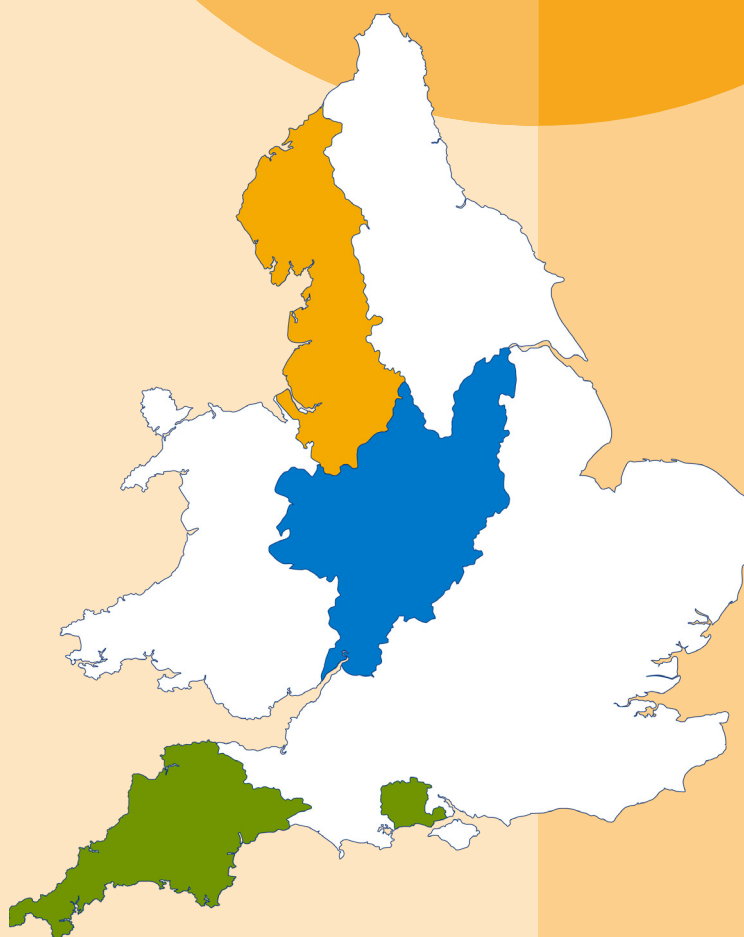


PR19 draft determinations: Overview of fast-track companies' draft determinations



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Our fast-track draft determinations at a glance

We are issuing three sector-leading water companies draft decisions on their prices and services over the next five years. Our draft decisions will unlock benefits for the customers they serve and the environment they depend on.

United Utilities



11% fall in
bills before
inflation



Leakage
down **20%**



Duration of
water supply
interruptions
down **75%**



£80 million
to start
improving
Haweswater
aqueduct



1,585
kilometres
of river
improved



£622 million
to improve
environment

Severn Trent Water



5% fall in
bills before
inflation



Leakage
down **15%**



£107 million
to improve
the water
supply grid



95% of
low pressure
complaints
resolved
first time



2,259
kilometres
of river
improved



1,090
hectares
of land
improved



£419 million
to improve
environment

South West Water



15% fall in
bills before
inflation



Leakage
down **15%**



External
sewer
flooding
down **38%**



£11 million
to improve
resilience



Pollution
incidents
down **58%**



£143 million
to improve
environment

Numbers may not add due to rounding

Delivering more of what matters

We set high expectations for water companies at the 2019 price review.

We pushed them to go further than ever before, improving efficiency, customer service and resilience.

We asked them to share any gains they make through financing arrangements with their customers. We asked them to make sure their policies on dividends and executive pay align with the quality of service provided to customers.

We asked them to look well beyond the next five years to meet the needs of future customers – and to protect and improve the natural environment.

Delivering to a higher standard

Companies submitted their business plans to us in September 2018, based on the methodology we set out in December 2017.

