

## Southern Water: Test question assessment

Test area	Overall test area grade	TQ#	Test question	Test question grade	Test question summary assessment
Engaging customers	C	EC1	What is the quality of the company's customer engagement and participation and how well is it incorporated into the company's business plan and ongoing business operations?	C	<p>Overall the business plan falls short of high quality with insufficient evidence provided in relation to the areas set out below.</p> <p>While the company provides sufficient evidence of elements of its approach to customer engagement, for example learning from customer complaints and other contact data is driving behaviour change programmes, there are areas where more convincing evidence would be needed for the plan to be considered high quality. This includes information on its sampling (to evidence that a broad range of vulnerable and non-household customers have been engaged with on a statistically robust basis) and evidence that its primary customer valuation research and approach to deriving incremental benefits for use in outcome delivery incentives (ODIs) is robust. The company provides sufficient evidence of having utilised a range of customer engagement techniques. There is also evidence of the company using more innovative research methods such as mobile app-based ethnographic research. However, there is insufficient evidence to support the rationale as to why these methods were chosen and how the results informed the company's business plan. The CCG raises concerns around the extent to which the company has effectively used comparative information to set the context for customers.</p> <p>The company provides sufficient evidence that it has begun to take forward the four themes of customer participation (i.e. increasing customer participation to improve the current and future sustainability of water, encouraging customer behaviour change actions, increasing community ownership of particular aspects of water as an essential resource, and increasing customer control of water in their home or of the customer service experience) outlined in the Tapped In report (which underscores the importance of engaging with customers, and sets out a broad and embedded definition of customer participation). For example, through the use of reward schemes and publicity campaigns to effectively incentivise behavioural change. The business plan also demonstrates that the company has a credible plan for further increasing customer participation in the next price review period with examples of innovative projects. This includes using augmented reality apps to reduce sewer blockages and Wi-Fi technology to help customers monitor and increase the control of their water usage without the need to install smart meters.</p> <p>The business plan provides sufficient evidence of the company specifically engaging with current and future customers to understand their views on longer term issues such as environmental protection and network resilience. There is also sufficient evidence that the company has engaged with customers to understand their priorities and preferences for service levels and that generally the results of this engagement are reflected in the business plan, including in the selection of performance commitments (PCs). While there is sufficient evidence of the company engaging with customers regarding the acceptability and affordability of its business plan, the company does not appear to fully reflect the results of this testing in its final plan. This is particularly so given that only 66% of customers found the business plan to be acceptable when the potential impacts of ODIs were included. Only 55% of informed customers and 49% of uninformed customers found the business plan affordable and no evidence could be found of the company explicitly testing long-term acceptability or affordability (for example post AMP7 bill profiles) with customers.</p>
Addressing affordability and vulnerability	B	AV1	How well has the company demonstrated that its bills are affordable and value for money for the 2020-25 period?	C	<p>Southern Water provides insufficient and unconvincing evidence that its bills will be affordable and provide value for money for 2020-2025.</p> <p>The company provides insufficient evidence that it understands the affordability issues in its region and that it has conducted high quality engagement on affordability issues. There is insufficient evidence of customer support for the company's proposals due to concerns surrounding the robustness of the acceptability and affordability testing undertaken including the inclusion of neutral responses as support, and limited involvement of the CCG in customer engagement. Additionally, the company has also adjusted run-off rates between water and waste water to give the same percentage reduction in both parts of the bills. We are not satisfied that these two completely net-off.</p> <p>However, the company is proposing a real bill reduction of 3% (£13.36) from 2019-20 to 2024-25. The company also demonstrates a high quality approach to implementing water efficiency measures to address affordability for all of its customers. The company also includes a limit of £5 change to bills over two years from ODI payments, which has the effect of smoothing ODIs in excess of this level over multiple years and has been credited as an approach to manage the impact of ODIs. The company also has a relatively efficient approach to providing overall affordability support to customers based on its level of growth in debt write-offs, the proportion of customers getting debt advice and the net benefits from water efficiency devices.</p>

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		AV2	How well has the company demonstrated that its bills will be affordable and value for money beyond 2025?	B	<p>Southern Water provides sufficient and convincing evidence of a high-quality approach to addressing the affordability of bills beyond 2025. In particular, it proposes to decrease bills by 4.2% for the 2025 to 2030 period, and we are satisfied with the company's use of financial levers. The company provides sufficient evidence of customer engagement on long-term preferences through an exercise that focused mainly on investment in services.</p>
		AV3	To what extent has the company demonstrated that it has appropriate assistance options in place for those struggling, or at risk of struggling, to pay?	B	<p>Southern Water provides sufficient and convincing evidence that it has appropriate assistance options in place for those struggling or at risk of struggling to pay. In particular, the company proposes an ambitious and stretching PC which targets 90% of customers being able to pay their bills after receiving affordability assistance.</p> <p>In addition, the company is proposing to grow its social tariff by over 50% which is supported by high-quality engagement to gain support for a £4 increase in the cross-subsidy from customers.</p> <p>In the round, we consider that its growth in social tariffs and stretching PC are sufficient to consider its overall approach to be high-quality.</p>
		AV4	To what extent does the company identify and provide accessible support for customers in circumstances that make them vulnerable, including proposing a bespoke performance commitment related to vulnerability?	C	<p>Southern Water provides insufficient and unconvincing evidence of a high-quality approach to supporting customers in circumstances that make them vulnerable.</p> <p>In particular, it has forecast to register 1.1% of its customer base on the priority services register by 2024/25. This is not sufficiently ambitious. We consider that the low reach of the priority services register (PSR) to be particularly significant given the issues with the company's performance in the context of the recent Freeze Thaw incident.</p> <p>In addition, it has not provided sufficient evidence of a high-quality use of data to understand vulnerable customers. For example, 0% of PSR customers have been contacted in the past two years to confirm they are receiving the right support. Moreover, we consider that there is a lack of evidence on how it will use data to positively impact vulnerable customers for its proposals to be high quality.</p> <p>However, we do note that the company has included a stretching PC on satisfaction of vulnerable customers. Moreover, we consider its partnership working to be high-quality, as evidenced by the work undertaken through the Customer Inclusion Partnership Network.</p> <p>In the round, we consider that whilst there are some elements of high-quality, its insufficiently ambitious reach of its PSR is particularly significant in light of recent issues with supporting vulnerable customers during Freeze Thaw.</p>

