

South East 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	B	B	C	B	C	C	D	B

South East 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 South East Water's business plan falls short of high quality with insufficient evidence in some areas.</p> <p>The company provides sufficient evidence of a high quality approach in the following areas:</p> <ul style="list-style-type: none"> Effective use of a wide range customer engagement techniques, including qualitative approaches such as focus groups, face to face interviews, online communities and deliberative events and quantitative approaches such as online surveys, telephone surveys, and online approaches. Adoption of the four areas of action set out in the Tapped In report, including: promoting customer action through 'the Resilient Customer' and 'Resilient Business Customer'; and engaging the wider community through the set-up of the 'Environmental Focus Group' to help agree on future initiatives. Engagement with customers on both the business plan and on longer-term issues in general, including its work on willingness to pay and how it considered the needs and requirements of future customers in its business plan. <p>The business plan falls short of high quality in the following areas:</p> <ul style="list-style-type: none"> The company's approach to ongoing engagement the absence of which demonstrates the lack of a truly embedded and customer-centric approach Insufficient evidence of the extent to which customer segmentation is driving customer outcomes and priorities, shaping delivery of services, or a tailored approach to engagement. Lack of robust data, with views based on qualitative studies along with no quantitative data to support some findings. 	EC1	C
Addressing affordability and vulnerability	B	<p>Overall South East Water's business plan demonstrates high quality with convincing evidence that covers the company's approach to affordability and vulnerability because it proposes a:</p> <ul style="list-style-type: none"> High quality and innovative approach to addressing vulnerability including four stretching performance commitments (PC), which is sector leading. High quality plan for supporting customers who are struggling to pay, including a doubling of financial support measures, and a good spread of schemes. <p>The business plan falls short of high quality in two areas because it:</p> <ul style="list-style-type: none"> Has a low quality approach to long-term affordability. It did not engage its customers sufficiently on this subject and we have concerns over its plans to use PAYG and RCV run rates to adjust cashflow profile between price review periods. Proposes to keep bills flat in real terms over 2020 to 2025. However, the plan does not include credible evidence of how combined bills over this period will impact customers. 	AV1	C
			AV2	D
			AV3	B
			AV4	A

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Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Delivering outcomes for customers	B	<p>Overall, across the delivering outcomes for customers test area, a generally high quality plan, with evidence that is generally sufficient and convincing, but not sufficiently ambitious and innovative to be exceptional.</p> <p>South East Water's plan provides evidence of a package of PCs that overall reflects customer views. The company evidences a high quality approach to its PCs and appropriately stretching levels for some PCs. For example, it proposes achieving upper quartile performance for leakage.</p> <p>The company proposes a high quality package of standard outcome delivery incentives (ODI) that follow the PR19 methodology principles and are founded on a well-evidenced approach based on customer views, and a well-justified package of caps, collars and deadbands.</p> <p>However, the business plan falls short of high quality in the following areas:</p> <ul style="list-style-type: none"> the company has a low ambition for per capita consumption PC given its high level of metering and water resource position; it forecasts asset health measured by the level of mains repairs to deteriorate from the levels in 2015-16 due to action to reduce leakage, however it does not provide sufficient evidence that its proposed PC level is adequately stretching; It has not applied an appropriate and high quality approach to its focus on service performance and in its risk/reward package. The company provides insufficient explanation of how its ODI package incentivises it against service under delivery, through better aligning the interests of management and shareholders with customers. although proposed a small ODI package the company has not considered appropriate protections to customers from higher than expected outperformance payments. 	OC1	B
			OC2	B
			OC3	C
Securing long-term resilience	C	<p>Overall, South East Water's plan falls short of high quality and the company has not provided sufficient and convincing evidence of securing long term resilience in certain areas.</p> <p>The company provides a high level assessment of operational, corporate and financial risks with some quantification which is sufficient. The plan also presents a good range of mitigation options that cover conventional, nature-based and behavioural options. The plan generally provides sufficient evidence of its approach to ensuring financial resilience referring to a commitment to reduce gearing, and providing an appropriate approach to financial risk mitigation.</p> <p>However, we consider that the company's 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"> While the company's assessment of financial resilience contains some elements of high quality and the company plans to reduce gearing to 75%, there is insufficient evidence that it has considered all issues. There is insufficient evidence that the company has adequately considered the risks that maintaining a credit rating one notch above the minimum for investment grade, is consistent with maintaining long term financial resilience. The company provides insufficient evidence that it has appropriately assessed and prioritised a full range of risks and consequences to its systems and services. The company's assessment of operational resilience mitigation options falls short of high quality. The plan relies more on "resistance" options and traditional engineering solutions, and much less on response and recovery measures. The company provides insufficient evidence of a fully systems-based approach to resilience. The plan sets out a baseline resilience assessment, although the assignment and aggregation of scores is unclear. While the plan provides some evidence of customer engagement on resilience, we consider this is limited in scale and lacks involvement of customers concerning options to co-create and co-deliver resilience. 	LR1	C
			LR2	C
Targeted controls, markets and Innovation	B	<p>Overall, South East Water provides sufficient and convincing evidence across most areas of Targeted Controls, Markets and Innovation. However, it is not sufficiently ambitious and innovative to be exceptional.</p> <p>The company's plan includes strong evidence across all areas of innovation with some evidence of best practice, particularly rated to collaboration.</p>	CMI1	B
			CMI2	C
			CMI3	B