Three companies – Severn Trent Water, South West Water and United Utilities – submitted plans that set a new standard for the sector. Other than some limited interventions, these plans were ready to implement, so we awarded these companies with 'fast-track' status. Not only will they receive their draft determinations from us earlier than other companies – they will also receive financial and reputational benefits.

Other companies, whose original plans required more significant interventions, submitted revised plans to us on 1 April 2019. We will publish their draft determinations on 18 July 2019.

What is a price review?

A price review is when water companies, together with their customers, create plans for the future that will deliver what customers want and need.

We set the framework for these plans, and scrutinise and challenge them to make sure they meet customers' needs and companies' obligations. Based on these plans and our interventions, we set each company's price, service and incentive package for the next five years. We call this the company's 'determination'.

Delivering government priorities

Our draft determinations for Severn Trent Water, South West Water and United Utilities are set in accordance with our statutory duties and the UK Government's statement of strategic priorities and objectives for us.

Our methodology for the 2019 price review (or PR19 methodology) set out stretching expectations across four themes, which reflect our statutory duties and the strategic priorities of the UK Government and the Welsh Government.

PR19 themes



Affordability



Great customer service



Long-term resilience in the round



Innovation

Our draft determinations for the fast-track companies meet our stretching expectations across the four themes.

UK Government strategic priorities	Welsh Government strategic priorities
Securing long-term resilience Protecting customers Making markets work	Affordability Innovation Long-term Markets and competition, where appropriate Resilience Strong customer focus Sustainable management of natural resources

Our draft determinations for the other companies, which will be published in July 2019, will demonstrate in more detail how our price review and draft determinations are in accordance with the strategic priorities of the UK Government and the Welsh Government.

Affordable bills

Water and wastewater services must be affordable to customers. This means affordable overall, in the long term and for people struggling – or at risk of struggling – to pay.

Customers' confidence in water and wastewater services depends on their satisfaction with the services they get and their ability to pay their bills. So customers must receive quality services and value for money, both now and in the long term. Getting customers the best deal and the best service is at the heart of what we do.

And affordability does not need to come at the expense of necessary investment. By reducing the cost of capital and creating opportunities for companies to improve efficiency, we have opened the way for lower bills.

Each of the fast-track companies rose to the challenges we set. They provided high quality plans for making sure bills are affordable, while also investing for the future and committing to deliver for customers, the environment and wider society.

Fast track companies' average bills for 2020-25 before inflation

Company	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	% change
Severn Trent	£343	£327	£327	£327	£327	£327	↓ 5%
South West	£527	£489	£478	£468	£458	£450	↓ 15%
United Utilities	£427	£378	£378	£378	£378	£378	↓ 11%

Bills are in 2017-18 CPIH prices



Inflation

Inflation is the rate at which the price of goods and services changes. It is measured by the Office for National Statistics. We set price controls for a five-year period.

If companies' revenue was not linked to inflation, we would need to set their allowed returns to take account of the risk of inflation varying significantly from forecast. This would increase prices overall. Instead we annually adjust the wholesale part of companies' revenues by the rate of inflation. This means that inflation will affect the amount customers pay.

United Utilities

11% fall in bills before inflation

152,000 customers getting financial assistance

£71 million of company funding towards schemes to help customers who struggle to pay

Expanding '**Lowest Bill Guarantee**' scheme – for two years after switching to a meter, customers are guaranteed to be billed the lowest of the unmetered or metered charge

Severn Trent Water

5% fall in bills before inflation

Almost **doubling** the number of customers on social tariffs, with discounts based on their circumstances

199,000 customers who struggle to pay supported through social tariffs, payment holidays and breaks and other schemes

South West Water

15% fall in bills before inflation

Doubling the number of customers on support tariffs to **50,000**

Jointly funded extension to **WaterCare** social tariff

An average **£43** extra income a week for customers helped to identify unclaimed benefits

Dual billing to help customers understand if they would benefit from a water meter

Great customer service

As part of this price review, we are challenging companies more than ever before to deliver great customer service.