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Delivering outcomes for customers	C	OC1	How appropriate, well-evidenced and stretching are the company's proposed performance commitments and service levels?	C	<p>Overall, the company provides insufficient evidence that it has selected appropriate PCs and that its PCs demonstrate stretching performance. However, there are elements of high quality within the plan.</p> <p>We identify the following concerns with the company's evidence that it is complying with the PR19 Final Methodology requirements:</p> <ul style="list-style-type: none"> <li>• The company includes statutory obligations in PCs with associated outperformance payments.</li> <li>• There is a lack of evidence of independent reporting methods for more than one PC.</li> </ul> <p>We note that:</p> <ul style="list-style-type: none"> <li>• The company adopts all relevant common PCs without significant material issues.</li> </ul> <p>We identify the following concerns with how stretching the company's PCs are:</p> <ul style="list-style-type: none"> <li>• The majority of the stretch levels for bespoke PCs are not sufficient, including three bespoke PCs with no improvement targets.</li> <li>• The company provides insufficient evidence to justify why it proposes to discontinue one particular site at PR19 for the abstraction incentive mechanism (AIM) PC.</li> </ul> <p>We note that:</p> <ul style="list-style-type: none"> <li>• The company proposes forecast upper quartile (UQ) performance for per capita consumption (PCC).</li> </ul> <p>We identify the following concerns with the company's performance reporting structures:</p> <ul style="list-style-type: none"> <li>• The company does not provide evidence that it will improve reporting to customers through increasing the regularity, transparency or otherwise enhancing the reputational effect of its PC and ODI performance reporting; and</li> <li>• The company proposes to only report through its Annual Performance Report (APR).</li> </ul> <p>We note that the company has focused on ensuring the quality of data and accurate compliance of its performance reporting including:</p> <ul style="list-style-type: none"> <li>• The company provides evidence of improvements in data quality and assurance to ensure accurate reporting against its PCs; and</li> <li>• The company provides evidence of ensuring that performance will be shared regularly with the Customer Challenge Group (CCG) as well as internally, but does not mention specific reporting to customers.</li> </ul>

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	OC2		How appropriate and well-evidenced is the company's package of outcome delivery incentives?	C	<p>Overall, Southern Water provides insufficient evidence on how appropriate its package of ODIs is, although we have identified elements of high quality where it has met our expectations on its approach to setting enhanced ODI payments. We have material concerns over its approach to setting ODI rates and adopting outperformance payments with insufficient justification. We also identify some concerns over the level it sets for some collars and deadbands.</p> <p>The company provides insufficient evidence to support its choice of the type of ODIs. In particular there are instances where the company chooses outperformance payment-only ODIs for scheme-specific PCs and provides insufficient evidence, explanation and customer support for these.</p> <p>The company's business plan falls significantly short of the required quality of evidence in justifying its ODI rates appropriately. We identify that:</p> <ul style="list-style-type: none"> <li>• The company forms marginal benefits based upon a triangulation methodology that places greater weight on recent observations and does not necessarily identify maximum willingness to pay valuations.</li> <li>• The company does not provide sufficient evidence to justify some of its ODI rates, in particular the low standardised ODI rates for leakage and supply interruptions relative to others in the sector, and how these incentivise the company against underperformance.</li> <li>• The company provides insufficient evidence to justify the 10% uplift it has applied to the Ofwat formula for PCC and leakage.</li> <li>• The company provides insufficient evidence to justify the use of a top-down methodology for its maintaining bathing waters at 'excellent' ODI.</li> </ul> <p>Although the proportion of deadbands within the company's ODI package is relatively low, and customers provide some general support for the use of caps and collars, we do not have confidence that the company has a sufficiently evidenced approach to ODI deadbands, caps and collars due to the following material concerns:</p> <ul style="list-style-type: none"> <li>• We have material concerns about the deadbands the company proposes for sewer collapses and mains bursts. The deadband it proposes for sewer collapses is particularly concerning, as it would allow the company's current performance to deteriorate significantly before it incurs any underperformance penalties.</li> <li>• The company proposes a significant number of underperformance collars without providing convincing justification. Whilst the company provides some evidence of customer support for caps and collars at a general level, it does not consider customer support for caps and collars on an ODI-specific basis.</li> <li>• We have particular concerns about the collars it proposes for water quality compliance, pollution incidents and mains bursts, which are set very close to the proposed deadbands / PC levels. These proposals severely constrain the potential for underperformance payments to be incurred, weakening the company's incentive to achieve their committed performance levels.</li> </ul> <p>The company provides a high-quality, ambitious and innovative approach to its enhanced outperformance and underperformance payments because:</p> <ul style="list-style-type: none"> <li>• it proposes a single, enhanced ODI for PCC, an area where it currently performs well; and</li> <li>• this enhanced ODI satisfies all the criteria we have identified for a good enhanced ODI, including having a threshold target consistent with moving the level of frontier performance in the industry, and a proposed enhanced reward rate that strikes a suitable balance between incentivising the company and protecting its customers.</li> </ul>

