

South West 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	B	B	C	B	B	D	C

South West 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 some areas, 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"> • Effective use of a wide range of customer engagement techniques, including more innovative techniques such as an interactive online video. In many cases, these meet best practice, confirmed by independent assurance of its approach. • Its approach to implementing customer valuation techniques including the use of a variety of stated preference techniques and some use of revealed preferences. • The company's approach to adopting the four areas of action set out in the Tapped In report, including an innovative customer behaviour change scheme which involves customers earning points for saving water and an initiative whereby customers can choose how to share in company financial rewards. • Demonstrable incorporation of engagement with customers on risk profiles and service expectations, as well as showing creativity in the techniques used. <p>However, the business plan falls short of high quality with insufficient evidence, in the following areas:</p> <ul style="list-style-type: none"> • The company's long-term satisfaction tracking survey is combined with customer priorities research to inform decisions, however it is not clear how the tracking surveys directly impact the business plan. • How research with different customer segments is incorporated within the plan. • Insufficient evidence of a high quality approach to engagement with future customers and how the company plans to address intergenerational equity. 	EC1	B
Addressing affordability and vulnerability	B	<p>Overall South West Water's business plan demonstrates high quality with convincing evidence that covers its approach to affordability and vulnerability because it:</p> <ul style="list-style-type: none"> • displays a high quality and innovative approach to helping customers in vulnerable situations. It has high quality performance commitments (PCs) on adding customers to its priority services register and was the only company to propose a PC on checking priority service register data; • proposes a relatively large bill reduction of 14% over AMP7 and received high customer support for its approach to overall affordability; • proposes a reduction of 12.5% to its bills in AMP8; and • proposes a high quality approach to helping customers who struggled to pay their bills, with a large increase to affordability schemes, and shows a high quality approach to understanding the impact of its schemes in this area. <p>The business plan falls short of high quality because:</p>	AV1	B
			AV2	B
			AV3	B

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		<ul style="list-style-type: none"> The company proposes a high quality approach to long term affordability and affordability for customers who are struggling to pay. However, customer engagement on long term affordability and affordability for customers who struggle to pay lacks sufficient innovation and ambition to be considered exceptional. 	AV4	A
Delivering outcomes for customers	B	Overall, across the delivering outcomes for customers test area, South West Water's plan is a high quality plan, with evidence that is generally sufficient and convincing, but not sufficiently ambitious and innovative to be exceptional.	OC1	B
		The company's plan provides evidence of a balanced package of PCs that overall reflects customer views and in some cases appropriately stretching performance levels. In particular, its forecasts are upper quartile for internal sewer flooding and pollution incidents that will be achieved by 2025 and near forecast upper quartile for almost all common PCs.	OC2	B
		The company's plan provides evidence of a high quality package of standard outcome delivery incentives (ODIs) that follows the PR19 methodology principles and is founded on a well-evidenced approach based on customer valuations. The plan provides convincing evidence that ODIs are balanced across different areas and will provide incentives for ambitious service delivery for customers. However, the business plan was not deemed high quality in the following areas: <ul style="list-style-type: none"> Its business plan is not stretching across all PCs. The company has not provided full details of the definitions of PCs, nor the plans it has to be able to report all common PCs in line with the guidance. Although the company provides an approach to protect customers in cases its ODI outperformance payments turn out to be much greater than expected, it provides insufficient detail on what level of benefits it will share. 	OC3	B
Securing long-term resilience	B	Overall, the company's plan presents high quality evidence in most aspects of securing long term resilience, although it falls short of being ambitious and innovative. The plan is high quality with regard to engaging with customers on longer term issues. This includes engaging with customers on risk profiles and service expectations, as well as showing creativity in the techniques used. There is sufficient evidence that the company has considered a wide range of both internal and external risks that impact on operational and corporate resilience. The plan is also high quality in that it has considered a wide range of options to mitigate the resilience risks identified in the plan: the Upstream Thinking and Downstream Thinking initiatives demonstrate the inclusion of infrastructure options, options that influence customer behaviour and environmental options. The company also provides sufficient evidence that it has engaged with customers to select its preferred resilience mitigation options, including using participatory approaches. The plan provides sufficient evidence of engaging with a wide range of stakeholders to develop options, including those from other sectors and with a number of third parties. The company also provides sufficient evidence that it is using environmental valuation techniques to ensure the objective assessment of nature-based solutions against more traditional options. The plan demonstrates a high quality and convincing assessment of financial resilience with assessment of risks relevant to its circumstances. The company provides convincing evidence that its targeting of ratios consistent with an investment grade credit rating, and maintenance of gearing around 63% in the period to 2025 are consistent with long term resilience. It also provides sufficient and convincing evidence of its processes to manage and mitigate financial risks.	LR1	B

