

July 2019

Trust in water

PR19 draft determinations

**South East Water – Accounting for past
delivery actions and interventions**

o f w a t

www.ofwat.gov.uk

PR19 Draft Determinations: South East Water - Accounting for past delivery actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised actions, the model the action relates to, a summary of the company’s response to the action, our assessment of the company’s response, and any further interventions we are making as part of the draft determination. Table 1 also sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each action and further intervention that is not resulting from an action has a unique reference. The prefix ‘SEW’ denotes the company South East Water. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Actions whose numbers are preceded with an ‘A’ denote required actions. Actions whose numbers are preceded with a ‘B’ denote advised actions. Interventions not resulting from an action are preceded with a ‘C’ followed by a three digit code for the model the intervention is relevant to, and a two digit reference for the interventions in that model. The model codes are set out below.

Model	Code
ODIs	002
Land sales	003
WRFIM	005
Totex	006
Water trading	007
Residential retail	008
SIM	009
RCV adjustments feeder model	010
Revenue adjustments feeder model	011

Table 2 below is supplementary to Table 1 and provides additional information on our assessment of the evidence provided in response to required actions on deliverability. This constitutes our feedback on these required actions as set out in ‘[PR19 initial assessment of plans: Summary of test area assessment](#)’.

For all other documents related to the South East Water draft determination, please see the [draft determinations webpage](#).

Table 1 – South East Water’s response to required actions and interventions for draft determinations

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Land disposals	SEW.PD.A1	Required	PR14 Land sales: South East Water is required to provide sufficient evidence to support the forecast trajectory in table App9.	1 April 2019	South East Water provides additional evidence in App9 to support a revised adjustment but not the forecast trajectory. The company’s commentary supports the change in formula but not the forecasts – ‘The commentary that we included in Appendix 22 of our business plan still applies to our updated App9 table.’	No intervention required but action needed by South East Water. The company provides insufficient evidence to support its forecast trajectory.	We expect the company to provide revised commentary in its representations on the draft determinations to support the data for 2018-19 and the forecast for 2019-20.
Outcomes	SEW.PD.A2a	Required	PR14 outcome delivery incentives: South East Water is required to update its forecast for 2019-20 performance to take account of the actual 2018-19 performance for all its performance commitments. We expect the company to pay particular focus where we found the evidence provided in its business plan for the 2018-20 forecasts to be insufficient which was for:	15 July 2019	No company action required for the draft determination.	No intervention required. We will review South East Water’s updated data before making any interventions for the final determination.	N/A
Outcomes	SEW.PD.A2b	Required	H2: Meeting the water resource deficit	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2c	Required	I1: Mean zonal compliance (MZC)	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Outcomes	SEW.PD.A2d	Required	N4: Water mains bursts	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2e	Required	G2: Average time lost per property (measured in minutes, per property served)	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2f	Required	A1: Customer satisfaction - appearance of water	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2g	Required	B1: Customer satisfaction - taste and odour of water	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2h	Required	C1: Customer satisfaction - level of leakage	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2i	Required	D1: Customer satisfaction - direct interaction experience	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2j	Required	F1: Customer satisfaction - water supply is of sufficient pressure	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a
Outcomes	SEW.PD.A2k	Required	G1: Customer satisfaction - frequency and duration of supply interruptions	15 July 2019	As SEW.PD.A2a	As SEW.PD.A2a	As SEW.PD.A2a