This starts with getting an in-depth understanding of customers' preferences and priorities. Companies with this understanding can plan to deliver the level of service that their customers expect and are prepared to pay for.

To help us assess companies' plans, we asked water companies' Customer Challenge Groups to give us independent assurance of the quality of each company's engagement with its customers, and how this engagement informed its business plan.

We want water companies to involve customers in developing and delivering services. Customers' experience of their water company should match their experience of the best companies in other sectors.

We expect water companies to commit to delivering what customers really want at a price that they can afford. Where companies deliver great customer service and new standards for the sector, they will receive payments reflecting the improvements they achieve. Where companies do not deliver their promises, customers will get money back through lower bills.

Measuring customer experience

We are introducing a new customer experience measure, C-Mex, to replace the service incentive mechanism (SIM). C-Mex compares water customers' experience with customers of other water companies, and also with customers of companies in other sectors. It covers the satisfaction of all water company customers, not only those who have contacted their company.

For the first time, we are also setting an explicit incentive to improve experiences for new connections customers. This involves another new measure, D-MeX, encompassing a customer satisfaction survey and performance on key service metrics.



Severn Trent Water

Based on its customers' views, Severn Trent Water is committing to:

- halve the time it takes to fix significant customer-reported leaks; and
- achieve performance in the sector's upper quartile on internal and external sewer flooding.

The company is including **9.7%** of its customers on its priority services register, so that they get the extra help they need. This is beyond the level we expect in our common performance commitment.

Severn Trent Water's Customer Challenge Group says:

"We are confident that the company has a deep understanding of customer priorities. Most critically, we can see a clear connection between those priorities and the company's business plan."

South West Water

South West Water leads the sector with its outcome performance commitment and incentives package.

The company is pushing itself further in areas customers particularly care about, like reducing pollution incidents by **58%** and incidents of sewer flooding inside customers' homes by **24%**.

South West Water is proposing making its support more accessible and effective for vulnerable customers. Plans include a WaterCare app, which will provide vulnerable customers with better, more tailored services.

The WaterFuture Customer Panel, South West Water's Customer Challenge Group, says:

"The company has demonstrated that its investment proposals deliver the improvements that customers want to see across the business, that is, critically at a price that customers are willing to pay."

United Utilities

Based on customers' views, United Utilities is committing to:

- achieve performance in the industry's upper quartile on internal sewer flooding;
- reduce the number of external sewer flooding incidents by **22%**; and
- reduce the number of customers receiving low water pressure by **20%**.

The flexible payment options United Utilities is offering customers in vulnerable circumstances, or who struggle to pay their bills, are setting an example for the whole water sector.

The company is also working with local energy networks and other partners, as part of plans to tailor its customer service to meet the specific needs of different groups of customers.

United Utilities' Customer Challenge Group says:

It "believes that the evidence and information obtained from customers has genuinely driven and informed the development of the company's business plan to benefit current and future customers".

Resilience in the round

Customers expect reliable water and wastewater services that can avoid, cope with and recover from disruption, as well as protect the natural environment.

This means water companies need the right information, systems, processes, governance, capabilities and finances to take decisions about their operations, maintenance and investment in the short and long term. They need to have operational, financial and corporate resilience: to be 'resilient in the round'.

Severn Trent Water, South West Water and United Utilities all demonstrate a commitment to resilience in the round. As a result, their customers will benefit not only from more reliable water and wastewater services, but also from a healthier natural environment.

Long-term financial resilience

In response to our challenge, each fast-track company commits to assess its financial resilience beyond 2025 in its next long-term viability statement.

Investing for the future

Water companies need long-term resilience to environmental pressures, demographic change, shifts in customer behaviour and the impacts of climate change. This means investing for the future as well as reducing consumption, helping to make their services more resilient to drought.

