

Southern Water Draft Business Plan - Reporter's Public Summary

Introduction

1. Southern Water has prepared a Public Summary of its Draft Business Plan (DBP) in line with Ofwat's requirements as part of a series of submissions for the PR09 price-setting process. The purpose of the DBP is to inform stakeholders of proposed future service standards and to set out a supported and costed business case with associated costs, benefits and price impacts. The DBP will be used by Government Bodies and Regulators to make strategic decisions with regard to the provision of water services and prices between 2010 and 2015. Ofwat will determine prices using the Company's Final Business Plan (FBP) to be submitted in April 2009, which will incorporate feedback on DBP.
2. The DBP fully describes how the Company will meet the first five years of its longer term strategy as described in its Strategic Direction Statement (SDS). In the DBP, the Company sets out its approach to business planning, the supporting studies, the projected activities, outputs and costs and the associated price implications necessary to properly finance the business. The plan will need refining for the FBP because of uncertainties in a number of areas.

Reporter's Role

1. The Reporter's role is to provide independent opinion to Ofwat on the Company's regulatory submissions by checking compliance with regulatory requirements and advising Ofwat of material discrepancies. Ofwat approves Reporter appointments and regulates their activities through an agreed protocol.
2. The purpose of this Summary is to provide independent commentary on Southern Water's public summary of its DBP, to confirm or otherwise whether the Company processes used were adequate, whether the plan is well founded and whether the public summary is consistent with the full DBP submission.
3. We have extensively audited the DBP in line with Ofwat's requirements. Our audit included checks on Southern Water's processes, controls and assurance arrangements and our team of experts and specialists examined the underlying customer research, performance assessments and analysis. We checked the submitted data, compliance with Ofwat's requirements and challenged the Company on areas of materiality and have provided a detailed commentary to Ofwat.
4. We have provided feedback to the Company's management, but were not required to present our findings to the Directors prior to their endorsement of the Company's submission. We will, however, be attending the Board meeting on 24th September 2008 to enable the Board to clarify any of our findings with a view to taking these into account for the FBP.

Liaison with Regulators

1. Throughout the preparation of DBP, we have maintained an on-going dialogue with Ofwat and an open liaison with the Quality Regulators (Drinking Water Inspectorate (DWI), Environment Agency (EA) and Natural England). We specifically contacted the DWI to confirm support for the water quality enhancement schemes. We have received copies of the meeting minutes between the Company and the EA at which the environmental schemes were discussed.
2. We have liaised with the Company's financial auditors to establish the validity of assumptions and supporting data and shared information on audits.

Cooperation from the Company

1. We confirm having received full co-operation from management and staff at all levels with full access to data. We have received all of the documentation requested to enable us to conduct our audit and are aware of no information having been withheld by the Company. However, some of this data only became available towards the end of the audit period and we did not complete audits before the Company submission.

Context

1. Southern Water is now in the fourth year of its current capital programme (AMP4). To date, it has made good progress in delivering service improvements to customers and has achieved a number of outputs ahead of schedule, including reducing the numbers of properties at risk of sewer flooding and quality improvements for wastewater treatment works discharges. Leakage has been maintained below the targets set by Ofwat.
2. During the AMP4 period, the Company installed a new telephone system and a new billing system. These two systems suffered initial teething problems resulting in a decline in Customer Service performance. Southern Water has apologised to its customers for the inability to contact the Company during times of heavy stress on the system.
3. Customer Service levels in all areas have now returned to a more acceptable standard and the Company is driving for further improvements in order to achieve Ofwat 'good' status in all customer service metrics.
4. Southern Water has sought its customers' views through its 'Willingness to Pay' surveys. The results have been used to develop the business strategy. The Company has also engaged with its stakeholders.
5. Last year, Southern Water published its Strategic Direction Statement "Water Services, Customers and the Community", which set out the 25-year business strategy based on consultation with key stakeholders and customers. This identified some of the key challenges faced by the Company and set out the Company's plans for dealing with them.

6. The draft business plan has been developed in this context, with a view to providing value to customers, delivering resilient services and enabling sustainable growth. Southern Water also faces some significant challenges, including climate change effects on water resources and flooding, growth in the South East, energy price rises and meeting the requirements of new environmental legislation.
7. In order to meet these challenges and maintain the levels of service that customers expect, Southern Water is proposing to deliver its largest capital programme yet in AMP5. The larger programme causes above-inflation price rises that, according to the 'Willingness to Pay' surveys, are supported by customers.

Reporter's Opinion

1. We have audited and reviewed all elements of the Draft Business Plan and confirm that:
 - Southern Water has fully reviewed the services that it provides and its operating environment. The plans for future services are guided by customer and stakeholder consultations and information from regulators on expected requirements.
 - Southern Water's Public Summary is consistent with the DBP and is based on comprehensive studies that the Company has carried out to inform the process. The numerical information and assumptions for the Public Summary are drawn from the DBP. However, we note two discrepancies: the *typical unmeasured water household bill for 2012/13* should be £158 (not £168) and the *sewerage service average household bill for 2011/12* should be £267 (not £287).
 - The Company's cost estimates are mainly based on historic costs, supported by its contractors' and suppliers' cost estimates. We consider that these are appropriate for the purposes of the DBP, but they should be improved upon for the FBP.
 - The Company has made an assessment of future operating and capital cost efficiencies although there are residual uncertainties that will need revisiting before the FBP.
2. The Company's large capital programme is subject to specific uncertainties and risks relating to the regulatory and quality frameworks, some of which may not be clarified until after the 2009 Determination of Prices. Where possible, these will need to be addressed before April 2009 or an appropriate regulatory mechanism agreed. An "early start" programme, similar to that adopted for AMP4, would assist the Company by enabling construction work to be commenced from the start of the AMP5 period.