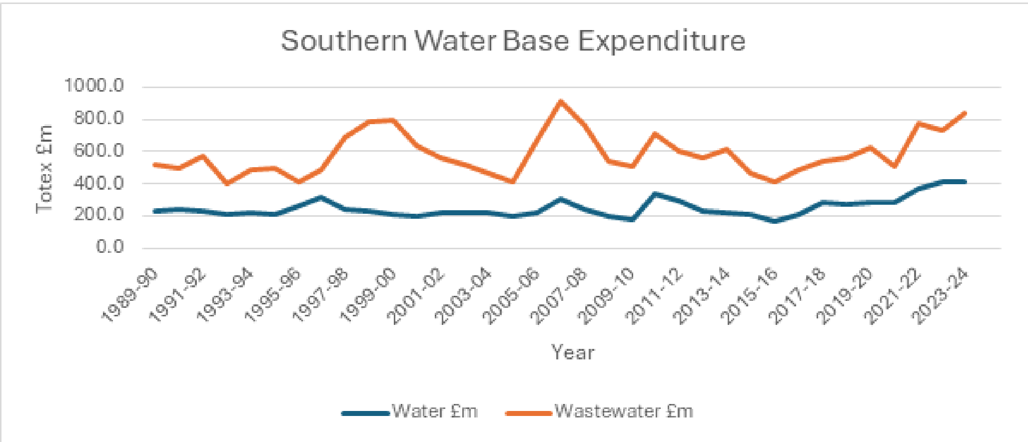
Replacement rates of assets

We have evolved our approach to assets between AMP7 (2020 – 2025) and AMP8 (2025 – 2030), with the latter part of AMP7 focussing on rapid delivery of our Turnaround Plan, and AMP8 focussed on strategic planning and proactive asset management.

AMP 7

During AMP7, our primary focus was on addressing legacy issues and driving performance improvements across both water and wastewater services. This was a key part of our Turnaround Plan which aimed to deliver a short, sharp and ambitious improvement by 2025.

The below graph shows the base expenditure invested over the years. Expenditure fluctuated but increased in AMP7 for both water and wastewater.



As an example for water, the Hazard Review (HazRev) programme was central to our capital maintenance efforts, targeting water quality risk and asset health, alongside significant investments in leakage reduction.

Replacement rates for our network assets are reported annually, although historically we have focussed on alternative interventions in our network to deliver performance improvements across AMP7. We recognise that mains replacement is the only means to secure long term network performance levels – especially leakage and burst rates. By investing in the optimisation of existing assets, we have been able to demonstrate greater control over our network performance and assess those pipes that require replacement, whose life cannot reasonably be extended by other means.

The optimisation of pressure, such as by changing pumping regimes or installing pressure control valves reduces stresses on the network whilst maintaining pressure at levels required by our customers. By utilising the latest high velocity loggers, we can identify where short (sub second), high-energy pressure spikes are passing through our pipes, which can cause leaks or bursts to occur and start to address these, reducing the burst and leakage rates of the affected assets. Solutions may be as simple as changing the operating profile of existing pumps but may require investment in pumps and surge mitigation measures or working with customers to change their consumption patterns.

Additionally, we renewed 30.5km of water mains during AMP7. Please note that the AMP7 Year 5 data has not been published yet.

Our outturn expenditure on capital maintenance and operational expenditure in AMP7 materially exceeded the regulatory funding allowance. For water, this was driven by the HazRev programme identifying over 500 improvement interventions and significant investment in leakage reduction, exceeding the final determination by over £100 million.

For wastewater, this was driven by additional investment to:

- Improve availability and reliability of pumping station and treatment works assets to reduce pollution performance risks
- Reduce infiltration into our sewerage system, which is distinct from condition related replacement (referred to above). This has been exacerbated by 3 years of high groundwater in the last five years.
- Address legacy flow compliance issues, with investment in 39 wastewater sites through the Environment+ programme.

This increased expenditure was funded through additional shareholder investment.

AMP8

Key step changes between AMP7 and 8 include:

- Increasing our leakage reduction programme for water to arrest asset health and deterioration by replacing higher levels of mains and the associated communications pipes
- Increasing the rate of planned sewer renewal accounting for the need to stabilise serviceability and the rate of collapse.
- Delivering investment to meet growth predictions (base expenditure element)
- Investment related to IT infrastructure renewal

In AMP8, we are shifting towards a more planned and proactive approach to asset management, as explained in our PR24 Botex Appendix. Our AMP8 plan flows from the implementation of our Turnaround Plan performance levels, as set out in our Service Commitment Plan.