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		<p>The company only convincingly demonstrates a commitment to using market led solutions in certain aspects of its plan. On water resources, the company's plan shows sufficient and convincing evidence around third-party engagement and preparation for bilateral markets. It also adequately responds to Ofwat's draft WRMP representations. However, for water-network plus, whilst there are some good elements to the plan, there is insufficient evidence that the company have given consideration to market solutions.</p> <p>The company considered DPC in its plan with two schemes, which met the threshold test, subjected to further assessment. The company provided evidence of a decision-making process for technical suitability, however, while the company undertook a Value for Money analysis, there is insufficient evidence that the company followed the Five Case Treasury model.</p>	CMI4	N/A
			CMI5	B
			CMI6	C
			CMI7	C
Securing cost efficiency	C	<p>Overall, we do not consider South East Water's costs to be efficient. At the company level its costs are around 20% above our view of efficient costs. Despite this we give the company a C grade for this test because it has relatively efficient costs in the key areas of base wholesale water costs and retail.</p> <p>Its wholesale water costs are around 23% above our benchmark costs, mainly due to inefficient enhancement costs. This is largely due to high projections for costs associated with accommodating new developments, where we disallow £95m based on benchmarking the company's costs to its peers.</p> <p>Some aspects of the company's plan are positive. Base cost projections are relatively efficient at around 5% above our view of efficient base costs. The company's costs for residential retail are efficient at around 4% below our view of efficient retail costs.</p> <p>The company proposes two cost adjustment claims, one of which receives a partial pass and the other fails our quality assessment.</p>	CE1	D
			CE2	N/A
			CE3	B
			CE4	C
Aligning risk and return	C	<p>Despite some aspects of South East 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 area of the plan is high quality:</p> <ul style="list-style-type: none"> It is based on our Final Methodology 'early view' cost of capital and retail margins. <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"> In support of its board statement that its plan is financeable - specifically around the steps taken to inform that assessment, and in support of its choice of target credit rating on the actual structure (Baa2/BBB Moody's/S&P). In support of its proposed PAYG and RCV run-off rates - particularly the proposed adjustment to its PAYG rate, in the context of evidence that the company's customers prefer smooth bills. In respect of customer preferences to support the final bill profile, where this evidence was based on presenting customers with a 2025-30 bill profile based on a cost of capital that is supported by unconvincing evidence. <p>While there is high quality evidence in the company's assessment of risk for the notional company in its RoRE analysis in the round, there is insufficient evidence to explain why the distribution of totex RORE outcomes are skewed towards the downside for the notional company.</p>	RR1	B
			RR2	B
			RR3	C
			RR4	C