Our draft determinations include £26 million for Severn Trent Water and £26 million for United Utilities to develop options to transfer water between the River Severn and River Thames, in co-ordination with Thames Water.



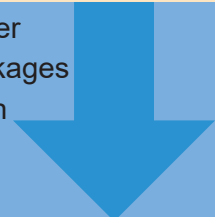
Severn Trent Water

As part of its resilience planning, Severn Trent Water engaged well with customers, both about risks to service delivery and about ways to mitigate those risks.

The company's plan demonstrates well established corporate systems and processes, and outlines how it will mitigate future skills gaps.

On operational resilience, Severn Trent Water is committing to the following.

Sewer blockages down **5%**



Average duration of water supply interruptions that last longer than three hours down **66%**

15% fewer customers with persistent low water pressure

96% of customers with service restored within 24 hours of a single failure event

£107 million

to increase the resilience of its strategic water supply grid network, focusing on single points of failure in its trunk mains, four large surface water treatment works and a cohort of groundwater sites.

South West Water

South West Water collaborates strongly with its stakeholders to develop efficient options and integrated systems around resilience.

On operational resilience, South West Water is committing to the following.


Sewer collapses down **28%**

Sewer blockages down **17%**

Average duration of water supply interruptions that last longer than three hours down **61%**

27% fewer properties affected by unplanned supply interruptions that last longer than 12 hours

38% fewer external sewer flooding incidents



£11 million

to improve the resilience of its water and wastewater services by preventing flooding, minimising the risk of fire and improving its operational control system.

United Utilities

United Utilities approaches resilience planning by using qualitative and quantitative approaches to prioritise and assess a wide range of resilience-related risks. As well as collaborating with third parties, it promotes solutions that take advantage of natural processes.

On operational resilience, United Utilities is committing to the following.

Sewer blockages down **11%**

Sewer collapses down by **9%**

Average duration of water supply interruptions down **75%**

Reducing the risk of long-term supply interruptions from water main or treatment works supply failures by **6%**

£22 million

to replace a section of the Haweswater aqueduct that serves communities in Manchester and the Pennines.

£57 million

to develop a scheme to improve resilience for the remainder of the Haweswater aqueduct.

Innovation

To meet future challenges head on – challenges like population growth and climate change – companies will need to exploit new technologies and new ideas, as well as finding innovative new uses for the tools they already have.

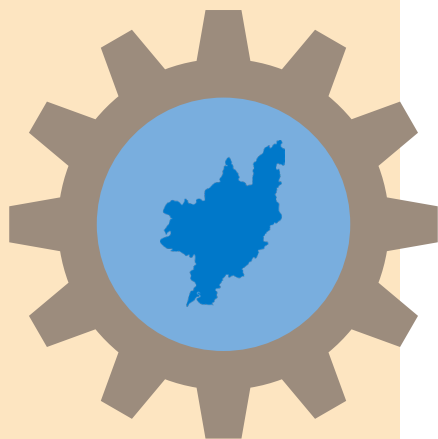
Innovation must be at the core of every company. It must form a vital part of the approach to our other themes for this price review: long-term resilience, great customer service and affordability.

To keep the benefits of innovation flowing consistently and effectively, companies need to have a culture of innovation. As part of this price review, we set companies stretching challenges, expecting that meeting them would have to mean proposing new and innovative approaches in their business plans. We are providing incentives to companies who show they are stepping up to meet those challenges.

The fast-track companies demonstrate real ambition in creating the culture and capability for innovation – and have many specific examples of innovation arising from that culture, all to customers' benefit.

We expect these companies to share their ideas and to continue learning from other companies in the sector and outside, so that all customers benefit from innovation.

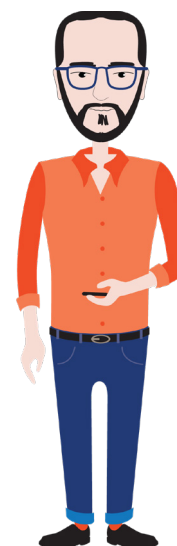
Severn Trent Water



There are many examples of best practice in innovation culture at Severn Trent Water, from #BrightSparks – a company crowdsourcing platform – to the annual Challenge Cup, where employees compete to solve specific business challenges.