With regards to mains replacement, in AMP8, Ofwat's Final Determination includes a provision for a 360km water mains replacement programme. However, Ofwat's approach in the FD has resulted in a substantial funding shortfall for this programme and we are seeking a resolution to this via ongoing conversations with our economic regulator.

Line description	PCD Output Description	Units	2029-30
Mains renewals - base	Base wholesale water model funded renewals in kilometres	km	285.251
Mains renewals - asset health adjustment	Base asset health adjustment renewals in kilometres	km	20.397
Mains renewals - enhancement leakage	Enhancement leakage renewals in kilometres	km	54.480

(Table 5: Mains Replacements in AMP8)

More specifically for water and in addition to our Turnaround Plan, our AMP 8 plan requires we continue with a similar level of investment in support of asset health to sustain water quality, supply resilience and the service required by customers. In developing our bottom up water Botex plan we see the need for the run rate for AMP8 to remain above the long-term regulatory allowance.

For water, we will continue the HazRev approach while modernising strategic sites, focusing on sustainable capital maintenance levels to maintain the required service.

For wastewater, there was a strong focus on improving asset availability and reliability through AMP7, resulting in significant performance improvements through our published Turnaround Plan. This approach continues into AMP8, building on the progress made to date.

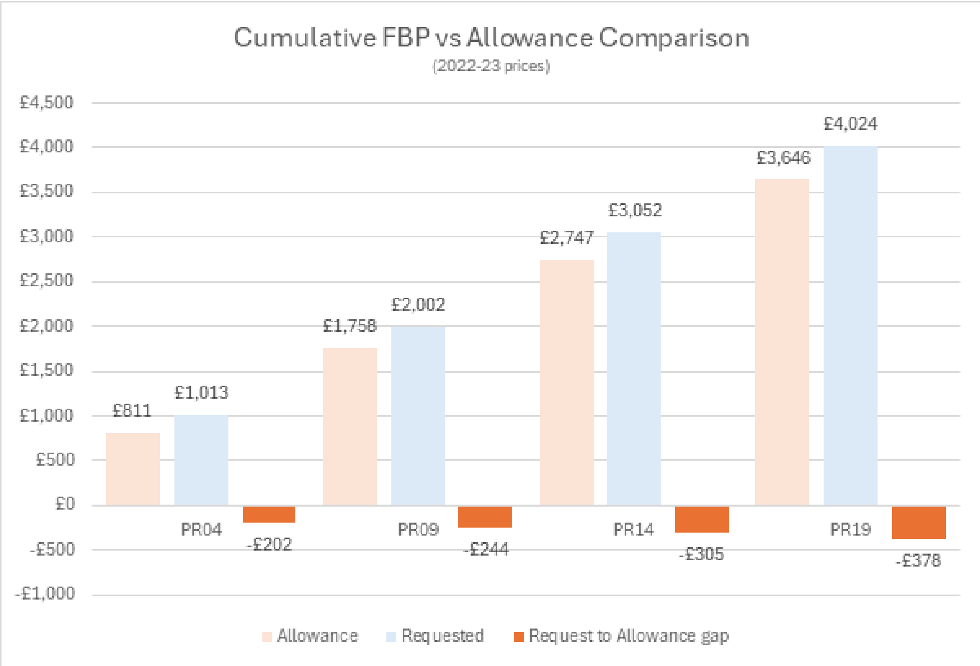
We are increasing planned sewer and rising main renewal and focusing on smarter networks and data-driven approaches. A key focus in AMP8 is managing rising main bursts. Analysis indicates an average deterioration rate of 2% across AMP6 and AMP7, with projected burst rates reaching 140 per year without intervention. Our strategy aims to reduce this to 80 bursts per year or less through targeted interventions, including pump calming techniques and rising main replacements. We have identified 48 rising mains for potential intervention, with partial replacement being the preferred option.

Additionally, we have now installed 34,000 sewer level monitors, enabling us to proactively identify potential blockages. Using machine learning, we can start to differentiate between normal changes of flow levels due to rain and unusual levels which may signify and issue. Similar approaches are being used with pressure monitoring on rising mains.

Our Wastewater Treatment Works (WTW) Planned Capital Maintenance programme focuses on replacing assets based on their risk to specified Performance Commitments, considering factors like age, obsolescence, and inefficiency. In our bioresources estate, a significant proportion of our BOTEX will be dedicated to replacing assets such as dewatering/thickening equipment, biogas treatment and usage systems, and sludge capacity infrastructure.

