

July 2019

Trust in water

PR19 draft determinations

Portsmouth Water – Securing confidence and assurance actions and interventions

ofwat

www.ofwat.gov.uk

PR19 Draft Determinations: Portsmouth Water – Securing confidence and assurance 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, 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.

Each action has a unique reference. The prefix 'PRT' denotes the company Portsmouth 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 and actions whose numbers are preceded with a 'B' denote advised actions.

Table 2 below sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix 'PRT' denotes the company Portsmouth 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. Intervention numbers are preceded with a 'C'.

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

Table 1 – Portsmouth Water's response to required actions and interventions for draft determinations

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Securing confidence and assurance	PRT.CA.A1	Required	Provide restated Board assurance that 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. The Board's original statement did not contain explicit assurance on the deliverability, cost efficiency and protection of customer interests regarding the company's large investment proposal.	1 April 2019	Portsmouth Water's Board provides the following revised assurance statement: "The Company has one large investment proposal, a new reservoir which is supported by option appraisal carried out on behalf of the Company by Water Resources in the South East (WRSE) and an analysis by PA Consulting. Atkins has appraised the deliverability of the project and believe the costs are at P50 level. PA consulting also conducted a review of whether the project should be considered as a DPC contract. The conclusion was that this was not the best way forward for customers. The reservoir will be used to enable an additional bulk supply to Southern Water services and we are working in collaboration with them. They also conclude that this is the best approach to deliver for their customers. The Board evaluated these reports and analysis to ensure deliverability and cost efficiency, determining that the proposals were both deliverable and the most cost efficient option. In doing so, the Board concluded that the proposal	No intervention required. The Board of Portsmouth Water provides a compliant assurance statement.	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
					put forward in the Business Plan is in the best interests of the customers of both companies."		
	PRT.CA.A2	Required	Provide restated Board assurance that the company's business plan is financeable on both the notional and actual capital structure and the plan protects customer interests in both the short and long term. The statement should clearly set out the steps taken to provide this assurance. The Board's original statement did not confirm that the plan is financeable on the notional and actual capital structure and that it protects customer interests in both the short and long term.	1 April 2019	<p>Portsmouth Water's Board provides the following revised assurance statement: "As a consequence of the Board's review of financeability and financial resilience, the Board concluded that the Company's Plan;</p> <ul style="list-style-type: none"> • Is financeable in the notional and actual capital structures • Remains financially resilient over the longer-term • Protects customer interest in the short and long-term" 	<p>No intervention required.</p> <p>The Board of Portsmouth Water provides a compliant assurance statement.</p>	N/A
	PRT.CA.A3	Required	Provide restated Board assurance that the Board's governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term. The Board's original submission only refers to financial resilience.	1 April 2019	Portsmouth Water's Board provides the following revised assurance statement: "The Board has robust governance and assurance processes and believes they are appropriate to ensure long-term financial, operational and corporate resilience."	<p>No intervention required.</p> <p>The Board of Portsmouth Water provides a compliant assurance statement.</p>	N/A
	PRT.CA.A4	Required	<p>On dividend policy the company is required to confirm that it is committed to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' to include:</p> <ul style="list-style-type: none"> - clear board commitment to signal changes to stakeholders; and - commitment to transparency about how the dividend policy in 2020-25 takes account of obligations and commitments to customers for the dividend policy that is applied in 2020-25 and when determining dividends. <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.</p>	1 April 2019	Portsmouth Water confirms that it is committed to adopting all of the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' position statement. If the dividend payment or policy changes, the Board commits to being open and transparent with stakeholders, especially customers, clearly communicating what and why the changes have occurred. It also confirms that the base dividend will be adjusted to reflect wider performance factors such as performance in relation to service levels and outcome delivery incentive measures.	<p>No intervention but further action needed by Portsmouth Water.</p> <p>The company provides sufficient evidence of its intention to meet the expectations on dividends as set out in 'Putting the sector in balance' position statement but its response lacks detail on how it will demonstrate annually to stakeholders that it has met them.</p> <p>It provides insufficient transparency as to:</p> <ul style="list-style-type: none"> i) the specific obligations and commitments to customers; ii) the level of performance delivery they will be considered against; and iii) how they will impact on dividends. 	<p>We expect Portsmouth Water to be transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers and to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our position statement. We expect the company to respond to this issue in its response to our draft determination.</p> <p>We expect the company to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and other stakeholders, including performance in delivery against the final determination. In doing so, the company should refer to the examples of best practice we have identified among companies.</p>