The company is also pushing the industry frontier on the issue of internal sewer flooding. We are providing extra incentives for the company to keep raising the bar in this area.

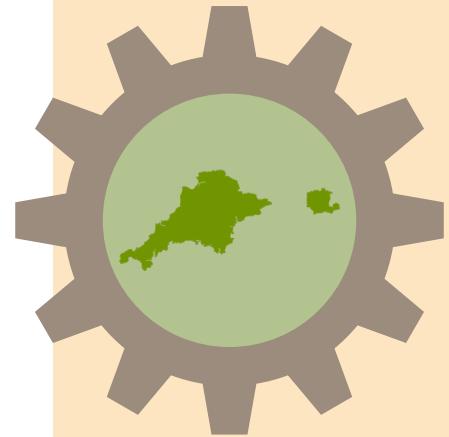
Severn Trent Water and United Utilities are contributing members of the new World Water Innovation Fund alongside organisations from Australia, Brazil and the USA. The fund aims to develop innovative techniques and carry out new research and large-scale trials of new technologies. It will share and publish its findings, allowing customers all around the world to benefit.



South West Water

South West Water's business plan showcases innovative ideas and solutions. For example, it has an ambitious plan to use collaboration and markets to secure resilient and sustainable water resources for the long term.

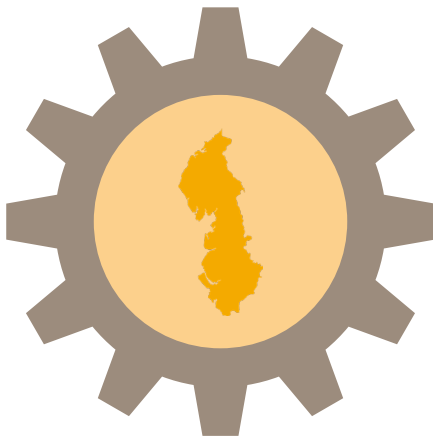
South West Water is raising standards with its initiatives to reduce leakage and internal sewer flooding incidents. We are providing extra incentives for the company to keep shifting this particular frontier.



United Utilities

Out of all the water company business plans we have assessed, United Utilities' plan has the best evidence of an embedded culture of innovation.

The plan makes innovation a core value of the company, linked to every employee's annual appraisal and bonus process. There is a good structure in place to recognise employees' contributions and support the development of ideas throughout the entire company.



The company also demonstrates a balanced approach to risk tolerance, where it accepts that not all innovations succeed and that it can learn from failure.

United Utilities' work on reducing pollution incidents sets an example for the whole industry. We are providing extra incentives for the company to deliver on the promise of its plan and show other companies what innovation can achieve in this area.

Environment

Water companies rely on the environment to provide water and wastewater services. They also need to provide their services in a way that helps to meet environmental goals. We expect companies to plan on a long-term basis and their business plans to reflect longer-term strategies and Water Resource Management Plans.

For this price review, our ambition for the environment is higher than ever. Both the UK Government's and the Welsh Government's strategic priorities recognise the importance of sustainably managed natural resources and a resilient ecosystem. We recognise the role we have to play in this, working with others like the Environment Agency, Natural Resources Wales and Natural England.

Our draft determinations allow companies the costs required to deliver the Water Industry National Environment Programme efficiently. They also include stretching performance commitments that push companies to go even further on important environmental outcomes, such as reducing pollution.

The fast-track companies have committed to protecting and enhancing the environment. They go further than their environmental obligations, increasingly working with nature to design solutions – for example, through more catchment management approaches.


Severn Trent Water

Our draft determinations for Severn Trent Water deliver more of what matters for the environment.