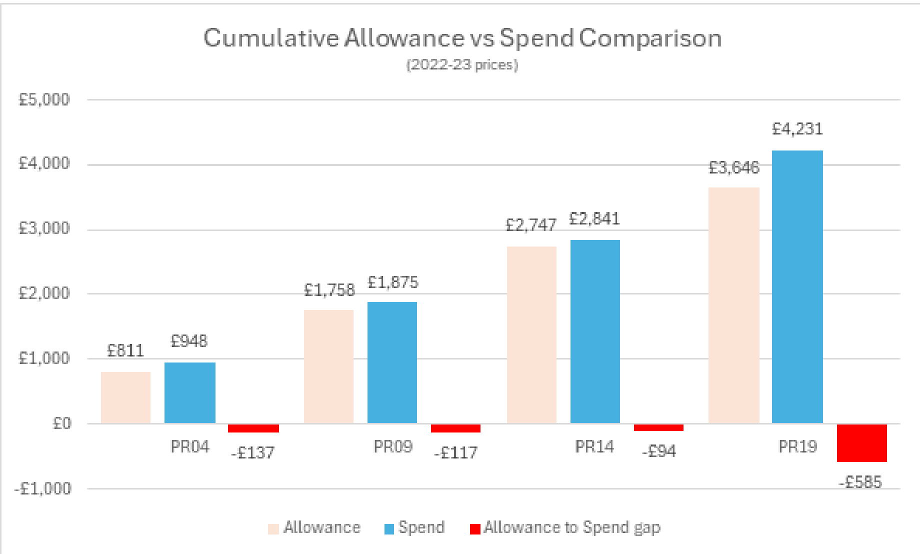
In AMP8 we continue to focus on flow compliance, using the processes and flow data developed during AMP7 to ensure our system meets regulatory requirements. This is the minimum maintenance expectation, with significant enhancement programmes focussing on reducing the number of spills from storm overflows.

In general, botex allowances were substantially lower than that requested in PR04, PR09 and PR14. This underfunding by Ofwat, despite Southern spending close to the amounts it requested over AMPs 4 through 6, eventually led to a deterioration in performance which had to be addressed through additional spending in AMP7. This can be seen in the Figure below which shows that there is cumulative gap of £305m (over the period 2005 to 2020) between requested expenditure and allowed expenditure.



(Graph 2: Cumulative final business plan vs allowance comparison (water))

The figure below shows the cumulative gap between the allowed expenditure and outturn expenditure. Through each price review period between 2005 and 2020 we attempted to outturn closer to the regulatory allowance than our forecast through ambitious efficiency initiatives. Ultimately, this led to a considerable overspend in AMP7 such that in cumulative terms we have now spent £207 million more than we forecast over the full 20 year period and £585m more than the 20 year total regulatory cost allowance on operating and maintaining our water assets.



(Graph 3: Cumulative Allowance vs Spend Comparison)

In wholesale water, in line with previous AMPs, we are forecasting significantly higher spend requirements in AMP8 than the Ofwat allowance. Despite the investment made in recent years above our expenditure allowance, overall asset age has continued to increase compared to previous price review assessments. Although our capital maintenance strategy is not an age-based replacement approach, the increasing asset age underlines the need for further capital maintenance spend in AMP8.

We continue working to deliver a more reliable asset base supported by a robust maintenance strategy. Our asset health monitoring and proactive maintenance programme will be key to delivering this. We are completing comprehensive assessments of our assets and will continue to update our asset maintenance strategies and care plans in AMP8.

Tackling water poverty

We assess the extent of water poverty in our area by identifying the proportion of customers whose average dual water bill exceeds 5% of their equivalised household income. Equivalised income is determined through a combination of internal and external income data sources. Based on our customer base of approximately 2.1 million connected customers, we project that by 2030, 6.5% of customers will fall within this definition of water poverty. We acknowledge this projection exceeds the current industry commitment. To address this, we are implementing a range of measures aimed at reducing the projected forecast of water poverty. This includes phasing in new drainage charges to ensure our charges are reflective of the costs involved and make household bills more affordable.

To date, we provide support to over 161,000 customers through our discounted Essentials tariff, with a target of increasing this to 182,000 by 2030 underpinned by increased customer acceptance and a request to use outcome delivery incentive (ODI) penalty funding, pending approval from Ofwat.

We are working collaboratively with local authorities to provide auto enrolment to discounted bills, reducing the burden for customers to identify support available, as well as progressing plans to introduce WaterSure discounts for single occupancy household to increase the support for those with additional water requirements. Furthermore, during AMP 8 we have expanded the support available through our Hardship fund from £250,000 to £1,250,000 per year. Through the fund we offer debt relief as well as grants for essential white goods and household items, for those individuals facing exceptional circumstances. This additional support will be strategically directed towards those most in need ensuring assistance reaches households at risk of water poverty.