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Outcomes	SEW.PD.C002.01	Intervention not resulting from an action	N/A	N/A	N/A	<p>F2 (number of properties at risk of low pressure, as recorded on the DG2 register)</p> <p>The corrigenda to South East Water's PR14 final determination (originally published 13 February 2015, subsequently republished on 2 November 2016) states that the 'Form of reward/penalty' is 'Adjustment to RCV'.</p>	<p>We are intervening to move the actual and forecast outperformance payments for performance commitment F2 (properties at risk of low pressure), from 'end of period ODI revenue adjustments' to 'end of period ODI RCV adjustments'. The outperformance payments (in £ million) for each year are:</p> <p>2015-16: 0.00200 2016-17: 0.00300 2017-18: 0.00400 2018-19: 0.00416 (forecast) 2019-20: 0.00416 (forecast)</p> <p>Total for the 5-years: 0.017320</p> <p>Our intervention increases the total net performance revenue underperformance payment at the end of the 2015-20 period from - £0.066 million to - £0.084 million and decreases the RCV adjustment at the end of the 2015-20 period from - £0.624 million to - £0.605 million (2017-18 FYA CPIH deflated price base).</p>
Residential retail	SEW.PD.A3a	Required	PR14 Residential retail: South East Water is required to amend the discount rate in table R9 to the correct value.	1 April 2019	South East Water provides an amended discount rate of 3.6%. This addresses our action to replace the value of 100% provided but is still not the WACC the company should use.	Intervention required.	Please see SEW.PD.C008.01 below.
Residential retail	SEW.PD.A3b	Required	PR14 Residential retail: South East Water is required to re-submit the Ofwat published version of the PR14 retail reconciliation model.	1 April 2019	South East Water does not resubmit its PR14 retail reconciliation model as it has not made any changes since its last submission in September 2018.	No intervention required. The company provides a satisfactory response to this action.	N/A
Residential retail	SEW.PD.A3c	Required	PR14 Residential retail: South East Water is required to clarify the justification for its 2019-2020 forecast which departs from the previously observed trends.	1 April 2019	South East Water provides evidence to support its forecasts by referring to the effect of its compulsory metering programme.	No intervention required. The company provides a satisfactory response to this action.	N/A

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Residential retail	SEW.PD.A3d	Required	PR14 Residential retail: South East Water is required to provide further clarity on the reasons for the difference between reforecast customer numbers and actual customer numbers in 2018-2019.	1 April 2019	South East Water does not directly address this action but it sets out its approach for 2019-20 which will be to have the same values for reforecast and actual customer numbers.	No intervention required. The company provides a satisfactory response to this action.	N/A
Residential retail	SEW.PD.C008.01	Intervention not resulting from an action	N/A	N/A	N/A	Intervention required. We are intervening to apply the appointee WACC as the discount rate to be used to provide a financing adjustment for the time value of money of the reward or penalty in line with the 'PR14 reconciliation rulebook'. This may be required if the materiality threshold for financing adjustment is exceeded. Our intervention ensures that there is no mismatch between the discount rate used and the revenue control to which it is applied.	For South East Water, we are including a figure of 3.74% for the 'Materiality threshold for financing adjustment - Discount Rate.' This replaces the figure of 3.6% contained in South East Water's April 2019 submission. Our interventions do not result in any changes to the total residential retail revenue payment at the end of the 2015-2020 period which remains at £0.167 million (2017-18 FYA CPIH deflated price base) because the materiality threshold is not exceeded. Please see published draft determination residential retail revenue reconciliation model for South East Water.
SIM	SEW.PD.C009.01	Intervention not resulting from an action	N/A	N/A	N/A	Intervention required. We are intervening to adjust South East Water's household retail revenue as a result of its SIM performance from 2015-16 to 2018-19.	We are intervening to set the service incentive mechanism adjustment to - 0.75% of household retail revenue, which is - £0.863 million (2017-18 FYA CPIH deflated price base) in total over the period. We further explain how we calculate this in the 'Accounting for past delivery technical appendix'.
Totex	SEW.PD.A4a	Required	PR14 Totex: South East Water is required to re-submit the published model without amending it, or alternatively provide a reasonable explanation of why it is necessary to make changes to it.	1 April 2019	South East Water responds to this action and published a model without any unauthorised changes.	No intervention required. The company provides a satisfactory response to this action.	N/A

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Totex	SEW.PD.A4b	Required	PR14 Totex: South East Water is required to provide a detailed and numerically supported explanation to support its forecasted performance for years 2018-19 and 2019-20 in table WS15.	1 April 2019	South East Water responds to this action in 'Chapter 8 Accounting for Past Delivery' (P.9). Its forecast performance is driven by its power procurement savings and efficiencies achieved through its contracting approach.	No intervention required. The company provides sufficient explanation in support of its forecasts.	N/A
All models	SEW.PD.A5	Required	PR14 reconciliations: Further to the actions we have set out to address our concerns over the evidence provided in its business plan for the individual reconciliations, we will require the company to refresh all of its PR14 reconciliations to replace its 2018-19 forecast performance with 2018-19 actual performance and update the evidence for its forecast 2019-20 performance taking into account of the actual 2018-19 performance.	15 July 2019	No company action required for the draft determination.	No intervention required. We will review South East Water's responses to its actions and further information provided for all the PR14 reconciliation models before making any further interventions for the final determination.	N/A