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	OC3		How appropriate is the company's focus on service performance in its risk/return package?	B	<p>Overall, the company applies an appropriate and high-quality approach to its focus on service performance in its risk/reward package including that it aligns proposed ODI payments with the timing of service performance, has a sufficient asset health ODI package that should protect customers from poor performance and has suitable protections for customers through using outperformance caps for a number of its PCs. However, we have a concern with the company's limited explanation of how its ODI package will incentivise it, and the overall the balance of its ODI package.</p> <p>The company's overall approach to bringing ODI payments closer in time to the service performance that generated them is in line with our expectations. It applies most of its financial ODIs as in-period, and the ones proposed as end-of-period are related to scheme-specific PCs which will be delivered at the end of the AMP. We have identified no concerns.</p> <p>The company has met our expectations for asset health PCs. The company demonstrates that it understands and has addressed its asset health past performance challenges, as it has a PC and ODI on wastewater treatment works compliance. However, the company does not demonstrate sufficient customer support for its asset health outperformance payments.</p> <p>We have confidence in the evidence which the company provides that it is protecting customers against higher than expected ODI payments because:</p> <ul style="list-style-type: none"> <li>• the company states that it will smooth customer bills by ensuring that bill increases/decreases are limited to £5 between any two years;</li> <li>• the company sets appropriate caps for some of its outperformance ODIs, based on the company's ODI research, to limit large payments; and</li> <li>• At 1.0%, it has the fifth lowest RORE P90 (outperformance payments) in the sector and so will not expose its customers to large financial risk.</li> </ul> <p>The company has not met our expectations for the size of its overall ODI package because:</p> <ul style="list-style-type: none"> <li>• it provides limited explanation of how its ODI package incentivises it to deliver its PCs; and</li> <li>• the ODI package is not sufficiently balanced. There is a mismatch between customer priorities and ODI payments, as well as a potential for double-counting of incentives.</li> </ul>

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Securing long-term resilience	D	LR1	How well has the company used the best available evidence to objectively assess and prioritise the diverse range of risks and consequences of disruptions to its systems and services, and engaged effectively with customers on its assessment of these risks and consequences?	D	<p>Southern Water presents a plan that falls significantly short of high quality with little and unconvincing evidence of how the company has assessed risks and consequences to its systems and services.</p> <p>Positive aspects of the plan include good collaboration with a number of stakeholders to identify a broad range of risks, including both conventional stakeholders, such as catchment participants and regulators, as well as novel collaborations with a futurist to identify region specific trends. The HazRev process to identify water service risk has been utilised by the company, although it is unclear if a similar approach has been applied to wastewater assets.</p> <p>However, the baseline maturity assessment presented in the plan is limited in its detail and only covers some areas of corporate resilience. The high-level risks identified lack detail on consequence assessment and therefore, it is difficult to assess what key risks the company faces across its systems and what areas of improvement should be focussed. In this sense, the plan lacks a systems-based approach to resilience that accounts for the interdependencies and interactions between external and internal systems. The company focuses on resilience challenges in providing water services, but there is a significant lack of evidence in relation to the resilience of its wastewater business, especially in light of the company's past performance issues in this area.</p> <p>The lessons learnt in the freeze-thaw report and mitigation actions appear adequate, however, the overall lessons learnt within the plan do not appear to have been given enough weight, given the corporate resilience issues the company has faced. A higher quality plan would have identified in detail areas where there was underperformance and detailed actions on how this was being resolved, whereas the detail provided in the company's compliance framework appendices is insufficient. While the company acknowledges that issues around corporate governance (i.e. organisational structure, processes, culture and behaviours) have been responsible for compliance incidents, the plan is limited in presenting details regarding the 'Modern Compliance Framework' (e.g. implementation timeline, planned improvements and systems affected).</p> <p>The company's business plan demonstrates some elements of high quality in its assessment of financial resilience, which takes account of its financial restructuring. It is supported by a specific board statement on financial viability and a third party report, and the assessment makes reference to its corporate risk register. There is, however, insufficient evidence that the company has taken adequate account of the possible impacts on its financial resilience of the outcomes of extant regulatory investigations.</p> <p>The company has assessed the prescribed financial stress scenarios and some company specific scenarios. The company does not achieve its target financial ratios in all scenarios, including the company specific downside scenarios, but suggests impacts are assessed before mitigation measures and that it will retain credit ratings within the investment grade. Furthermore, the company has not considered stress test results beyond 2025.</p>