We are also in the discovery phase of tariff trials to address both water efficient and affordability goals. Options being explored include seasonal tariffs, as recommended to us in a report we commissioned to advise us as we are in a water-stressed region. The purpose of this is to drive behaviour change and shift the burden of cost to those customers using water for less than efficient purposes. Recent tariff trials by other companies to date are encouraging, and we intend to conduct our own trials with both household and non-household customers. We hope that by end of AMP 8, it will be the right time to implement such innovative tariffs, once we have completed a full smart-meter rollout and a considerable upgrade to our billing system.

Data transparency

We recognise the importance of transparency and public access to environmental information, both in terms of our responses to Environmental Information Regulation 2004 (EIR) requests and with our proactive publication of information.

The number of EIR requests we respond to has risen by 20% per year on average since 2019. In 2024, we responded to 721 requests, providing a reply to 71% of requests within the statutory timescale (20 working days) and a further 28% within a permitted extension (40 working days). This year we have continued to improve our responsiveness, providing a response to 97% of requests within the statutory timescale. Earlier this year, we published our levels of compliance with EIR requests and a summary of EIR requests received since January 2025 on our website. This information is updated on a quarterly basis. We are working towards publishing a full disclosure log, sharing the content of our EIR responses.

Regulation 35 of the Water Supply (Water Quality) Regulations 2016 contains an obligation to provide drinking water quality data when requested. For ease and transparency this data is published on our website using a postcode look up, based on the 2024 dataset. It focuses on water hardness as this is the most widely requested result used for setting up domestic appliances like water softeners and dishwashers. We have also published the historic data set of drinking water compliance data for the years 2021 to 2023 on the Stream website. This consists of more than 180,000 data points covering 120 determining factors. We hope that this is a useful resource for academics and other who may want a wider understanding of drinking water quality.

For bathers, water quality is tested and reported on by the Environment Agency. We report annually on bathing water, and these reports are available on our website. To inform bathers about the potential impact of storm overflows on bathing waters, we also provide Rivers and Seas Watch, an online service which provides the public with near real-time information about storm overflow releases across our region. When a potential storm overflow release is identified by our monitoring equipment (EDMs), a release event is created and shown on Rivers and Seas Watch. Every storm overflow outfall in our region is shown. We are proud to have been the first water company to provide such a service. The Storm Overflow release data from this feed is relied upon and re-used by Surfers Against Sewage in its own app.

One of the key components of ensuring we provide the most accurate storm overflow data possible is our tidal modelling. Rivers and Seas Watch shows coloured beachfront areas to represent bathing water areas that are frequently used by the public and are part of the Environment Agency's water quality sampling regime. Because of the frequent use of these bathing waters by the public, we use tidal modelling to determine whether a bathing water locality might have been impacted by a storm related release.

Tidal modelling involves simulating what happens to a storm overflow release once it's into the marine environment, and then how it moves in the tidal currents. We use these simulations to predict whether intestinal enterococci (IE) and E.Coli are above or below thresholds for public health. For our region, we've worked with tidal modelling and water quality experts to create a detailed model which reliably predicts this movements. This model factors in tidal states, wind speed and directions, flow rates from overflows, and other key variables. We provide this information to the public via Rivers and Seas Watch, and users of this service can subscribe to receive email notifications for their favourite bathing sites – so they're kept up to date if there is a potential impact to water quality because of storm overflows.

However, it is important to note that storm overflows are not the only thing to impact coastal and river water quality. Other sources of pollution like road, farming and industrial surface water run-off, along with waste from other water and beach users – even dogs and seabirds – are all well known to make a big difference to the marine environment. We work closely with our partners to make sure that we're doing all that we can to improve the quality of our local waters.

I hope that this provides your Committee with the answers that you need to further your inquiry. Significant change and service improvement both take time, but I am confident that we have the plans and proposals in place to get to where we need to be. If there's any more information my team can provide to assist, please let me know.

Yours sincerely,

Lawrence Gosden
Chief Executive Officer

Appendix A: Dividend policies

From 2025

1. Introduction

1.1 To enable the successful delivery of our plan for 2025–30 and beyond, all stakeholders must share in success: customers benefit through environmental and water resilience improvements and better services, and shareholders earn a fair return on the money they have invested. Therefore, our dividend policy, covering both the appointed and non-appointed activities of the Company, will ensure a fair, balanced and sustainable reward between customers, stakeholders and investors as well as complying with the dividend policy condition of our licence.