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Revenue adjustments	SEW.PD.C011.01	Intervention not resulting from an action	N/A	N/A	N/A	<p>Intervention required.</p> <p>We are standardising the discount factor used to profile revenue adjustments.</p> <p>Companies can choose to apply revenue adjustments either in the first year, or, spread over a number of years in the 2020-25 period to minimise the impact on bills or to generate a bill profile that is appropriate for its customers.</p> <p>We consider the wholesale WACC is an appropriate discount factor as this is a measure of the time value of money that is consistent with the price control framework. We are not intervening in South East Water's choices for profiling revenue adjustments in 2020-25.</p>	We are using our view of the wholesale WACC (3.09%) as the discount factor to preserve the net present value of the outperformance or underperformance payments due when spreading adjustments over the period.

N/A	SEW.PD.A6	Required	<p>South East Water should produce and provide additional evidence that it has identified:</p> <ul style="list-style-type: none"> the drivers of its past and current outcomes performance, including financial and reputational performance commitments; lessons learnt from good and poor past and current performance; the performance gap between current performance and proposed performance in the 2020-25 business plan; and the measures planned or already in place to ensure deliverability of the 2020-25 business plan. 	1 April 2019	<p>South East Water provides additional evidence on deliverability for five performance commitments with performance that is materially different from its targets set for the 2015-20 period. These performance commitments are leakage, properties at risk of low pressure, average time lost per property, discolouration contacts, water mains repairs and customer satisfaction.</p>	<p>We have reviewed South East Water's response to this action on the performance commitments over which we had material concerns in our initial assessment – water supply interruptions, mains repairs, discolouration contacts and customer satisfaction. For our assessment and rationale see table 2.</p> <p>Water supply interruptions performance commitment</p> <p>No additional intervention required.</p> <p>Mains repairs performance commitment</p> <p>Intervention required.</p> <p>Discolouration contacts performance commitment</p> <p>Intervention required.</p> <p>Customer satisfaction performance commitments</p> <p>No intervention required.</p> <p>South East Water provides additional evidence that confirms that many of these performance commitments were set at zero tolerance causing any drop in performance to result in failure in our initial assessment.</p> <p>Customers are adequately protected by C-MeX, with which there is a significant overlap. No additional protections required especially given the innovative nature of some of these performance commitments and the company's zero tolerance approach which, whilst leading to more failures, will protect customers' interests.</p>	<p>These conclusions on interventions take account of the evidence submitted for actions SEW.PD.A6 and SEW.PD.A7.</p> <p>Water supply interruptions performance commitment</p> <p>We are already intervening through our outcomes assessment to protect customers by providing sufficient incentives to mitigate the risks around delivery of 2020-25 stretch. See SEW.OC.A12 within the 'South East Water – actions and interventions' document for outcomes.</p> <p>Mains repairs performance commitment</p> <p>We are intervening to protect customers by increasing South East Water's outcome delivery incentive underperformance payment rate to the top of the reasonable range (average +0.5*standard deviation) as we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan. This increases South East Water's outcome delivery incentive underperformance payment rate from £0.0833m per mains repair per 1,000km to £0.101m per mains repair per 1,000km.</p> <p>Discolouration contacts performance commitment</p> <p>We are intervening to protect customers by increasing South East Water's outcome delivery incentive underperformance payment rate to the industry average as we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan. This increases South East Water's outcome delivery incentive underperformance payment rate from £0.947m per 1,000 population to £2.55m per 1,000 population.</p> <p>Customer satisfaction performance commitments</p> <p>N/A</p>
-----	-----------	----------	--	--------------	---	--	--

