

## Northumbrian Water: Test area assessment

All company test area grades								
Engaging customers	Addressing affordability and vulnerability	Delivering outcomes for customers	Securing long-term resilience	Targeted controls markets and innovation	Securing cost efficiency	Aligning risk and return	Accounting for past delivery	Securing confidence and assurance
B	B	C	C	C	C	B	C	C

Northumbrian Water - test area results				
Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Engaging customers	B	<p>Overall the business plan demonstrates high quality with convincing evidence in the areas set out below, but it is not sufficiently ambitious or innovative to be considered exceptional.</p> <p>The company provides sufficient evidence of a high quality approach in the following areas:</p> <ul style="list-style-type: none"> <li>Use of a wide range of customer engagement techniques including face to face interviews, online surveys, telephone surveys, hall tests and co-creation events.</li> <li>Its approach to ongoing engagement with customers including with social media 'mining' to yield insights and an engagement vehicle ('Flo') which interacts with customers at community events.</li> <li>A clear two-way and innovative dialogue with customers including, for example, customers attended the company senior team leadership conference, where they helped co-create elements of the business plan.</li> <li>The company's innovative approaches to adopting the four themes of customer participation in the Tapped In report, including its annual innovation festival which demonstrates co-creation, encouraging some customers to help in initiatives to maintain water quality by actively participating in the company's 'water rangers' scheme and working on a range of initiatives with all customers in a focussed area, resulting in significant reduction in water consumption.</li> <li>The company's three-phase approach includes customer engagement on business plan acceptability, appetite for risk and resilience, through both quantitative and qualitative studies.</li> <li>Customer research on asset health and resilience determined what actions for resilience were included in the plan.</li> </ul> <p>However, the business plan falls short of high quality with insufficient evidence, in the following area:</p> <ul style="list-style-type: none"> <li>The company has sourced the marginal benefit values used in the calculation of outcome delivery incentive (ODI) rates from a single piece of research, with no evidence of triangulation against other sources of customer valuation or cross-checking against the insights of its wider customer engagement research. The company has provided insufficient evidence that the single piece of customer valuation research used is high quality, as we found no evidence of cognitive testing, piloting, validity assessment or peer review.</li> </ul>	EC1	B
			Affordability and vulnerability	B
			AV2	C

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		<ul style="list-style-type: none"> <li>a high quality approach to helping customers who cannot afford to pay their bills, including a PC on reducing the number of households who spend more than 3% of their disposable income on water bills.</li> </ul> <p>The business plan falls short of high quality in one area because:</p> <ul style="list-style-type: none"> <li>The company proposed a bill increase for 2025-30 and did not provide evidence that it tested the bill increase or profile with customers.</li> </ul>	AV3	B
			AV4	B
Delivering outcomes for customers	C	<p>Overall, across the delivering outcomes for customers test area, the evidence Northumbrian Water provides to support its proposed PCs and ODIs in its plan falls short of high quality and the evidence is insufficient or unconvincing in some areas.</p> <p>Overall, the plan provides sufficient evidence both that its PCs for 2020-25 and the long term are stretching and that the company's reporting structures are robust. In particular, the company proposes to stretch beyond the industry upper quartile for pollution incidents over the 2020-25 period. However, the evidence that the company provides to support its package of outcome delivery incentives and its focus on service performance within its risk/return package falls short of sufficiency.</p> <p>Key areas of concern where the business plan falls short of high quality are:</p> <ul style="list-style-type: none"> <li>The company does not provide sufficient evidence to justify its ODI rates or demonstrate that these are formed based upon robust customer valuations. The company does not provide sufficient evidence that ODI rates adequately incentivise the company against service under delivery.</li> <li>The company does not propose any protection measures for customers in cases where outperformance payments exceed expectations, or set out its approach to bill smoothing.</li> <li>The company does not provide sufficient evidence to demonstrate that it has addressed its asset health past performance challenges. For example, the company does not have an appropriate ODI on sewer collapses.</li> </ul>	OC1	B
			OC2	C
			OC3	C
Securing long-term resilience	C	<p>Overall, the plan falls short of high quality and the company does not provide sufficient and convincing evidence of securing long term resilience in certain areas.</p> <p>The plan provides sufficient evidence that a wide range of options have been considered for operational resilience ranging from traditional infrastructure, catchment options, improving response and recovery, smart wastewater network development and customer education campaigns. There is sufficient evidence of a partnership approach for nature based schemes and the overall resilience approach for critical water assets is sufficiently justified and convincing. The plan also provides sufficient evidence of customer engagement on resilience and longer term issues.</p> <p>The plan provides sufficient evidence for some aspects of financial resilience assessment and risk management, but there is insufficient or unconvincing evidence in other areas.</p> <p>We consider that the company plan does not provide sufficient and convincing evidence in the following areas:</p> <ul style="list-style-type: none"> <li>The plan provides insufficient evidence in certain key areas of the company's approach for the identification and prioritisation of risks. There is insufficient evidence that the resilience assessment is a clear and robust risk management process. The approach adopted to assess the resilience of wastewater assets is materially different to the approach taken to assess the resilience of water assets with little justification.</li> <li>The plan includes a maturity assessment of current systems, but lacks aspirational resilience levels (for the 2020-25 period and the long term) and future actions that will be required to improve maturity levels;</li> <li>There is insufficient evidence of an integrated and systems-based approach to resilience, where interdependencies or cascading impacts of one system to another should be considered.</li> <li>The company assesses a range of financial stress scenarios, but the results are only presented as pass/fail outcomes and impacts on key financial metrics are not shown. This leads to a conclusion that there is insufficient evidence to determine the impacts on the company's financial resilience. Whilst there is evidence that the company has considered financial risk mitigation approaches, there is insufficient evidence that issues around additional equity support have been addressed. There is insufficient evidence that the company has considered the risks to its long term resilience in the context of a negative outlook to one of its credit ratings in the event that it were downgraded and there is no discussion around the risks of raising new debt, or refinancing existing debt.</li> </ul>	LR1	C
			LR2	C
Targeted controls, markets and Innovation	C	Overall, despite a high quality approach on innovation and on business gaps /voids, Northumbrian Water's plan falls short of high quality across the Targeted Controls, Markets and Innovation test area and evidence is insufficient and/or unconvincing in some areas.	CMI1	B

