

January 2019

Trust in water

PR19 initial assessment of plans: United Utilities company categorisation

About this document

In ‘[Delivering Water 2020: Our final methodology for the 2019 price review](#)’ (the methodology) we said that we wanted all 17 regulated water and wastewater companies to produce high-quality, ambitious and innovative business plans, pushing forward the performance and efficiency of the sector for customers. To encourage this we developed the initial assessment of business plans (IAP) process. The IAP was designed to incentivise all companies to produce well-evidenced plans that reflect their customers’ preferences and priorities and are efficient.

We explained that the IAP would:

- assess company business plans against nine key test areas that reflect our PR19 themes and the strategic policy statements of the UK and Welsh Governments and help make sure companies deliver for customers, the environment and wider society;
- assess company business plans against three key characteristics (quality, ambition, and innovation); and
- categorise company business plans into four categories (significant scrutiny, slow-track, fast-track, or exceptional).

Following the submission of companies’ business plans on 3 September 2018, we have carried out an extensive and detailed review of these plans. This review has been carried out in accordance with our methodology. More details on our overall approach to the initial assessment of business plans and our key findings by test area are set out in the ‘PR19 initial assessment of plans: Summary of test area assessment’. The results of the review of all 17 business plans are summarised in the ‘PR19 initial assessment of plans: Overview of company categorisation’. Our assessment is based on the information the company submitted to us as part of its business plans for the period 2020-25. The documents we have published are available on our [website](#).

This document sets out our assessment of United Utilities’ business plan submission under the IAP. It explains our assessment of the company’s plan in the round at an aggregate level and our assessment across each of the nine test areas as set out in our methodology.

This document and the actions in the ‘United Utilities: Actions summary table’ should be read in addition to the ‘PR19 initial assessment of plans: Overview of company categorisation’ document.

1. Overview of United Utilities categorisation

Our assessment of the plan

We set high expectations for water companies at PR19. We pushed them to go further than ever before, improving efficiency, customer service and resilience. We asked them to share financing gains with customers and to ensure that their dividend and executive pay policy is aligned to delivering for customers. We asked them to look well beyond the five-year price review period to meet the needs of future customers and protect and improve the natural environment. We indicated in our PR19 methodology that the bar is high, and our IAP is the categorisation of company plans against those high expectations at this stage of the price review process. Where our expectations have not been fully met, we will continue to work closely with companies during the draft and final determination stages.

We are pleased to categorise United Utilities' plan as fast-track. This categorisation is made after an in the round consideration of our assessment of United Utilities' plan across the nine test areas, agreed targeted actions and the level of intervention required in the plan to protect the interests of customers. Our grades for each test area are set out in Table 1 below.

United Utilities' plan is assessed as high quality across a range of test areas. Its plan includes ambitious, innovative and sector-leading proposals to make customers' bills affordable and on providing support for vulnerable customers. For example, the company proposes a large bill reduction of 11% between 2020 and 2025 in real terms, with high customer acceptability and support for its approach on affordability and its proposed bills. It proposes sector-leading flexible payment plans for customers who are struggling to pay. It commits to achieving accredited standards to assure the quality of the Priority Services it offers its customers. It is also leading the sector by working with its local energy network to address customer vulnerability.

Other areas it performs well on include:

- **engaging customers** - using a wide range of techniques, it shows ambition and innovation in the use of behavioural economics techniques within immersive methods and overall approach to bringing research findings together with other sources of customer data;
- **long-term resilience** - good evidence to demonstrate financial resilience up to 2025;
- **targeted controls, markets and innovation** - it proposes an ambitious approach to innovation and its long-term strategy for its water network;

- **accounting for past delivery** - it provides good evidence to support the delivery of and the performance it proposes in its 2020-25 plan;
- **confidence and assurance** - it has good proposals on executive pay, dividend policy and gearing benefits sharing and proposes a high quality and ambitious voluntary benefit sharing package; and
- **risk and return** - its plan uses our early view on the cost of capital and retail margins, and has provided Board assurance that its plan is financeable and the company is able to fund its activities.
- **cost efficiency** - we consider United Utilities' 2020-25 cost projections to be relatively efficient when compared with our view of efficient costs.