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
N/A	SEW.PD.A7	Required	<p>South East Water should produce and provide an action plan that sets out:</p> <ul style="list-style-type: none"> how South East Water will continuously monitor performance against PR14 and PR19 performance commitments, including how this relates to section 3 of the Annual Performance Report and what evidence it will look for beyond itself and the sector; how South East Water will identify drivers of performance and lessons learnt from both good and poor performance; how South East Water will identify measures to improve performance and integrate these into its business; and how South East Water will ensure that this is a continuous rather than one-off process. 	1 April 2019	The company provides one action plan, at a generic not performance commitment specific level, in response to this action.	<p>See assessment for action SEW.PD.A7 above for conclusions on interventions. For our assessment and rationale see table 2.</p> <p>We have reviewed South East Water's response to this action on the performance commitments over which we had material concerns in our initial assessment.</p> <p>Water supply interruptions performance commitment;</p> <p>Mains repairs performance commitment;</p> <p>Discolouration contacts performance commitment; and</p> <p>Customer satisfaction performance commitments</p>	<p>Water supply interruptions performance commitment</p> <p>See interventions for SEW.PD.A6.</p> <p>Mains repairs performance commitment</p> <p>See interventions for SEW.PD.A6.</p> <p>Discolouration contacts performance commitment</p> <p>See interventions for SEW.PD.A6.</p> <p>Customer satisfaction performance commitments</p> <p>See interventions for SEW.PD.A6.</p>

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
N/A	SEW.PD.B1	Advised	<p>South East Water should produce and provide additional evidence that it has identified:</p> <ul style="list-style-type: none"> the drivers of incidents performance and customer communication and support performance during and after major incidents, pollution incidents and where statutory and licence obligations enforced by the EA/NRW, DWI and Ofwat have not been met; lessons learnt from good and poor past and current performance; the performance gap between current performance and proposed performance in the 2020-25 business plan; and <p>measures planned or already in place to ensure deliverability of the 2020-25 business plan.</p>	24 May 2019	The company provides further evidence to support the deliverability of its plan.	<p>No intervention required.</p> <p>Because our deliverability concerns were not substantial in this area, and so we set an advised action, we will conduct a risk-based review of the company's response to the action and will determine the need for further interventions for the final determination.</p>	N/A

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
N/A	SEW.PD.B2	Advised	<p>South East Water should produce and provide an action plan that sets out:</p> <ul style="list-style-type: none"> • how South East Water will continuously monitor incidents performance and customer communication and support during and after major incidents and deliver targets set by the EA/NRW in the Environmental Performance Assessment (EPA), by DWI and by Ofwat's regulations , including what evidence it will look for beyond itself and the sector; • how South East Water will identify drivers of performance and lessons learnt from both good and poor performance; • how South East Water will identify measures to improve performance and integrate these into its business; and <p>how South East Water will ensure that this is a continuous rather than one-off process.</p>	24 May 2019	The company provides an action plan as requested.	<p>No intervention required.</p> <p>Because our deliverability concerns were not substantial in this area, and so we set an advised action, we will conduct a risk-based review of the company's response to the action and will determine the need for further interventions for the final determination.</p>	N/A

Table 2 – Past delivery deliverability assessments supplementary table

Action reference	Our assessment and rationale
SEW.PD.A6	<p>Water supply interruptions performance commitment</p> <p>South East Water provides sufficient and convincing evidence of lessons learnt.</p> <p>The company provides sufficient evidence that it recognises the performance gap between current outcomes performance and proposed performance in the 2020-25 plan.</p> <p>It provides sufficient and convincing evidence that it has identified and understood the main drivers of its past performance on water supply interruptions. The company provides an analysis of its interruptions to supply incidents and a more detailed investigation of individual events which have had the biggest impact on customers, a summary of the lessons learned from these events and planned/completed investment. The company then describes company-level lessons learnt such as the appointment of a senior manager to carry out an independent internal review, reporting directly to the Executive and to the Board.</p> <p>South East Water provides insufficient evidence of measures to improve performance and deliverability of the stretch proposed in its 2020-25 business plan.</p> <p>The company provides sufficient evidence that it has identified areas for improvement and a convincing description of preventative, mitigation and response measures.</p> <p>The company describes the areas it intends to address and activities it plans to implement which will allow it to meet future performance commitments, but does not provide any detailed plans with associated timetable for the implementation. The company states that all performance commitments are owned by a senior manager within South East Water and performance is tracked through reports and steering groups led by a member of the Executive Team.</p> <p>Mains repairs performance commitment and discolouration contacts performance commitment</p> <p>South East Water provides insufficient and unconvincing evidence of lessons learnt and drivers of past performance.</p> <p>The company provides sufficient evidence that it recognises the performance gap between current outcomes performance and proposed performance in the 2020-25 plan.</p> <p>The company provides sufficient analysis of the underlying reasons for poor performance but presents limited reasoning without lessons learnt.</p> <p>For discolouration contacts the company explains it is the geological characteristics of its supply area that elevates the number of contacts and that it has made significant improvement in the number of water supply zones (WSZ) which experienced a contact rate above 2/1000 population; this is however focussing on one sub-element of the total measure for which the performance has deteriorated and the company does not evidence it understands the drivers for the measure as a whole.</p> <p>For mains burst the company presents a high level overview that does not sufficiently explain the reasons for poor performance. The company explains it by the increase in proactively detected leaks but does not provide any further information, for example how it impacted the number of reactive repairs. The company adds that there is general increase across the industry in number of burst mains due to additional active leakage control and lists examples of other companies that forecast an increase in mains bursts.</p> <p>The company provides insufficient and unconvincing evidence that it has identified areas for improvement.</p> <p>South East Water provides insufficient and unconvincing evidence of measures it has implemented, or will be implementing, to deliver the level of stretch proposed in the 2020-25 business plan.</p> <p>The company explains how its proposed performance commitment levels are stretching but provides insufficient evidence of measures it will put in place to ensure it will successfully deliver its commitments. The company states that all performance commitments are owned by a senior manager within South East Water and performance is tracked through reports and steering groups led by a member of the Executive Team.</p>