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	C	<p>The company's plan overall was high quality regarding culture of innovation. The company provides strong evidence of encouraging a climate of challenge and debate, complemented by clear innovation goals, leadership support, aligned resources and internal/external collaboration. However, evidence of risk tolerance and providing an appropriate degree of autonomy in the development of innovation is insufficient.</p> <p>An ambitious and innovative approach to managing business gaps and voids contrasts with insufficient evidence of an effective plan for residential gap sites and voids, and the identification and application of learnings from business retail market opening. The evidence on catchment management for wastewater (including RAINWISE customer engagement) is of high quality, but the plan lacks detail in respect of use of markets within water. The company evidences limited engagement with third parties for supply options beyond the reverse trade with Thames Water, and does not evidence any engagement on demand solutions nor third party options.</p> <p>In its revised WRMP the company only partially addresses our representations regarding its customer engagement. We remain concerned about the deliverability of Essex and Suffolk's PCC strategy, where there is limited evidence to support the outcomes. There is also limited engagement with third parties to support delivery of the plans. The company has not explored the risks and opportunities of bilateral market opening. The company's bioresource strategy outlines that it is engaging with Yorkshire Water but lacks detail on the opportunity, risks and impacts to services, how customers share the benefits and other third party opportunities. The company's RCV allocation addresses Ofwat's earlier feedback on Water Resources and evidence is complete. Its bid assessment framework for water resources provides insufficient information on what parties might have to provide or how appeals might be handled.</p> <p>Although the company evidences an appropriate process for identifying DPC projects over the threshold, it lacks sufficient detail to be high quality. The technical assessment of Howden STW as a potential DPC is not of high quality, with the decision to reject at this stage unconvincing given contradictory evidence in the cost adjustment claim options.</p>	CMI2	C
			CMI3	D
			CMI4	C
			CMI5	B
			CMI6	C
			CMI7	D
			Securing cost efficiency	C
CE2	D			
CE3	C			
CE4	A			
Aligning risk and return	B	<p>Overall, Northumbrian Water's plan is high quality, providing sufficient and convincing evidence supporting its approach in the area of aligning risk and return.</p> <p>The following areas of the plan are high quality:</p> <ul style="list-style-type: none"> <li>• It is based on our Final Methodology 'early view' cost of capital and retail margins.</li> <li>• It contains a clear board statement that the plan is financeable under its actual and the notional financial structure, with appropriate evidence to support this.</li> <li>• There is convincing evidence to support the company's choice of PAYG and RCV run-off rates.</li> </ul> <p>The plan provides insufficient evidence on risk mitigation measures in its assessment of RoRE scenarios for the notional company and we have concerns about the assessed exposure to revenue risks, but this is not material enough an issue to affect the overall grade.</p>	RR1	B
			RR2	C
			RR3	B
			RR4	B

