

July 2019

Trust in water

PR19 draft determinations

Southern Water – Securing confidence and assurance actions and interventions

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PR19 Draft Determinations: Southern 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 ‘SRN’ denotes the company Southern 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 ‘SRN’ denotes the company Southern 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 Southern Water draft determination, please see the [draft determinations webpage](#).

Table 1 – Southern 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	SRN.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 original statement did not provide assurance on deliverability of large investments or that an options assessment had occurred.	1 April 2019	Southern Water provides the following updated Board assurance statement: "Large investment proposals presented in the Plan are robust and deliverable, an assessment of options has taken place, and the options proposed are the best for customers over the long term."	No intervention required. The Board of Southern Water provides a compliant assurance statement.	N/A
	SRN.CA.A2	Required	Provide restated Board assurance that the Board has identified the risks associated with delivering the plan. In the original statement the Board acknowledges that there are risks to delivery of its plan, but it did not provide assurance that it had identified these.	1 April 2019	Southern Water provides the following updated Board assurance statement: "The scale of the change programme gives rise to significant risks across a number of areas; the Board has identified and discussed the risks associated with delivering the plan and considers that the risk mitigation and management plans in	No intervention required. The Board of Southern 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
					place are appropriate for this point in time. Risk mitigation and management plans will be monitored closely to assure us that customers will be protected from non-delivery."		
	SRN.CA.A3	Required	Provide restated Board assurance that the risk mitigation and management plans the Board has in place are appropriate. The original statement did not explicitly provide assurance that appropriate risk mitigation and management plans are in place.	1 April 2019	Southern Water provides the following updated Board assurance statement: "The scale of the change programme gives rise to significant risks across a number of areas; the Board has identified and discussed the risks associated with delivering the plan and considers that the risk mitigation and management plans in place are appropriate for this point in time. Risk mitigation and management plans will be monitored closely to assure us that customers will be protected from non-delivery."	No intervention required. The Board of Southern Water provides a compliant assurance statement.	N/A
	SRN.CA.A4	Required	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: position statement' to include: <ul style="list-style-type: none"> clear Board commitment to publish detail on dividend policies in the APR and 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	Southern Water confirms its commitment to adopting the expectations on dividends for 2020-2025 as set out in the 'Putting the sector back in balance: position statement.' Its board is committed to publishing its dividend policy annually as part of its Annual Performance Report with any changes clearly signposted to stakeholders. It also commits to being transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers.	No intervention but further action needed by Southern Water. 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. It provides insufficient transparency as to: <ol style="list-style-type: none"> the specific obligations and commitments to customers; the level of performance delivery they will be considered against; and how they will impact on dividends. 	We expect Southern 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 putting the sector in balance: position statement and we expect the company to be clear about how it will take account of the particular risks to its long term financial resilience, set out in the securing long-term resilience actions and interventions tracker. We expect the company to respond to this issue in its response to our draft determination. We expect Southern Water 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.
	SRN.CA.A5	Required	On executive pay the company is required to confirm that it committed to adopt the expectations on performance related pay for 2020-	1 April 2019	In addition to the initial assessment of plans response Southern Water has provided further information on its proposed policy for 2020-25.	No intervention but further action needed by Southern Water. Southern Water proposed policy demonstrates the company's commitment	There remain some details to be finalised, for example the finalisation of the policy for 2020-25 including details of the underlying metrics and

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			<p>25 as set out in 'Putting the sector in balance: position statement' to include:</p> <ul style="list-style-type: none"> visibility and evidence of substantial linkage of executive remuneration to delivery to customers; clear explanation of stretching targets and how they will be applied; clearer explanation of how the policy will be rigorously applied and monitored; commitment to report how changes, including the underlying reasons, are signalled to customers; and commitment to publish the executive pay policy for 2020-25 once it has been finalised. <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>		<p>Southern Water states that it has embraced expectations of 'Putting the sector in balance: position statement' with regard to executive performance related pay for 2020-25. The company states that the specific metrics for 2020 onwards will be set at the end of 2019 and based upon the final determination. The company states that as an illustration of the company's commitment the 2019-20 proposals are:</p> <ul style="list-style-type: none"> - Annual bonus based on 25% Totex, 25% ODI and regulatory dates delivery, 30% customer service delivery and 20% efficient customer service delivery - Long term bonus based on 35% Totex glide path, 15% maturity assessment glide path, 20% people management, 10% data quality, 10% cash collection and 10% CRI performance. - Targets for 2019-20 have been set but for 2020 onwards are aligned to delivering the commitments in the business plan. - The remuneration committee has overall discretion to vary any bonus payments based upon critical factors. - Full details of the policy and how it has been applied will be published in the annual accounts together with any changes and the underlying reasons. <p>Southern Water commits to publishing the executive pay policy for 2020-25, once it has been finalised by the remuneration committee.</p>	to move in the direction of the expectations set out in 'Putting the sector in balance: position statement.'	<p>associated weightings and how the long term policy demonstrates a substantial alignment to the interests of customers. Once finalised, we expect Southern 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>
	SRN.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	Southern 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>Southern Water provides a satisfactory response to this action.</p>	N/A
	SRN.CA.A7	Required	Provide an external data assurance statement for App1 and ensure consistency of unit and measure reporting for PCs.	1 April 2019	Southern Water provides an external data assurance statement for App1 and ensures consistency of unit and measure reporting for performance commitments.	<p>No intervention required.</p> <p>Southern Water provides a satisfactory response to this action.</p>	N/A
	SRN.CA.A8	Required	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	1 April 2019	Southern Water includes a third party report which summarises the scope of the assurance work performed on the tax inputs. The report confirms that judgements, assumptions and methodology are considered and confirmed to be	<p>No intervention required.</p> <p>Southern Water provides sufficient evidence in response to this action.</p>	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			clarify the scope of the assurance work that was undertaken and the outcome of that work. Whilst the business plan included a reference that the capital expenditure allocations were externally reviewed, there was no mention of any other tax information.		reasonable and that no exceptions are noted.		
	SRN.CA.B1	Advised	Provide an updated financial model that is consistent with business plan tables e.g. addresses differences in capex creditor days and uses dividend yield and growth rates as advised in the guidance.	1 April 2019	Southern Water provides an updated financial model based on version 17z (as communicated to companies since the initial assessment of plans action was set) that is consistent with its business plan tables. The company provides an updated financial model with a combined dividend yield and growth of 4.52% (3.22% dividend yield and 1.30% growth).	Intervention required. Southern Water provides an unsatisfactory response to this action as the combined dividend yield and growth are below our early view of the real (CPIH based) cost of equity.	We are intervening to use our view of dividend yield and growth.

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.

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