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	C	LR2	How well has the company objectively assessed the full range of mitigation options and selected the solutions that represent the best value for money over the long term, and have support from customers?	C	<p>Southern Water presents a plan that falls short of high quality with insufficient and unconvincing evidence in some of the necessary areas, in particular: prioritisation of risks and how these are addressed by the range of proposals in the plan; details of various schemes proposed by the company; and customer support of specific schemes. Its financial resilience assessment assumes it achieves its planned gearing reduction at the level of the Appointee, but there is insufficient evidence it has considered the risks that debt raised above the ring-fence might place on the Appointee.</p> <p>The plan includes consideration of a wide range of options to improve resilience across a number of systems. The overall five basic and five transformational programmes appear to be well thought out and target key risk areas, but due to their early development stage the level of detail within these programmes falls short of a high quality plan. The proposed outcomes' package generally lacks well-defined and stretching common and bespoke resilience PCs.</p> <p>However, there are particular concerns concerning the deliverability of some aspects of the plan due to historic performance and insufficient detail on steps taken to learn from these past issues. The plan also shows unresolved issues raised by the CCG around the validity of the methodology used to triangulate customer views when developing PCs and ODIs, which undermines confidence in customer support for these. The limited detail in the risk prioritisation also makes it harder to clearly link the selected schemes to the risks they are addressing and the impact that these have on risk levels.</p> <p>The company is highly geared at around 80%. Although its plan provides evidence of its proposals to reduce Appointee gearing to 70% or lower through an equity injection of £700 million, this will involve increased indebtedness elsewhere in its ownership group. There is insufficient evidence the company has adequately considered risks that debt raised by group companies above the level of the ring-fence might place on the financial resilience of the Appointee, given the financial structure of the group and the refinancing arrangements it has set out.</p> <p>In other respects, the company provides evidence that it will be able to meet financing requirements of £570m through issuance of fixed rate debt, bank facilities, and through retention of earnings.</p> <p>The company states that it would be able to mitigate the impacts of severe scenarios by rescheduling investments or seeking additional equity funding, however there is insufficient evidence presented in the plan that equity investors have the capacity to contribute such equity, particularly because its refinancing proposals are to be achieved by the issuance of debt above the level of the regulatory ring fence.</p> <p>The company has referred to its management of its pension deficit position.</p>
Targeted controls, markets and Innovation	C	CMI1	How well does the company's business plan demonstrate that it has the right culture for innovation which enables it, through its systems, processes and people, to deliver results for customers and the environment from innovation?	C	<p>Southern Water's business plan falls short of high quality with insufficient evidence to demonstrate that it has the right culture for innovation. However, there are some elements of that plan that high quality innovation capability.</p> <p>The company demonstrates that it has considered ways to identify and communicate business challenges to its employees and the supply chain, for example its plan to put in place a collaboration platform in 2019. However, it provides insufficient evidence and no details on its plan to roll out the platform. It brings teams together through its Innovation Week events, digital idea portal and innovation database. More convincing evidence would be needed on the link between those interdisciplinary debates and innovative outputs. There are other areas where insufficient evidence to demonstrate the right culture has been provided. These include the company's approach to provide individuals with ownership to progress their ideas and mechanisms to mitigate innovation related risks.</p> <p>The company provides sufficient evidence on some elements of leadership support through mechanisms such as the bluewaves approach, Innovation hub, Innovation Leadership Workshops and R&amp;D programme, as well as evidence on the investment it puts forward for innovation. However, there are areas where more convincing evidence would be needed for the plan to be high quality. These include innovation goals and how those are communicated company-wide, approach to reward and recognise individuals, team supportiveness and supervisors' support to empower individuals to challenge the status quo.</p> <p>The company provides sufficient information on elements of its approach to collaborate with stakeholders through problem solving workshops and external "sprints" with some convincing evidence of external collaboration with universities third parties and a wide range of other stakeholders. However, further evidence on whether its innovation vision acts as unifier to bring people together to solve challenges, as well as whether and how its business partners and customers understand the companies' innovation goals and strategy, are needed for the plan to be considered as high quality.</p>

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		CMI2	How well does the company use and engage with markets to deliver greater efficiency and innovation and to enhance resilience in the provision of wholesale and retail water and wastewater services to secure value for customers, the environment and the wider economy; and to support ambitious performance for the 2020-25 period and over the longer term?	B	<p>Overall, Southern Water provides a high quality plan in relation to this test question. The company provides a high quality plan regarding lessons learned from the business market. For example, there is evidence of considering what business customers value and some of the different business models. The company also has an appropriate evaluation criteria and there is a sufficient nexus between the company's learnings and their plan.</p> <p>Regarding the use of markets, catchment management and partnership working for delivery services related to water and wastewater network-plus both water and waste-water network plus, the company provides a high quality plan, with a range of positive examples. The company provides sufficient evidence for how they intend to manage residential voids; however, there is insufficient evidence for how they intend to manage business voids, residential gap sites and business gap sites.</p>
		CM3	To what extent has the company set out a well evidenced long-term strategy for securing resilient and sustainable water resources, considering a twin track approach of supply-side and demand-side options and integrating third party options where appropriate, to meet the needs of customers and the environment in the 2020-25 period and over the longer term?	D	<p>Southern Water's business plan is of substantial concern regarding its strategy for a long-term resilient and sustainable water resources and the use of markets to that purpose. The plan falls significantly short of the required quality and for this reason is graded as a 'D' in this test question.</p> <p>There is limited evidence on whether the stated trading options have been fully developed and appraised in the short-run and there is insufficient evidence that the company has engaged with third parties to deliver demand-side outcomes. On the future deployment of bilateral markets, the company does not go beyond providing the required business tables Wr6 and Wr7 and which are not presented at the expected quality. The company's WRMP has unresolved issues on adaptive pathways, regional solutions and customer engagement and we consider there a significant risk relating to deliverability and the optimisations of the proposed water resources strategy.</p> <p>Finally, the company fails to recognise the need for a Long-term risk sharing arrangement on its proposed Fawley desalination plant, which incurs a significant water resources cost (totex of over £50m in the lifetime of the project) and adds a substantial water capacity (approx. 75Ml/d). There is no mechanism in place to protect customers from the risk of such a significant investment.</p>
		CMI4	To what extent does the company have a well evidenced long-term strategy for delivering bioresources services, integrating an assessment of the value from the delivery of bioresources services by third parties for the 2020-25 period and over the longer term?	C	<p>Southern Water has an insufficiently evidenced long-term strategy for delivering bioresources services, and falls short of a high quality approach across all areas. It shows limited ambition to utilise markets with only short term trades to provide capacity proposed. There is mixed evidence regarding forecast sludge production and poor evidence on the split of fixed and variable costs to set the bioresources control appropriately. The company largely took a business as usual approach to its long term strategy failing to use third party options.</p>
		CMI5	How appropriate is the company's proposed pre-2020 RCV allocation between water resources and water network plus - and, if relevant, between bioresources and wastewater plus - taking into account the guidance and/or feedback we have provided?	B	<p>We issued guidance on RCV allocation for the purposes of separate price controls in early 2017. The company submitted draft RCV allocation proposals for bioresources in September 2017 and for water resources in January 2018. We issued generic feedback on the companies' approaches to draft RCV allocation proposals in early 2018. We also issued company specific feedback to the company on February 2018. Taking into account the company's response to our initial guidance and our subsequent feedback on its draft proposals, the company's proposed RCV allocations appear appropriate.</p>