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Accounting for past delivery	C	Overall, Northumbrian Water's business plan falls short of high quality in accounting for past delivery.	PD1	B
		<p>In the round we have some concerns with the evidence for deliverability for the 2020-25 plan, in particular for outcomes and major incidents.</p> <p>The plan is high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> <li>The company is forecast to underspend against its cost allowance for 2015-20.</li> <li>The company is already meeting CCWater's 2020 household customer complaints target of resolving 95% of customer complaints at stage one and has falling total household customer complaints.</li> </ul> <p>The plan falls short of high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> <li>The company is proposing stretching performance commitments for leakage, internal sewer flooding, wastewater treatment works compliance and sewer collapses. The plan provides insufficient evidence that it includes appropriate measures to achieve this performance improvement.</li> <li>The company has had four major pollution incidents in 2015-18 and has had a high number of category one and two pollution incidents. It provided insufficient evidence on measures to address this performance and so we have some concerns with the evidence for deliverability of performance improvements in relation to major incidents.</li> </ul> <p>There is sufficient and convincing evidence for five out of the eight PR14 reconciliation areas and insufficient evidence for outcome delivery incentives, service incentive mechanism and totex. There is a marginal difference (1.4% of 2019-20 revenue) between expected and proposed reconciliations. In the round, the sufficient and convincing evidence for the PR14 reconciliations is not sufficient to raise the accounting for past delivery test area score.</p>	PD2	C
Securing confidence and assurance	C	Overall, Northumbrian Water's business plan falls short of providing sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.	CA1	C
		The company's business plan provides some evidence of high quality.		
		The company's Board provides a compliant statement of assurance with sufficient supporting evidence to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes.		
		There is sufficient and convincing evidence that overall, the company's business plan tables and the assurance and commentary provided are consistent, accurate and assured.	CA2	D
		The company's business plan falls short of high quality in the following areas:		
		Although the company's Board provides the majority of assurance statements requested to demonstrate that all the elements of its business plan add up to a plan that is high quality and deliverable, an insufficient number of them have supporting evidence of the Board's challenge and assurance process.	CA3	C
		On demonstrating a fair balance between customers and investors:		
		<ul style="list-style-type: none"> <li>The company proposes a bespoke voluntary benefits sharing mechanism which we assess could have a value of £0.6m per year to reduce water poverty and support customers and donations to social tariffs and hardship funds which we assess could have a value of £1.8m per year. The company's proposals for voluntary benefits sharing are high quality in the context of the company's size.</li> <li>On executive pay, the company demonstrates insufficient evidence of its intention to meet the expectations set out in the 'Putting the sector in balance' position statement. There is little evidence of how the targets will be stretching and aligned with delivery to customers. Also, there is no reference to the policy for 2020-25 and how it will be rigorously applied and monitored.</li> <li>On gearing benefits sharing, the company does not propose a mechanism since it does not consider its gearing will exceed 70% despite forecasting limited headroom.</li> </ul>	CA4	B

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	C	<ul style="list-style-type: none"> <li>On dividend policy, there is insufficient evidence of the company's intention to meet the expectations set out in the 'Putting the sector in balance' position statement. There is no clear Board commitment to publish detail on dividend policies annually and to signal changes to stakeholders. Also there is insufficient evidence of how the dividend policy in 2020-25 takes account of obligations and commitments to customers for the dividend policy that is applied in 2020-25 and when determining dividends.</li> <li>The Board also provides a partially compliant statement that the company's business plan will enable customers' trust and confidence through high levels of transparency and engagement on corporate and financial structures.</li> <li>Additionally, there is insufficient evidence of transparency on the company's corporate and financial structures and how this relates to its long-term resilience</li> </ul> <p>In our assessment of the company in the 2018 Company Monitoring Framework (not including the elements related to the PR19 business plans) while the company exceeds expectations in 1 area and meets expectations in 7 areas, it has minor concerns in 2 areas.</p> <p>The company's plan falls significantly short of high quality in demonstrating that the Board's governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term since the Board's statement is only partially-compliant.</p>	CA5	C
			CA6	B