In the round, we considered that United Utilities' plan should receive fast-track categorisation, though there were targeted actions that it needed to confirm it would undertake to achieve that status. It has accepted the targeted actions and therefore it is categorised as fast-track. These actions include committing to more stretching performance commitments including a leakage reduction target of 20% to reflect its historically poor performance, adjusting its costs to come into line with our view of an efficient level and providing more evidence to support its adjustment to pay as you go (PAYG) rates.

The list of agreed actions are set out in the 'United Utilities: Actions summary table'.

United Utilities proposes to deliver a scheme to improve the Haweswater Aqueduct to deliver long-term water supply resilience to Manchester using the direct procurement for customers approach. We welcome the company's proposal, however, further optioneering work is required before approval. We propose to progress our assessment of this scheme outside of the fast-track process.

An overview of our assessment of the business plan in relation to the nine test areas and our grades for each test area are set out below. Our detailed assessment of the test areas is provided in the 'United Utilities: Test area assessment' and 'United Utilities: Test question assessment' documents. These reflect the business plan that was submitted to us and do not take into account the company's decision to accept our targeted actions to achieve fast-track status without conditions.

Table 1: Overall test area assessments

Test Area	Our assessment
Engaging customers	B
Addressing affordability and vulnerability	A
Delivering outcomes for customers	C
Securing long-term resilience	B
Targeted controls, markets and innovation	B
Securing cost efficiency	B
Aligning risk and return	C
Accounting for past delivery	B
Securing confidence and assurance	B

A = High quality, ambitious and innovative plan with evidence that overall is sufficient and convincing

B = High quality plan, not sufficiently ambitious and innovative to be exceptional with evidence that overall is sufficient and convincing

C = Concerns with the plan: Plan falls short of high quality and/or evidence is insufficient and/or unconvincing in some areas

D = Substantial concerns with the plan: Plan falls significantly short of required quality and/or little or no evidence, or no convincing evidence

Engaging customers

Overall, United Utilities' business plan demonstrates a high quality approach to customer engagement with convincing evidence. It uses a wide range of techniques which have been tailored to suit target audiences. It shows innovation and ambition in the use of behavioural economic techniques within immersive methods, such as puzzles, and its approach to bringing customer research findings together with other sources of customer data. It has a sector-leading communication approach with its customers using a wide range of methods.

Addressing affordability and vulnerability

United Utilities' business plan provides strong and convincing evidence to demonstrate an ambitious and innovative approach to addressing affordability and vulnerability issues. Its approach is sector-leading receiving the highest available grade in a test area.

It displays an innovative approach to the provision of services to customers in vulnerable circumstances. This includes working with partners, committing to attaining the British Standards Institute (BSI) standard on customer accessibility to Priority Services, and leading the sector in its partnership with its local energy network. It also proposes sector-leading options in payment flexibility. It is working with its customers and stakeholders to develop appropriate schemes for those who struggle to pay.

It proposes a large bill reduction of 11% by 2025, with high customer support on acceptability and affordability. It is committing £71m of its shareholders' money to schemes which help customers who are struggling or at risk of struggling to pay their bills.

Delivering outcomes for customers

Overall, across the delivering outcomes for customers test area the plan proposed by United Utilities falls short of high quality.

It proposes a balanced package of performance commitments that generally reflects its customers' views. It proposes a package of outcome delivery incentives that is balanced between different business areas, and there is clear explanation as to how the outcome delivery incentive package delivers appropriate incentives and aligns the interests, of shareholders / management with customers.

However, the evidence it provides to support its performance commitments and outcome delivery incentives is insufficient or unconvincing in some areas. Some of the performance commitments it proposes are unclear. The targets it proposes for its leakage, per capita consumption and internal/external sewer flooding performance commitments are not sufficiently challenging when compared to the rest of the sector.

Securing long-term resilience

United Utilities plan presents convincing evidence of operational, corporate and financial resilience to be graded as high quality.