Our draft determination for Severn Trent Water includes **£419 million** to deliver its environmental obligations and another **£102 million** to ensure an adequate balance between water supply and demand.

Water use
down to
less than
129 litres
per person
per day

Leakage
down **15%**



Category
1 to 3
pollution
incidents
down **29%**

2,259
kilometres
of river
improved

37 new
catchment
manage-
ment
schemes

1,090
hectares of
land with
improved
biodiversity

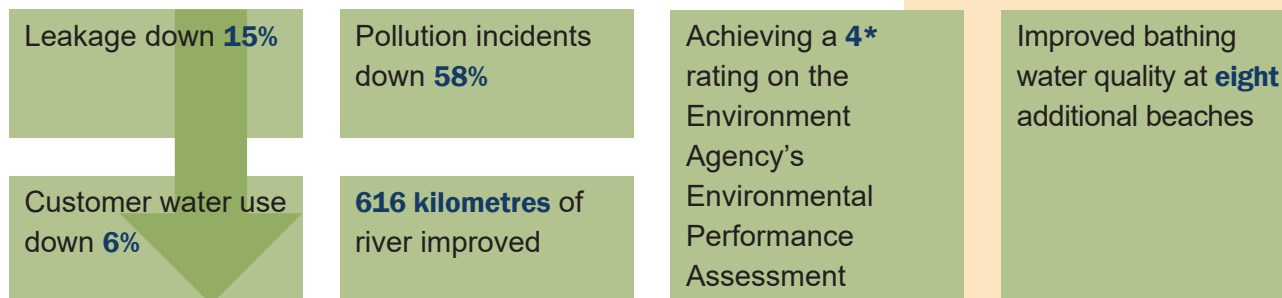
Case study: improving biodiversity

Severn Trent Water will work with partner organisations to deliver an extensive landscape restoration programme in the moorland and clough woodland areas around the Derwent Valley reservoirs.

South West Water

Our draft determinations for South West Water deliver more of what matters for the environment.

Our draft determination for South West Water includes **£143 million** to deliver its environmental obligations.



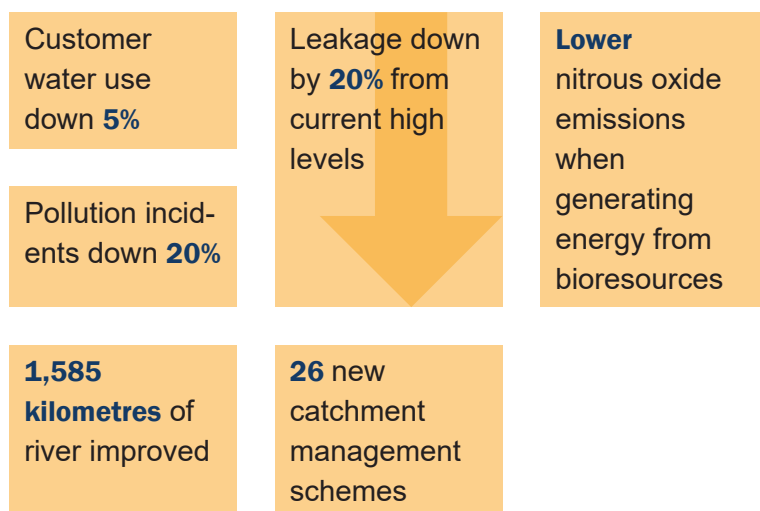
Case study: catchment management

Working closely with the Environment Agency and catchment partners, South West Water will put a new operating regime in place in the Otter Valley. This includes a novel abstraction incentive mechanism, which should reduce abstraction during dry weather and help protect the environment.

United Utilities

Our draft determinations for United Utilities deliver more of what matters for the environment.

Our draft determination for United Utilities includes **£622 million** to deliver its environmental obligations.



Case study: natural capital

United Utilities is working with potential partners to develop a natural capital trading platform, and intends to create a catchment marketplace to help shift to a natural capital investment approach. It has already started to implement this on its River Petteril catchment pilot.