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		<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"> • 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. • The resilience maturity assessment is insufficiently detailed to explain how it supports the company's resilience service improvement project. It also doesn't provide predictions for maturity levels that the company will achieve by end of 2025. • There is insufficient evidence concerning how the long list of resilience risks considered in the plan have been prioritised and whether these have been considered in combination. There is also insufficient evidence of any quantitative analysis of risks. • Although the plan identifies a wide range of environmental risks, there is limited evidence that these have been assessed using environmental valuation techniques that ensure their objective assessment. • The company provides evidence of initiating a Resilience Service Improvement project based on an independent resilience assessment but it provides limited evidence to illustrate how the improvements would impact on resilience maturity. • There is insufficient evidence directly linking the package of common and bespoke PCs to the company's overall resilience framework. We consider there are specific concerns, in terms of structure and definition, relating to some of the individual bespoke resilience PCs. • In the context of generally high quality assessment and assurance of long term financial resilience, the company has not modelled financial stress tests for the period after 2025. 	LR2	B
Targeted controls, markets and Innovation	C	Overall, despite some areas of high quality, South West Water's plan falls short of high quality across the Targeted Controls, Markets and Innovation test area.	CMI1	C
		The company's evidence on water resources is innovative with the creation of an internal water resources market and its evidence on RCV allocation was high quality. On catchment management and partnership working in wastewater the company evidences a good approach, although additional evidence of how natural capital is embedded in decision making would have been beneficial. The company's bid assessment framework for water resources is of good quality and appeared consistent with the key principles and best practice recommendations. The company's business plan describes its existing and future approach to innovation and references appropriate leadership support, resourcing and 3rd party collaboration (with Exeter University).	CMI2	C
		The areas where the company fell short or high quality included providing limited evidence to demonstrate it has an innovative culture. In particular how its corporate values of innovation translated into organisational and functional innovation goals, and how the company's culture accepted a certain level of risk of failure in order to develop innovative ideas.	CMI3	A
		The company's evidence on its approach to managing business voids, and residential and business gap sites, and on retail market learnings is insufficient. On the water network plus, despite referencing plans to expand catchment management approaches and partnership working, there is insufficient evidence related to AMP7 delivery.	CMI4	C
		The bioresource strategy evidences use of markets and consideration of pricing and appointed asset use. However, there is insufficient evidence to justify the split of bioresources fixed/variable revenues to set the separate control appropriately.	CMI5	B
		The threshold process for identifying projects which would be suitable for DPC is also of high quality and it provides a convincing technical assessment of 2 schemes. However, the value for money decisions on these two schemes are based on very conservative assumptions that appeared to be biased towards in-house solutions, and thus their rejection as DPC schemes at the Value for Money (VfM) stage is therefore unconvincing.	CMI6	B
			CMI7	C
Securing cost efficiency	B	Overall, South West Water's projected costs for the 2020-2025 period are broadly considered to be efficient. At the company level its costs are slightly above our view of efficient costs.	CE1	B
		Its costs in water are in line with our view of efficient costs. However, its wastewater and retail costs are approximately 5% and 14% above our view of efficient costs respectively, with base costs above our efficient baseline. Its wastewater enhancement costs are mostly efficient and we allow these costs in the round, apart from the proposals to enhance bioresources treatment capacity.	CE2	C
			CE3	C
		The company proposes six cost adjustment claims, four of which we assess as reasonable quality and the remaining two of poor quality. This gives the company a grade of C for the cost adjustment claim test.	CE4	C

