

## Portsmouth 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
C	C	C	C	C	B	C	C	C

Portsmouth Water - test area results				
Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Engaging customers	C	<p>Overall Portsmouth Water's business plan falls short of high quality with insufficient evidence provided in the areas set out below. Portsmouth's business plan and CCG report provide sufficient and convincing evidence of some elements of its approach to customer engagement but the following areas need more convincing evidence for the plan to be high quality:</p> <ul style="list-style-type: none"> <li>Customers were engaged on longer term issues and their views were incorporated in the business plan.</li> <li>Comparative information used to inform customer choices during performance commitment research.</li> <li>Use of tracker surveys and ongoing complaints analysis outside of the price review process to understand customer priorities and relevance of outcomes.</li> </ul> <p>The plan falls short of high quality in the following areas</p> <ul style="list-style-type: none"> <li>The small number of customers with which it engaged (which undermines the company's ability to provide adequately robust results) as well as the lack of variety and/or use of effective engagement methods.</li> <li>The company's approach to triangulation, where there is a lack of independent assurance and it is unclear how outcome delivery incentive rates reflect customer views.</li> <li>The lack of segmented research techniques and a lack of direct engagement with vulnerable customers which leads to uncertainty that the full breadth of the company's customer base is represented in its business planning.</li> <li>Insufficient evidence that the company understands how customer behaviour may and should influence its approaches to resilience currently and beyond 2025.</li> </ul>	EC1	C
Addressing affordability and vulnerability	C	Overall Portsmouth Water's business plan falls short of high quality with insufficient evidence of its approach to affordability and vulnerability.	AV1	C
		The plan demonstrates some aspects of high quality because:	AV2	C
		<ul style="list-style-type: none"> <li>The company has sufficient customer support for the acceptability and affordability of bills in the 2020 to 2025 period. Bills are falling by 4% over the period.</li> </ul>	AV3	C
		<p>The business plan falls short of high quality in the following areas:</p> <ul style="list-style-type: none"> <li>The evidence provided does not sufficiently demonstrate that the company is increasing the reach of its affordability support, particularly its social tariff.</li> <li>The company has a low quality approach to understanding vulnerability in its area, and proposes an insufficiently ambitious reach for its Priority Services Register.</li> <li>The company is using financial levers to move money between periods, without providing sufficient evidence or explanation of why or how it is doing so.</li> </ul>	AV4	C

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Delivering outcomes for customers	C	<p>Overall, across the outcomes test area, the evidence Portsmouth Water provides to support its proposed PCs and ODIs in its plan falls short of high quality, and the evidence it provides is insufficient or unconvincing in some areas.</p> <p>There are some individual areas of high quality such as the proposal for upper quartile performance for supply interruptions. However, the overall Outcomes package presented has some specific issues and a lack of evidence to support it.</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 provides insufficient evidence that its service levels for leakage, per capita consumption, catchment management, compliance risk index and water quality contacts are appropriate;</li> <li>the company provides insufficient supporting evidence for the calculation of ODI rates and there are also concerns with the customer research and triangulation;</li> <li>the company's approach to setting caps and collars is insufficiently evidenced. Whilst the company does not propose to use any deadbands, it proposes a number of caps and collars without providing any convincing evidence to support these features; and</li> <li>the company does not provide sufficient evidence that its overall ODI package will provide appropriate incentives, in particular the plan does not provide sufficient evidence that the company understands its past performance asset health issues and that its asset health ODIs will protect customers from poor service.</li> </ul>	OC1	C
			OC2	C
			OC3	C
Securing long-term resilience	C	<p>Overall, Portsmouth Water's 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 presents sufficient evidence that a wide range of risks to resilience have been considered. The evidence provided in relation to risk assessment and prioritisation is clear and transparent. The plan provides a risk register at a suitable level of detail in order to support the company's resilience assessment.</p> <p>There is sufficient evidence that the company has considered the extent to which it might reasonably avoid, mitigate and recover from financial shocks consistent with those referred to in its 2017-18 long term viability statement and there is sufficient evidence of scrutiny and challenge by the board. The company demonstrates a high quality assessment of financial resilience in some respects, but it does not sufficiently considers risks associated with some significant issues referenced in the plan.</p> <p>We consider that the company plan does not provide sufficient and convincing evidence of a commitment to resilience in the round in the following areas:</p> <ul style="list-style-type: none"> <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's resilience assessment is not sufficiently detailed to enable an understanding of where and why the company's level of resilience has been assessed as insufficient or sufficient. A comprehensive, long term maturity profile is not provided;</li> <li>there is insufficient evidence in the plan that the company has used environmental valuation techniques to ensure the objective assessment of nature-based solutions against more traditional options;</li> <li>there is insufficient evidence that the company has assessed the risks to its long term resilience of maintaining a credit rating that is one notch above the minimum for investment grade. The company's financial resilience relies heavily on an equity injection associated with the development of the Havant Thicket reservoir, but there is insufficient evidence of a detailed assessment of the full range of risks associated with the development, or the impacts on the company's financial resilience were the project not to proceed. The company has requested a company specific cost of debt adjustment, but the PR19 methodology does not guarantee this uplift and the company does not set out the steps it could take to address its financial resilience in the absence of the adjustment.</li> </ul>	LR1	C
			LR2	C
Targeted controls, markets and Innovation	C	<p>Overall, despite some areas of high quality, Portsmouth 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.</p> <p>The company provides sufficient evidence it had addressed Ofwat's feedback on the RCV, and good evidence and proposals on management of gaps/voids and its plans for 3rd party partnerships to support its catchment and options for water resources. The company provides good evidence of engagement with 3rd parties for supply and demand solutions, and its strategy for water resources is aligned with the WRMP in respect of leakage.</p>	CMI1	C
			CMI2	C
			CMI3	C