	<p>Customer satisfaction performance commitments</p> <p>For the customer satisfaction performance commitments, the company provides additional evidence that confirms that many of these performance commitments were set at zero tolerance causing any drop in performance to result in failure in our initial assessment. We do not consider it necessary to intervene:</p> <ul style="list-style-type: none"> • as customers are adequately protected by C-MeX, with which there is a significant overlap; and • given the innovative nature of some of these performance commitments and the company's zero tolerance approach which, whilst leading to more failures, will protect customers' interests.
SEW.PD.A7	<p>The generic action plan for continuous improvement covers:</p> <ul style="list-style-type: none"> • water supply interruptions performance commitment; • mains repairs performance commitment; • discolouration contacts performance commitment; and • customer satisfaction performance commitments. <p>South East Water has provided sufficient and convincing evidence of how it will continuously monitor performance against PR14 and PR19 performance commitments at a Board, senior management and customer challenge group / customer panel meeting.</p> <p>Whilst the company refers to section 3 of the Annual Performance Report, it does not demonstrate clearly how its performance monitoring relates to this. It provides some evidence on how it is seeking best practice from beyond itself and the sector. Where appropriate, rolling 'deep dive' reviews include a review of industry performance to help identify where improvements can be made within the company.</p> <p>South East Water provides insufficient and unconvincing evidence of how the company will identify drivers of performance and lessons learnt from both good and poor performance.</p> <p>The company makes very limited reference to drivers of performance and lessons learnt in its submission, and where it does refer to these it is in the context of reporting lessons learnt to Board rather than how the company will identify them. The only reference that the company makes to lessons learnt is in the "Accounting for past delivery" section of the company's revised business plan where it states "Variances against target (positive and negative) are explained in detail by SEW Management Team allowing the Board to review any lessons learnt and to scrutinise plans in place to improve performance"</p> <p>South East Water provides insufficient and unconvincing evidence of how the company will identify measures to improve performance.</p> <p>The company makes limited reference to the process it will use to identify measures to improve performance other than stating in the "Accounting for past delivery" section of the company's revised business plan, where appropriate rolling deep dive reviews will include a review of industry performance and out of sector performance to help identify where improvements can be made within SEW". The other references the company makes to measures to improve performance focus on how it will monitor / report on the measures rather than how it will identify them in the first place. The company does not state how it will integrate measures to improve performance into the business.</p> <p>South East Water provides some evidence that this is a continuous rather than a one off process.</p> <p>The company provides sufficient and convincing evidence of the continuous process that it has in place to ensure that lessons learnt and improvement measures (once they are identified) are monitored at Board, senior management and CCG level. However, the company provides insufficient and unconvincing evidence on the process it will use to continuously identify lessons learnt and improvement measures.</p>

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.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

July 2019

© Crown copyright 2019

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gov.uk.