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Aligning risk and return	B	<p>Overall, South West 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"> 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 choice of PAYG and RCV run-off rates. <p>The plan includes insufficient evidence in aspects of its risk management and mitigation in its RoRE assessment for the notional company. Our assessment of RoRE is however not sufficiently material to affect the overall grade.</p>	RR1	B
			RR2	C
			RR3	B
			RR4	B
Accounting for past delivery	D	<p>Overall, South West Water's business plan falls significantly short of the required quality in accounting for past delivery.</p> <p>In the round we have substantial concerns with the evidence for deliverability for the 2020-25 plan, in particular in relation to major incidents, and some concerns for costs and customer complaints handling.</p> <p>The plan is high quality for deliverability in the following areas:</p> <ul style="list-style-type: none"> The company has good performance on costs and is forecasting to significantly underspend against its cost allowance for 2015-20. We therefore do not have concerns with the evidence for deliverability of the planned costs. <p>The plan falls short of high quality for deliverability in the following areas:</p> <ul style="list-style-type: none"> The company has the worst performance in category one and two pollution incidents per 10,000km of sewer in the sector for 2015-18. The plan provides insufficient evidence that the company has learnt lessons from this experience and identified measures to address this performance. We therefore have substantial concerns with the evidence for deliverability of improved performance in relation to major incidents. The company has delivered or is forecast to deliver 73% of its PCs with financial ODIs in 2015-20. The company provides evidence that it understands the drivers of its performance, but the measures proposed do not give sufficient confidence that the planned 2020-25 outcomes performance will be delivered given the level of stretch in the plan. We therefore have some concerns with the evidence for deliverability for outcomes. Though the company is already meeting CCWater's 2020 household customer complaints target of resolving 95% of customer complaints at stage one, it has high and increasing total complaints. The plan provides insufficient evidence that the company has learnt lessons from this experience and identified measures to address this performance. We therefore have some concerns with the evidence for deliverability for customer complaints handling performance. <p>There is sufficient and convincing evidence for six out of eight PR14 reconciliation areas and insufficient evidence for land sales and totex. There is a marginal difference (0.2% 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>	PD1	B
			PD2	D
Securing confidence and assurance	C	<p>Overall, South West Water's business plan falls short of providing sufficient evidence to demonstrate overall 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>	CA1	C

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	D	The company's plan also provides sufficient and convincing evidence that overall, its PR19 business plan tables and the assurance and commentary provided are consistent, accurate and assured.	CA2	D	
		The plan falls short of high quality in the following areas: The company's Board provides statements of assurance in the majority of the requested areas to demonstrate that all the elements of its business plan add up to a plan that is high quality and deliverable and most are supported by sufficient evidence of the Board's challenge and satisfaction process. However a minority are omitted.	CA3	C	
		On providing evidence of a fair balance between customers and investors: <ul style="list-style-type: none"> Whilst the company does not include a gearing benefit sharing mechanism, there is convincing evidence that the company does not expect to exceed the gearing threshold of 70%, as it is committed to remain below the threshold by a covenant with one of its lenders. The company is proposing a bespoke outperformance sharing mechanism on the cost of embedded debt which we assess could have a value of £4m per year, a share ownership scheme for customers from the cost of new debt and donations to social tariffs and hardship funds which could have a value of £0.2m per year. The company's proposals for voluntary benefits sharing are ambitious in the context of its size as a company. The company proposes a base dividend yield less than 5%. The company's Board provides assurance that the company's business plan will enable customers' trust and confidence through high levels of transparency and engagement on corporate and financial structures and how this relates to long term resilience but there is insufficient evidence of the Board's assurance process. 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 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. Additionally, the company demonstrates insufficient evidence of transparency on its corporate and financial structures and how these relate to its long term resilience. 	CA4	B	
				CA5	C
			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 2 areas and meets expectations in 6 areas, it has minor concerns in 1 area and has serious concerns in 1 area.	CA6	B
			The 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 company's Board provides a non-compliant statement of assurance.		