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		<p>The company does not provide sufficient information to demonstrate a high quality plan in relation to its approach to enabling innovation, its strategy for bilateral markets, its bid assessment framework and consideration of DPC options (beyond Havant Thicket) in the creation of its business plan. Issues around metering and PCC ambition and board assurance are only partly addressed. The business plan does not include a strategy for bilateral markets, and the company's data table on Water Resources (WR6) is incorrect. The company's bid assessment framework sets out how it will assess bids and sets out measures to ensure proportionality. However the framework is not transparent, and includes little detail on how the company would handle appeals or satisfy audit and compliance best practice recommendations. The company provides limited evidence of a thorough technical assessment of the Havant Thicket scheme that considered all the criteria. The case for it being technically detrimental to Portsmouth Water's operation is unconvincing. The Value for Money (VfM) and Five Case business model that favours in house delivery appears driven by assumptions on gearing and cost of debt which are not well justified.</p> <p>There is insufficient evidence that the proposed commercial arrangements between Portsmouth Water and Southern Water for the development of the Havant Thicket reservoir will adequately protect the customers of Portsmouth Water. We are concerned that the company's customers will be exposed to costs and risks of the development which is for the benefit of the customers of Southern Water.</p>	CMI4	N/A
			CMI5	B
			CMI6	C
			CMI7	C
Securing cost efficiency	B	<p>Overall, we consider Portsmouth Water's costs are efficient when compared with our efficient baselines. At the company level its costs are 2% below our view of efficient costs. Its retail costs are not as efficient as its wholesale costs. Its base costs are the most efficient in the industry.</p> <p>However, the company provides limited evidence to explain how the benefits for the proposed reservoir development will be proportioned between supporting trading and internal resilience and therefore we are not including the full costs of the scheme in our view of enhancement costs.</p> <p>The company only propose one cost adjustment claim, which we do not assess in the same way as for other companies because it simply references a third party report the company provides with its business plan. Since there are no further claims to review we give the company a grade of A in this test.</p>	CE1	B
			CE2	N/A
			CE3	C
			CE4	A
Aligning risk and return	C	<p>Despite some areas of Portsmouth Water's plan which are high quality, shortcomings in other aspects mean that it overall falls short of providing convincing and high quality evidence to support 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>the proposed uplift to the allowed cost of debt is accompanied by convincing evidence that the level of uplift is appropriate, that customers receive adequate compensating benefits and that there is convincing evidence that the uplift is supported by customer preferences; and</li> <li>there is convincing evidence to support the company's choice of PAYG and RCV run-off rates.</li> </ul> <p>There are three main areas where the plan falls short of high quality. It does not provide sufficient and convincing evidence:</p> <ul style="list-style-type: none"> <li>To support the choice of target credit rating for the notional structure (A3 Moody's).</li> <li>To support its choice of target credit rating for the actual structure (Baa2 Moody's), in the context of the investment programme and debt raising needs and further assurance is required to support the view that its financial ratios are consistent with the target credit rating for its actual structure.</li> <li>In respect of risk and risk mitigation measures in the RoRE assessment for the notional company and we have concerns about the company's exposure to revenue risk.</li> </ul>	RR1	B
			RR2	C
			RR3	C
			RR4	B
Accounting for past delivery	C	<p>Overall, Portsmouth Water's business plan falls short of high quality in accounting for past delivery.</p> <p>In the round we have some concerns with the evidence for deliverability for the 2020-25 plan, in particular in relation to 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 has good actual and forecast performance in costs as it is forecast to underspend against its cost allowance for 2015-20. We therefore do not have concerns with the evidence for deliverability of the planned costs.</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 the lowest number of household customer complaints per 10,000 connections in the sector. We therefore do not have concerns with the evidence for deliverability for customer complaints handling.</li> </ul>	PD1	C