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		CMI6	To what extent has the company produced a company bid assessment framework for water resources, demand management and leakage services that demonstrates a clear commitment to the key procurement principles of transparency, equality/non-discrimination and proportionality and the best practice recommendations?	C	<p>Southern Water has developed a bid assessment framework that is proportionate and largely transparent. The document does not provide sufficient details to conclude that it will be non-discriminatory or that all of Ofwat's best practice recommendations will be met. The company outlines a number of ways it will help make sure the process is proportionate and has provided considerable detail on the criteria it may use to assess bids. There is limited information provided on how it will ensure in-house bids and third-party bids are treated fairly, appeals will be treated or the audit and compliance trial.</p>
		CMI7	To what extent has the company clearly demonstrated that it has considered, whether all relevant projects are technically suitable for direct procurement for customers? Where it has one or more technically suitable projects, to what extent has the company provided a well-reasoned and well-evidenced value for money assessment supporting its decision on whether or not to take forward each technically suitable project using direct procurement for customers?	D	<p>Southern Water provides evidence that it considered DPC as part of its business planning process. It assessed its schemes on whether they met the £100m threshold, carried out a technical analysis on the relevant schemes and proposed that a Value for Money (VfM) assessment should be carried out for Fawley Desalination plant. In the appraisal of the Southern Water DPC plan we took into account the following:</p> <ul style="list-style-type: none"> <li>The company describes its process to identify relevant schemes, either separately or in appropriate aggregated programmes, which met the £100m threshold.</li> <li>The company provides limited evidence on its technical assessment of the suitability of the 26 schemes that passed the threshold test. The process outlined does not reflect all aspects of the guidance and concentrates mainly on the interface, management and risk complexity. The company then excluded 21 projects with no supporting evidence and limited reasons for the decisions.</li> <li>The company proposed that Fawley desalination should proceed to VFM from the technical assessment but decided that it did not have sufficient information to carry out an economic assessment. In addition, it produces very limited information on its strategic and commercial cases and there is no evidence of a management or financial case. It has not produced a VfM assessment based on a best practice business case.</li> </ul> <p>In summary, the company's plan falls significantly short of the required quality with little evidence.</p>
Securing cost efficiency	D	CE1	How well evidenced, efficient and challenging are the company's forecast of wholesale water expenditure, including water resources costs?	D	<p>Southern Water's wholesale water costs are around 21% above our view of efficient costs. Its base costs are around 17% above our view of efficient costs. Its enhancement costs where we have a benchmark, such as for lead reduction, metering and growth, are less efficient than its peers. The company's non-leakage supply-demand balance unit costs are marginally less efficient than the industry benchmark. Its proposals for significant water supply investment and interconnection schemes are not fully justified. The company is not proposing to reduce leakage by more than 15% or to achieve upper quartile performance levels, so we make no enhancement allowance for leakage reduction. The company's metering unit costs are higher than the industry benchmark.</p>
		CE2	How well evidenced, efficient and challenging are the company's forecast of wholesale wastewater expenditure, including bioresources costs?	D	<p>Southern Water's wholesale wastewater costs are around 26% above our view of efficient costs. Its wastewater base costs are around 9% above our view of efficient costs. We have benchmarks in WINEP costs related to increasing flow to full treatment, increasing storm tank capacity, phosphorus removal and reduction of sanitary parameters. In all these areas the company is less efficient than its peers.</p>
		CE3	How well evidenced, efficient and challenging are the company's forecast of retail expenditure, including bad debt costs?	A	<p>Southern Water's residential retail costs are around 15% lower than our view of costs and it ranks second most efficient company.</p>

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		CE4	To what extent are cost adjustment claims used only where prudent and appropriate, and where they are used, are cost adjustments well evidenced, efficient and challenging?	B	Southern Water proposes three cost adjustment claims, two of which receive a partial pass for quality of the claim, and the third a fail.
Aligning risk and return	C	RR1	Has the company based the separate costs of capital that underpin each of its wholesale price controls, and the net margin(s) that underpins its retail price control(s), on those we state in our early view? If not, to what extent has the company robustly justified, in terms of benefits for customers, its proposed costs of capital and retail margin(s) within the context of expected market conditions for 2020-2025?	B	The company has provided sufficient and convincing evidence that it has based its business plan for 2020-25 on the cost of capital and retail margin caps set out as our PR19 Final Methodology 'early view'.
		RR2	To what extent has the company demonstrated a clear understanding and assessment of the potential risks in its RoRE assessment, including the effect of the risk management measures it will have in place, across each of the price controls?	B	<p>Overall Southern Water's business plan demonstrates high quality in its RoRE analysis. The company's assessment is supported by a third party report that has assessed the prescribed scenarios and has undertaken a number of other scenarios which incorporate macro shocks and Southern Water specific shocks to test the effects on RoRE. The economic assumptions and the associated risk management and mitigation measures are outlined for each scenario.</p> <p>We have some concerns that the overall range of RoRE outcomes is not convincing when compared with the range of other companies. We are concerned about the resulting downward skew on totex and whether the RoRE range has been incorrectly presented around a cost of equity of 3.8%. These are relatively minor issues considering the quality of the risk analysis. The company does not propose any bespoke uncertainty mechanisms.</p>
		RR3	Has the Board provided a clear statement that its plan is financeable on both an actual and a notional basis? Is the statement appropriate and how robust is the supporting evidence?	C	<p>Despite some aspects of Southern Water's business plan which are high quality, shortcomings in other aspects mean that it overall falls short of providing convincing and high quality evidence to support the Board's statement that the company is financeable on the notional and its actual company structure.</p> <p>The business plan does provide some evidence of high quality in specific areas:</p> <ul style="list-style-type: none"> <li>• The company has set out the steps taken to make the financeability assessment and to provide assurance over the assessment, supported by third party assurance of the procedures and calculations of the business plan data tables that support financeability.</li> <li>• The business plan provides sufficient evidence to support the target credit ratings of Baa1/A- (Moody's and S&amp;P) for its actual structure and that the plan is consistent with maintaining the target credit ratings for the actual structure.</li> </ul> <p>There is one main area where the plan falls short of high quality.</p> <ul style="list-style-type: none"> <li>• There is insufficient evidence that the company has undertaken an adequate assessment that a target credit rating of Baa2/BBB+ (Moody's and S&amp;P) is reasonable for the notional company in the context of the investment needs and the requirement to maintain long term financial resilience. The company has compared to Baa1/BBB+ credit ratings but concluded that the financial ratios were not consistent with this although the plan is financeable at Baa2. The company has not set out any actions that could be undertaken to enable the notional company to achieve the required ratios or provided convincing evidence that Baa2 is an appropriate credit rating given the stated potential increase in cost of debt at this credit rating set out in the plan.</li> </ul> <p>The company has not identified a financeability constraint on the notional or its actual structure.</p>