1.2 Dividend payments are designed to ensure that statutory obligations and key financial ratios are not prejudiced, that customer, environmental and other stakeholders are considered, and that the Company has adequate resources to carry out its work now, and into the future.

1.4 Our shareholders supported substantial investment in the business during 2020–25, significantly over and above regulatory allowances. They expect to receive no further dividends for the rest of the current investment period to 2025. No dividends have been paid to external shareholders since 2017.

1.5 When proposing payment of a dividend, the directors of Southern Water Services Limited, acting in accordance with their directors' duties and with the Company's licence, will consider the following:

- Base level of dividend – financial;
- Base level of dividend – performance; and
- Financial resilience.

Each of these is expanded upon in paragraphs 2, 3 and 4 below.

1.6 This dividend policy is also aligned to our articles of association. These were also updated ahead of the 2025-30 Asset Management Period.

2. Base Level of Dividend – Financial

2.1 The base level of dividend will be determined using an equity return consistent with our most recent final determination and our actual level of gearing. This recognises our management of economic risks and capital employed.

2.2 In assessing any adjustment to the base level of dividend, we will take into account all aspects of our performance. This will reflect our overall financial performance as compared to the final business plan as agreed by Ofwat.

3. Base Level of Dividend – Performance

3.1 The Board will consider if the payment or part payment of the dividend reflects, or would be consistent with achievement of, the long-term social, environmental, financial and operational performance commitments made to stakeholders, including customers, employees and members of the Southern Water pension scheme.
3.2 In considering this issue, the Board will assess whether the Company is significantly underperforming when compared with its final determination and/or has a serious performance issue. In order to determine performance, the directors will consider performance in the round and shall have regard to the suite of Performance Commitments that the Company has made which include targets in relation to:

- Performance for customers (including, but not limited, to C-MEX and D-MEX)
- The delivery performance of the large enhancement programme that we have committed to for the 2025-30 business plan period.

- Operational commitments which are of importance to customers (including, but not limited to, Leakage, Per Capita Consumption, Water Quality, Interruptions to Supply, Risk of Low Pressure and Pollutions).
- Wider social and environmental commitments (including, but not limited to, commitments in relation to vulnerable customers, sustainable abstraction, climate change mitigation and adaptation, and community investment).
- This assessment will also consider the previous performance of the Company and the relative performance of the company to our industry peers over the period from 2020 to 2030.
- Compliance of the business in line with statutory and regulatory obligations
- The base level of dividend yield can be adjusted up or down depending on performance.

3.3 The Board also takes into consideration the obligations of the Company to its employees including (but not limited to) the obligation to make appropriate investment in health, safety and wellbeing and to ensure that there is appropriate funding of the Company's pension scheme.

4. Financial Resilience

4.1 The Board will consider our financial resilience ahead of any dividend decision and whether any financial out-performance should be reinvested to benefit customers.

4.2 The financial resilience assessment works on the principle that dividends declared reward efficiency and the effective management of risks.

4.3 This will consider the interests of our employees, other stakeholders, and our pension schemes. Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of this, we review:

a. Headroom under debt covenants;
b. Reserves, ensuring we have sufficient reserves in place;
c. The impact on the company's credit rating;
d. The liquidity position and ability to fulfil licence conditions;
e. Key areas of business risk; and
f. The requirements of current and future investment needs.

4.4 The policy, as reflective of our draft determination response will ensure we restrict the payment of dividends if gearing is above 70%.

5. Payment and non-payment of dividends

5.1 We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.

5.2 The dividend policy applies to the payment of any dividend regardless of the purpose of that dividend.

5.3 The net benefits of unforeseen inflation will not be taken into consideration if they are not clearly linked to outperformance or the prudent actions of management.

6. Governance

6.1 We will publish our dividend policy annually (in the Annual Report) and highlight any changes. No changes are currently planned to be made to the existing policy ahead of the next investment period (2030– 35), but the Board will keep this under review.

2020-2025

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To enable the successful delivery of our plan for 2020–25, all stakeholders must share in success: customers benefiting through enhanced service and lower bills, and shareholders earning a fair return on equity invested.

When proposing payment of a dividend, the directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and with the company's licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account all aspects of our performance. This would reflect our overall financial performance as compared to the final business plan as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.
3. We will consider our financial resilience ahead of any dividend decision and whether any financial out-performance should be reinvested to benefit customers. This consideration will include taking into account the interests of our employees, other stakeholders, and our pension schemes. Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three, we carry out an assessment of: a. headroom under debt covenants b. the impact on the company's credit rating c. the liquidity position and ability to fulfil licence conditions d. key areas of business risk.
4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.
5. We will publish our dividend policy annually (in the Annual Report) and highlight any changes.