Its plan assesses a wide range of operational, corporate and financial risks and uses both qualitative and quantitative approaches to assess them. It reflects on past performance and shows how it has learnt from past failures to improve its approach to risk management and resilience. It provides clear links between the risks prioritised and the mitigation solutions developed. It provides good evidence of customer involvement in the development of mitigation options. It provides both Board and third party assurances to support its assessment of financial resilience.

There are some areas for improvement with insufficient evidence of an integrated and systems-based approach to resilience where interdependencies or cascading impacts of one system on another should be considered.

Targeted controls, markets and innovation

United Utilities provides a high quality plan across most areas of targeted controls, markets and innovation.

Its plan includes strong evidence of ambitious and sector leading ideas across all drivers on innovation. Innovation is clearly integrated throughout the culture of the company and it includes a number of innovative suggestions which are not seen in the sector, for example integrating innovation into its performance management. There is strong evidence of the use of markets including partnerships and catchment strategies across water and wastewater networks, with an ambitious long term strategy proposed for its water network.

United Utilities provides convincing evidence that it has considered direct procurement for customers as part of its investment programme. The technical and value for money assessments for the Manchester and Pennines resilience scheme which is taken forward is supported by convincing evidence.

However, the company only demonstrates a commitment to using market led solutions in certain aspects of its plan.

Securing cost efficiency

We consider United Utilities' 2020-25 cost projections to be relatively efficient when compared with our view of efficient costs. At the company level its costs are about 3% above our view of efficient costs. In wholesale water and retail its cost projections are in line with our view of efficient costs. In wastewater, the company is 7% above our view of efficient costs, largely due to high base costs in its wastewater services.

Aligning risk and return

Overall United Utilities' plan falls short of providing convincing and high quality evidence to support its approach in the area of aligning risk and return. Its RCV run-off rates and the notional company risk and risk mitigation measures in the return on regulatory equity (RoRE) assessment are not sufficiently evidenced.

There are a number of aspects of its plan which are high quality. It is based on our Final Methodology 'early view' cost of capital and retail margins. 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. There is convincing

evidence to support the company's starting position in its choice of pay as you go (PAYG) rates, although the adjustment to PAYG rates is not sufficiently evidenced.

Accounting for past delivery

United Utilities' plan demonstrates high quality in this area, with sufficient and convincing evidence both in support of PR14 reconciliations and on measures to support deliverability of the 2020-25 plan given past performance.

Securing confidence and assurance

United Utilities' business plan demonstrates high quality in the confidence and assurance test area. The company demonstrates a good track record of producing high quality data and its plan provides overall high quality proposals on executive pay, dividend policy and gearing benefits sharing. The company also proposes a high quality and ambitious voluntary benefit sharing package involving contributions towards its community fund and financial assistance measures, worth £71 million over 2020-25, and an additional sharing mechanism where distributions above a base dividend plus 2% return on regulatory equity will be matched one for one with contributions to its community fund.

2. Funding to facilitate the development of strategic water resources

We are providing funding to facilitate the development of strategic water resources options for the south and south-east of England to ensure that appropriate regional solutions can be taken forward in future investment plans. We expect companies to set out how they intend to work together to undertake more detailed feasibility and planning work.

£25.7 million of this funding will go to United Utilities.

3. Next steps and overall timeline

Actions for United Utilities are set out in 'United Utilities: Actions summary table'.

The next part of the process will be the draft determination, followed by the final determination, as set out in the table below.

Date	Milestone
11 February 2019	Fast-track companies to commit to all actions and submit relevant data tables by 10am
11 April 2019	Draft determinations for fast-track plans
24 May 2019	Representations on draft determinations due
11 December 2019	Final determinations published
1 April 2020	Price controls for 2020 – 2025 come into effect

Appendices

The appendices below can find be found on our [website](#).

- United Utilities: Test area assessment
- United Utilities: Test question assessment
- United Utilities: Actions summary table
 - United Utilities: Delivering outcomes for customers detailed actions
 - United Utilities: Accounting for past delivery detailed actions
 - United Utilities: Securing confidence and assurance detailed actions

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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