Test area	Overall test area grade	TQ#	Test question	Test question grade	Test question summary assessment
	C	RR4	How appropriate are the company's PAYG and RCV run-off rates? How well evidenced are they, including that they are consistent with customers' expectations both now and in the longer term	C	<p>Despite some aspects of Southern Water's business plan which are high quality, shortcomings in other aspects mean that it overall falls short of providing sufficient and convincing evidence to support its choice of PAYG and RCV run-off rates.</p> <p>The business plan does provide some evidence of high quality in specific areas:</p> <ul style="list-style-type: none"> <li>• The plan proposes adjustments to the starting point for PAYG rates to smooth bills within the price review period and there is sufficient and convincing evidence that the adjustments materially achieve this objective and are in line with customer preferences.</li> <li>• Overall, there is sufficient and convincing evidence that the resulting bill profile, which includes the impact of the transition to CPIH, is supported by customer preferences and there is evidence that bills are consistent with customers' preferences both now and in the future.</li> </ul> <p>There are three main areas where the plan falls short of high quality.</p> <ul style="list-style-type: none"> <li>• While the company has provided high level detail to explain its approach to the starting point for PAYG rates, it has provided insufficient evidence as to how these have been calculated.</li> <li>• There is insufficient evidence to support the starting point for its RCV run-off rates.</li> <li>• The company proposes to adjust run-off rates to calibrate revenues across water and wastewater customers but has provided insufficient evidence to support the level of the adjustments.</li> </ul> <p>The company has not demonstrated how the bill profile differs from one which assumes no transition to CPIH. However, this is not material to the overall assessment.</p>
Accounting for past delivery	D	PD1	How well has the company given evidence for its proposed reconciliations for the 2015-20 period, and has it proposed adjustments by following the PR14 reconciliation rulebook methodology?	B	<p>Southern Water's plan demonstrates high quality with sufficient evidence to support the PR14 reconciliation adjustments overall.</p> <p>There is sufficient and convincing evidence to support the PR14 reconciliations in terms of both the rationale provided and the accuracy of the calculated adjustments. The deviation of the overall value of the adjustments from what we would expect using the data in the business plan is marginal at -0.7% of the 2019-20 PR14 allowed revenue.</p> <p>The company has used the published versions of PR14 reconciliation models to calculate the proposed revenue and RCV adjustments.</p> <p>We have not found major data consistency issues between the submitted tables and populated reconciliation models. We have found minor consistency issues for residential retail and totex.</p> <p>Reported actual performance and resulting underperformance and outperformance payments are consistent in the annual performance report document and our independent checks of the reported ODI underperformance and outperformance payments are identical to those reported by the company for all PCs apart for interruptions to supply where there was an error in the ODI rate used.</p> <p>For most areas, the forecast trajectory appears reasonable in light of actual performance and PR14 determination, but for 13 of the 20 PCs, residential retail and totex there is insufficient evidence to provide confidence that the forecasts are appropriate or to support the forecast trajectories.</p>