Balancing risk and return

Our PR19 methodology aims to align the interests of companies and investors with those of customers, by setting a fair return.

Water and wastewater services are capital intensive and it is important the sector continues to be able to access capital markets on low cost basis. We consider that efficient companies should be able to access the funds they need to finance their activities on reasonable terms. A company that can do this is 'financeable'. Our draft determinations for each of the fast-track companies are financeable.

Putting the sector in balance

In our '[Putting the sector in balance](#)' document, we stated our expectations that:

- companies will share the benefits of high gearing with their customers;
- companies should consider voluntarily sharing the benefits of outperformance with customers; and
- companies will align their policies on dividends and performance-related executive pay with their delivery for customers.

In the 'Putting the sector in balance' document, we made targeted amendments to the PR19 methodology that aimed to encourage companies to take greater account of customers' interests. Our goal was to improve the sector's legitimacy and public standing, and to make sure that companies achieve the right outcomes for customers.

Severn Trent Water, South West Water and United Utilities do not forecast high levels of gearing in 2020-25. However, all three companies will share the benefits of high gearing with customers if their gearing does exceed 70%.

Cost of capital

The cost of capital is an allowance for the costs of providing investors with a return appropriate for the level of risk they take on.

In the PR19 methodology, we set out our 'early view' of the cost of capital. At 3.4% in CPIH¹ deflated terms (and 2.4% in RPI² deflated terms), it is the lowest cost of capital we have set since the privatisation of the sector. This is reflected in our draft determinations for the fast-track companies. We will update the cost of capital for our slow-track draft determinations in July 2019 and final determinations in December 2019.

The fast-track companies' proposed dividend policies meet our expectations. We expect companies to be clear about how they will take account of performance delivery to customers when declaring or making dividend payments in 2020-25.

Each fast track company has taken steps that demonstrate its commitment to meet our expectations on performance-related executive pay. We expect each company to ensure its performance-related executive pay policy delivers stretching performance for customers in 2020-25.

1. Consumer price inflation including housing: a measure of consumer price inflation in the UK.

2. Retail price index: a measure of retail price inflation in the UK.

Severn Trent Water

Severn Trent Water will voluntarily share benefits with customers by:

- donating **1%** of its profits to a community fund for local schemes;
- funding hardship payments; and
- building a new technical academy.

On performance-related executive pay, the company commits that:

- **51%** of the annual incentive will be weighted to customer, environment and health and safety delivery; and
- the long-term incentive will be aligned to customer delivery.



South West Water

South West Water will voluntarily share benefits with customers by:

- funding hardship payments; and
- sharing an estimated **£20 million** of its outperformance on the embedded cost of debt over 2020-25.

On performance-related executive pay, the company commits that:

- **70%** of the annual incentive will be based on customer delivery; and
- the long-term incentive will be aligned to customer delivery.



United Utilities

United Utilities will voluntarily share benefits with customers by:

- spending **£71 million** of its own money on financial assistance schemes over 2020-25; and
- matching any shareholder distributions with contributions to its community fund, if they are more than **2%** above its base dividend.

On performance-related executive pay, United Utilities proposes that:

- at least **60%** of the annual incentive will be linked to customer delivery; and
- the long-term incentive will be aligned to customer delivery.



Next steps for all companies

Company category	Next steps	Date
Fast-track companies	Fast-track companies make representations on their draft determinations	10 am on 24 May 2019
Slow-track companies	Ofwat publishes slow-track and significant-scrutiny draft determinations	7 am on 18 July 2019
	'Slow-track' and 'significant scrutiny' companies make representations on their draft determinations	10 am on 30 August 2019
All companies	Companies resubmit 2014 price review reconciliations to include 2018-19 actual data and updated forecasts for 2019-20	15 July 2019
	Ofwat publishes final determinations	7 am on 11 December 2019

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

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