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	PRT.CA.A5	Required	<p>On executive pay the company is required to confirm that it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' to include:</p> <ul style="list-style-type: none"> - providing full details and commitment to publish, including all performance metrics, the executive pay policy for 2020-25; - visibility and evidence of substantial linkage of executive remuneration to delivery to customers; - clear explanation of stretching targets and how they will be applied; - clear explanation of how the policy will be rigorously applied and monitored; - clear commitment to transparency of reporting; and - commitment to report how changes, including the underlying reasons, are signalled to customers. <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.</p>	1 April 2019	<p>Portsmouth Water states that it will adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' position statement. The company states that the remuneration committee will finalise the policy once the final determination is made, but in response to a further query has indicated the following:</p> <ul style="list-style-type: none"> • annual bonus based on 32% customer service or customer benefits, 30% water quality, efficiency or sustainability outcomes and 38% business investment and financial performance outcomes. • long term bonus based upon achieving strategic business objectives that underpin the delivery of the business plan, 40% of which is linked to customer, environmental, water quality or sustainability outcomes, but the company stated that this will increase for 2020-25. • targets will be set to drive upper quartile performance but will not be finalised until the final determination is made. • the remuneration committee will be responsible for the process of developing the implementing the policy. • commitment to clear and open reporting of the policy, through the annual report, including any changes and the underlying reasons for the change. 	<p>No intervention but further action needed by Portsmouth Water.</p> <p>The company's proposed policy demonstrates the company's commitment to move in the direction of the expectations set out in 'Putting the sector in balance' position statement.</p>	<p>There remain some details to be finalised, for example details of the underlying metrics and associated weightings for both the annual and long term bonus schemes and the finalisation and approval of the policy. Once finalised, we expect Portsmouth Water to provide an update in its response to the draft determination to demonstrate that it is committed to meet the expectations we have set out in 'Putting the sector in balance' position statement.</p> <p>We expect the company and its remuneration committee to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers through 2020-25 and is underpinned by targets that are stretching. Trust and confidence can best be maintained where stretching performance is set by reference to the final determination and taking account of stretching regulatory benchmarks (for example delivery of upper quartile performance) and should include a commitment that it will continually assess performance targets to ensure targets will continue to be stretching throughout 2020-25.</p> <p>We expect the company to report transparently, in its annual performance report, about further updates to the development of its policy that will apply in 2020-25.</p>
	PRT.CA.A6	Required	Provide a revised financial model (based on version 16z released on 31 January 2019) and data tables on 1 April 2019.	1 April 2019	Portsmouth Water provides a revised financial model based on version 17z (as communicated to companies since the initial assessment of plans action was set) and data tables.	<p>No intervention required.</p> <p>Portsmouth Water provides a satisfactory response to this action.</p>	N/A
	PRT.CA.A7	Required	Address validation issues and gaps in App1 and provide a revised App2 in which values for 2018-19 onwards	1 April 2019	Portsmouth Water addresses the validation issues and gaps in App1 and provides a revised App2 in which it	No intervention required.	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			in blocks B and C reflect the guidance i.e. old definition reporting for leakage and PCC.		presents forecasts for leakage and PCC in line with “old” methodology.	Portsmouth Water provides a satisfactory response to this action.	
	PRT.CA.A8	Required	<p>The company should explain the assurance process it has taken to develop its tax forecasts to demonstrate that amounts proposed for tax take account of customer interests, in particular to clarify the scope of the assurance work that was undertaken and the outcome of that work.</p> <p>There is also inconsistency between the notional cost of equity in tables Wr5 and Wn5. The company should ensure its subsequent submission is consistent in this respect.</p>	1 April 2019	<p>Portsmouth Water’s revised submission includes further narrative explaining the work performed by KPMG on the tax input. It confirms that judgements, assumptions and the methodology were considered and challenged.</p> <p>Please refer to PRT.RR.A6 for details of Portsmouth Water’s response to the second part of this action and our assessment and rationale.</p>	<p>No intervention required.</p> <p>Portsmouth Water provides sufficient information in response to the action on tax.</p>	N/A
	PRT.CA.A9	Required	<p>Address the following issues with tables Wr6 and Wr7:</p> <ul style="list-style-type: none"> - Table Wr6 is incorrectly completed with commentary stating that values are deployable output rather than water resource yield and post-2020 capacity is presented at a similar magnitude as pre-2020 capacity. - Table Wr7 has two options presented but one has an unusual name (Deployable Output) which is 3 borehole upgrades. Both options have no opex allocated which is also unusual. 	1 April 2019	<p>Portsmouth Water has:</p> <ul style="list-style-type: none"> - Revised Wr6 to include water resources and separated pre-2020 and post-2020 capacities. - Renamed option ‘(Deployable Output)’ in Wr7 and populated associated opex for both options presented. 	<p>No intervention required.</p> <p>Portsmouth Water provides a satisfactory response to this action.</p>	N/A

Table 2 – Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
N/A	N/A	N/A

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.