Test area	Overall test area grade	TQ#	Test question	Test question grade	Test question summary assessment
		PD2	How well has the company performed, and is forecast to perform, over the 2015-20 period and, taking into account this overall performance, how well has it put measures in place to ensure that it maintains confidence that it can successfully deliver its PR19 business plan?	D	<p>In the round we have substantial concerns with the evidence for deliverability for the 2020-25 plan, particularly for outcomes and incidents.</p> <p>There is average outcomes performance as the company has or is forecast to deliver 73% of its PCs with financial ODIs in 2015-20. The company provides insufficient evidence that it understands the drivers of its performance and learnt lessons from that performance. The company notes that it may need to restate some historical information, which suggests a poor understanding of performance. The company is proposing stretching PCs on leakage. The plan provides insufficient evidence that it includes appropriate measures to improve its performance. For example, the company provides poor evidence of recovery plans for distribution input, leakage, interruptions to supply and Mean Zonal Compliance. Taking into account the proposed level of stretch in the plan, we therefore have substantial concerns with the evidence for the deliverability of outcomes.</p> <p>There is good performance on cost efficiency as the company's actual and forecast costs are below cost allowances for 2015-20 for wholesale water and wastewater. While the company provides insufficient evidence it understands the drivers of its performance and that it has learnt lessons from its performance, it does not have a large overall efficiency challenge in its plan for 2020-25, except for residential retail costs. It provides sufficient and convincing evidence that it understands the drivers of retail costs. The company provides sufficient and convincing evidence that it has measures to deliver the reduction in retail costs, so we do not have concerns with the evidence for the deliverability for costs.</p> <p>The company has poor performance on major incidents. Over 2015-18 it had one major incident, above average number of category one and two pollution incidents per 10,000km of sewers but has an EA performance rating of three stars. It had four prosecutions from the EA and the DWI. It was required to provide an externally assured action plan following the 2018 freeze and thaw. The company provides insufficient evidence it understands the drivers of its performance and has learnt lessons from major incidents. Although the company learnt lessons from the 2018 freeze and thaw, it does not provide sufficient evidence it has done so in relation to its pollution incidents. The plan provides insufficient evidence the company has measures in place to improve performance in relation to major incidents. For example, it aims to coordinate incident response with neighbouring companies, but fails to provide sufficient detail. We therefore have substantial concerns with the evidence for the deliverability of improved performance in relation to major incidents.</p> <p>The company is not yet meeting CCWater's 2020 customer complaint target of resolving 95% of customer complaints at stage one but the proportion is increasing. It has an above average number of complaints per 10,000 connections in 2017-18 but this is declining. The company provides sufficient evidence it understood the drivers of its performance and learned lessons, such as addressing its slow resolution and response speeds and a lack of clarity in communication. The plan provides sufficient evidence that it includes appropriate measures to improve its performance, such as consolidating four customer service teams into a single unit, redesigning bills and expanding channel choice and availability. We therefore do not have concerns with the evidence for the deliverability of customer complaints handling performance.</p>

Test area	Overall test area grade	TQ#	Test question	Test question grade	Test question summary assessment
Securing confidence and assurance	C	CA1	To what extent does the company's business plan contain evidence that its full Board has provided comprehensive assurance to demonstrate that all the elements add up to a business plan that is high quality and deliverable, and that it has challenged management to ensure this is the case?	C	<p>Southern Water's business plan falls short of providing sufficient evidence that its full Board has provided comprehensive assurance 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.</p> <p>High quality Board assurance statements include compliant statements as set out in the PR19 Methodology which, in general are supported by sufficient evidence that Boards have challenged management and satisfied themselves prior to making the statements. The company provides ten compliant statements and all have sufficient supporting evidence, however the company also provides six partially-compliant statements.</p> <p>On the topic of business planning, the Board provides four compliant assurance statements as set out in the PR19 Final Methodology.</p> <p>For statements on the remaining topics, the Board provides six compliant statements from those set out. The Board's statements are partially compliant on resilience; whether large investment proposals are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers; and risk and return.</p> <p>For statements on the topic of business planning, we ask in the PR19 methodology that Boards demonstrate how they challenged management and satisfied themselves prior to making their statements. The company advises that its full Board attended 11 Board engagement days which 'were designed to provide a full opportunity for the Board to discuss, shape and challenge the key components of the Plan. At each session, [the Board] provided feedback and challenge to Management on the emerging Plan'. This is supported by a record of the topics discussed at the engagement days and associated challenges, which demonstrates sufficiently Board challenge of the four statements requested.</p> <p>For statements on the remaining topics, we ask that Boards demonstrate how they satisfied themselves. The Board describes how it satisfied itself, supported by references to topics discussed during Board Engagement days and external assurance. There is sufficient evidence of how the Board satisfied itself for the six compliant statements.</p>
		CA2	To what extent has the company's full Board been able to demonstrate that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term?	B	<p>Southern Water's business plan provides sufficient and convincing evidence that its full Board has been able 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>High quality assurance means that the Board provides a compliant statement supported by suitable supporting evidence.</p> <p>The Board's assurance statement advises that "The Board is satisfied that the Plan, and the company's governance and assurance processes, will deliver enhanced operational, financial and corporate resilience over the next control period and in the longer term."</p> <p>This is a suitable statement of assurance and the Board demonstrates its assurance process through the following statement "We have put in place an ongoing process to evaluate and monitor resilience risks going forward. Resilience risks are identified and managed as part of the company's risk system, which is discussed regularly with the Executive Leadership Team (ELT) and quarterly with the Board Audit and Risk Review Committee (ARRC). Further improvements are planned for monitoring around operational resilience risks, including the development of 'leading indicators' which the ELT will monitor (as part of redesigning the company's performance metrics) and escalate emerging issues to the Board. The company plans to undertake a dedicated holistic resilience assessment on an annual basis (our current resilience assessment is appended to the plan) which the Board will review."</p>