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		<p>The plan falls short of high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> <li>The company has or is forecast to deliver 71% of performance commitments with financial outcome delivery incentives in 2015-20. The company provides insufficient evidence that it understands the drivers of its outcomes performance. In the round we have some concerns with the evidence for deliverability of outcomes performance set out in the plan.</li> <li>The company had one major pollution incident in 2015-18 and it provides insufficient evidence on measures to address and maintain its performance in relation to customer communications following incidents. We therefore have some concerns with the evidence for deliverability of improved performance in relation to major incidents.</li> </ul> <p>There is sufficient and convincing evidence for five out of eight PR14 reconciliation areas and insufficient evidence for outcome delivery incentives, wholesale revenue forecasting incentive mechanism and water trading. We have found major data consistency issues between the submitted tables and populated reconciliation models for the wholesale revenue forecasting incentive mechanism and water trading. There is a marginal difference (1.7% of 2019-20 revenue) between expected and proposed reconciliations.</p>	PD2	C
Securing confidence and assurance	C	<p>Overall, Portsmouth Water's business plan falls short of providing sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.</p> <p>The company's business plan provides some evidence of high quality:</p> <p>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.</p> <p>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.</p> <p>The company's business plan falls short of high quality in the following areas:</p> <p>The company's Board provides statements of assurance in the majority of requested areas to demonstrate that all the elements of its business plan add up to a plan that is high quality and deliverable and that it has challenged management to ensure this is the case. However a number of statements are partially-compliant and one is omitted.</p> <p>The company's Board provides only a partially compliant statement of assurance to demonstrate that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term.</p> <p>On demonstrating evidence of a fair balance between customers and investors:</p> <ul style="list-style-type: none"> <li>The company proposes a base dividend yield of less than 5% and accepts our default gearing benefit sharing mechanism.</li> <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 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. Also there is insufficient evidence of a clear Board commitment to signal changes in dividend policy to stakeholders.</li> <li>The company's proposed policy for 2020-25 takes account of delivery of obligations and commitments to customers and other stakeholders and although the company commits to publishing its dividend policy annually, there is no specific commitment to signal changes to stakeholders.</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 insufficient 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. In addition, there is no evidence of transparency of reporting or how changes will be signalled to customers.</li> <li>Although the Board provides a compliant assurance statement that its plan will enable customers' confidence through high levels of engagement on its corporate and financial structures, there is insufficient evidence of the Board's assurance process.</li> <li>There is sufficient evidence of transparency on the company's corporate and financial structures and how these relate to its long-term resilience.</li> </ul>	CA1	C
			CA2	C
			CA3	C
			CA4	B
			CA5	C

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		<ul style="list-style-type: none"> <li>The company did not put forward proposals for a bespoke voluntary benefits sharing mechanism or donations to social tariffs and hardship funds. However, voluntary sharing mechanisms are not a requirement of the PR19 methodology, so this does not impact our assessment of this test area for this company.</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 meets expectations in 7 areas, it has minor concerns in 2 assessment areas.</p>	CA6	B