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Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Accounting for past delivery	D	Overall, South East Water's business plan falls significantly short of the required quality in accounting for past delivery.	PD1	C
		<p>In the round we have substantial concerns with the evidence for deliverability for the 2020-25 plan, in particular in relation to outcomes, and we have some concerns with the evidence for deliverability of improved performance in relation to major incidents.</p> <p>The plan is high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> The company is forecast to underspend against its 2015-20 cost allowance. The company is already meeting CCWater's 2020 household customer complaints target of resolving 95% of customer complaints at stage one and has a low and falling number of household customer complaints. The company also demonstrates senior leadership ownership of complaints. <p>The plan falls short of high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> There is poor performance on outcomes as it has or is forecast to deliver 66% of PCs with financial ODIs in 2015-20, excluding the company's stretching customer satisfaction measures. The company provides insufficient evidence that it understands the drivers of its performance and has learnt lessons from that performance. The plan provides insufficient evidence that it includes appropriate measures to improve its performance. We therefore have substantial concerns with the evidence for deliverability for outcomes. The company had no major pollution or drinking water quality incidents, but had poor performance following the 2018 freeze and thaw and was required to produce an externally assured action plan. The company does not provide sufficient convincing evidence to give us confidence in delivery. We therefore have some concerns with the evidence for deliverability improved performance in relation to major incidents. <p>There is sufficient and convincing evidence for seven out of eight PR14 reconciliation areas and insufficient evidence for residential retail. In general the company used the published models but has made unnecessary changes to the totex model. There is a minor difference (2.6% of 2019-20 revenue) between expected and proposed reconciliations. In the round, the evidence for the PR14 reconciliations is not sufficient to raise the accounting for past delivery test area score.</p>	PD2	D
Securing confidence and assurance	B	Overall, South East Water's business plan provides sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.	CA1	B
		<p>The company's Board provides all of the assurance statements requested 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. Most of the statements have sufficient supporting evidence.</p> <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 has minor concerns in 2 areas, it exceeds expectations in 2 areas and meets expectations in 5 areas.</p> <p>However, the plan falls short of high quality in some areas:</p> <p>The company's Board provides a 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. However, the company provides insufficient evidence to support this statement.</p> <p>On demonstrating evidence of a fair balance between customers and investors:</p> <ul style="list-style-type: none"> The company's proposals for its base dividend yield, dividend policy and gearing benefit sharing meet our requirements. 	CA2	C
		<p>The company's Board provides a 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. However, the company provides insufficient evidence to support this statement.</p> <p>On demonstrating evidence of a fair balance between customers and investors:</p> <ul style="list-style-type: none"> The company's proposals for its base dividend yield, dividend policy and gearing benefit sharing meet our requirements. 	CA3	C

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		<ul style="list-style-type: none"> 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 or evidence as to how changes will be signalled to customers. On dividend policy, there is sufficient evidence of the company's intention to meet the expectations set out in the 'Putting the sector in balance' position statement, but we require a clear Board commitment to publish detail on dividend policy in the Annual Performance Report. The company is also highly geared but does not provide a compliant statement that its plan will enable trust and confidence through high levels of transparency and engagement with its customers about its corporate and financial structures and there is little or no evidence of transparency on its corporate and financial structures and how they relate to its long term resilience. The company does not put forward proposals for a bespoke voluntary benefits sharing mechanism but proposes donations to social tariffs and hardship funds which we assess could have a value of £0.1m per year. The scale of the proposals for voluntary sharing are very modest in the context of the company's size. However, voluntary sharing mechanisms are not a requirement of the PR19 methodology, so the proposals do not impact our assessment of this test area. <p>The company's Board provides a compliant statement of assurance to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes but provides insufficient evidence of how the Board will monitor outcome delivery.</p> <p>The company's business plan falls short of providing sufficient and convincing evidence that overall, its PR19 business plan tables and the assurance and commentary provided are high quality as we identify several issues in the policy areas of outcomes, cost assessment, risk and return and financial modelling.</p>	CA4	C
			CA5	B
			CA6	C