Test area	Overall test area grade	TQ#	Test question	Test question grade	Test question summary assessment
		CA3	To what extent has the company's full Board provided assurance that the company's business plan will enable customers' trust and confidence through appropriate measures to provide a fair balance between customers and investors (which include outperformance sharing, dividend policies and any performance related element of executive pay) and high levels of transparency and engagement with customers, on issues that matter to customers (which extends to their ability to understand the company's corporate and financial structures and how they relate to its long-term resilience)?	C	<p>Overall the plan falls short of demonstrating sufficient evidence that covers all the necessary areas that the plan will enable customers' trust and confidence through appropriate measures to provide a fair balance between customers and investors and high levels of engagement and transparency on corporate and financial structures and how they relate to financial resilience.</p> <p>Southern Water's plan contains sufficient evidence that the company will commit to adopt two of the expectations set out in the 'Putting the sector in balance' position statement:</p> <ul style="list-style-type: none"> <li>• The company forecasts gearing to not exceed 70% and states that, for years where gearing exceeds 70%, it will apply our default gearing outperformance sharing mechanism; and</li> <li>• The company proposes a base dividend yield less than our 5% threshold.</li> </ul> <p>The company does not put forward proposals for a bespoke voluntary benefit sharing mechanism but commits to making voluntary contributions to social tariffs and hardship funds averaging £2.5m per year. However, the company's submission suggests that the figure provided for social tariff support involves some costs which are funded by customers. In the round, we consider that the company's proposals fall short of high quality in terms of voluntary sharing, when considering its size. However, this does not influence our overall assessment for this test question in this instance.</p> <p>We also have concerns in three areas.</p> <p>On dividend policy, the company's plan falls short of high quality with insufficient evidence that the company's proposed policy for 2020-25 takes account of delivery of obligations and commitments to customers and other stakeholders. While the proposed dividend policy refers to all of the required elements, no evidence has been provided on how the elements will be taken into account when determining dividends. The company states it expects to publish details of its dividend policy in its 2019 Annual Performance Report. However, there is no specific reference to annual publishing or signalling of changes in dividend policy to stakeholders.</p> <p>On executive pay, the plan falls short of high quality with insufficient evidence that the company has taken full account of all of the required elements in respect of its performance related executive pay policy for 2020-25. The company's Board assurance statement states that the company plans to further revise its policy on executive pay to build on the principles in its current policy and maintain the link to 'things our customers' value'. The company states it will report transparently on performance and the associated bonuses and that it will formally review its policy annually. While the company sets out details of its current policy and states performance related measures and targets will be further substantially linked to customer outcomes, there is insufficient evidence to explain how the policy will be adapted for 2020-25 e.g. to confirm that awards of any performance related element of executive pay demonstrate a substantial link to exceptional delivery for customers. While there is a clear commitment to publish the policy and the outcome of annual reviews, there is no reference as to how any changes and the underlying reasons for those changes will be set out clearly in its Annual Performance Reports.</p> <p>The plan falls short of high quality with insufficient evidence that the company's full Board has provided 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 financial resilience. The company provides only a partially compliant assurance statement from the Board as it makes no reference to corporate and financial structures. The plan falls short of high quality with insufficient evidence that the company has been transparent with its customers about its corporate and financial structures and how they relate to its long-term resilience, through clear and accessible published information. Although the company confirms closure of its Cayman Islands subsidiary and provides information about its corporate structure, we found no evidence of diagrams or sign-posts within the plan to published information.</p>

Test area	Overall test area grade	TQ#	Test question	Test question grade	Test question summary assessment
Business Plan Tables	B	CA4	To what extent has the company's full Board provided comprehensive assurance to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes (which should meet relevant statutory and licence obligations and take account of the UK and Welsh Governments' strategic policy statements)?	B	<p>Southern Water's business plan provides sufficient and convincing evidence that its full Board provides comprehensive assurance to demonstrate that the business plan will deliver - and that the Board will monitor delivery of – its outcomes.</p> <p>"The Board is committed to delivering outcomes for customers and reporting robustly on PC and ODI performance, and to continuing to strengthen the company's procedures around monitoring and reporting." The Board also confirms that this will continue into the 2020-25 price control period. We note that the company advises that it may need to restate some historical information.</p> <p>The Board provides assurance that it will monitor delivery of its outcomes and PCs and advises how it will monitor delivery through the following compliant statement "The Board is committed to delivering outcomes for customers and reporting robustly on PC and ODI performance, and to continuing to strengthen the company's procedures around monitoring and reporting. In particular, the Board has been extensively involved in plans to address previous feedback from regulators on how the company reports performance. For example, the Audit and Risk Review Committee is monitoring the completion of a risk-based programme of assurance activities designed to strengthen the practices, procedures and systems used to secure compliance with Licence and related Statutory obligations (including reporting against PCs and ODIs). This programme of activities is planned to continue into AMP7". The company also provides the following supporting statement "The Company is putting in place enhanced procedures and assurance to ensure that it will report robustly on PCs and ODIs, and projected performance. The Board is committed to monitoring delivery of outcomes and PCs now and in the longer term, and strengthening the processes used to capture and report information on performance."</p>
		CA5	To what extent does the company have a good track record of producing high-quality data, taking into account the company's data submission, assurance process and statement of high quality, and our 2018 assessment of the company under the company monitoring framework?	D	<p>Southern Water's track record of producing high-quality data is insufficient, taking into account the company's data submission, assurance process and statement of high quality and our assessment of the company in the 2018 Company Monitoring Framework (not including the elements related to the PR19 business plans).</p> <p>While the company sufficiently describes its data assurance, governance and audit processes within its business plan, overall it fell significantly short of high quality as:</p> <ul style="list-style-type: none"> <li>• 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 6 areas, it has minor concerns in 2 areas and has serious concerns in 2 areas.</li> <li>• There are minor inconsistencies between the data submitted in its Annual Performance Report and its business plan tables in the areas of outcomes, cost assessment and external communications and also minor omissions of actual data in outcomes.</li> <li>• The company does not sufficiently describe the interventions it has implemented as a result of the company's 'Prescribed' status in the 2017 Company Monitoring Framework.</li> </ul>
		CA6	How consistent, accurate and assured are the company's PR19 business plan tables, including the allocation of costs between business units, information on corporation tax, and the assurance and commentary provided?	B	<p>Overall, Southern Water's business plan provides sufficient and convincing evidence that its PR19 business plan tables, including the allocation of costs between business units, information on corporation tax and the assurance and commentary provided are consistent, accurate and assured.</p> <p>We identify some issues within our assessment of the data tables in financial modelling, outcomes, risk and return, and direct procurement for customers where the Fawley Desalination plant scheme is referred to as a potential direct procurement for customers' scheme in the company's narratives but not in its business plan tables. However, these do not materially affect our overall assessment.</p>