

July 2019

Trust in water

PR19 draft determinations

South East Water – Securing confidence and assurance actions and interventions

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PR19 Draft Determinations: South East 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 ‘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 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 ‘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. Intervention numbers are preceded with a ‘C’.

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

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	SEW.CA.A1	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: position statement’ to include:</p> <ul style="list-style-type: none"> • clear Board commitment to publish detail on dividend policies in the APR. <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>South East Water confirms its commitment to adopt the expectations on dividends for 2020-25 as set out in ‘Putting the sector in balance: position statement’ including a commitment to publish details on its dividend policy in its Annual Performance Reports.</p> <p>The company states that when considering dividend payments it will take into account its performance against pre-set stretching ODI targets and its performance outside of the ODI framework, including other commitments made to customers. Its dividend policy is linked to its business plan.</p>	<p>No intervention but further action needed by South East 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> <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. 	<p>We expect South East 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. We expect the company to respond to this issue in its response to our draft determination.</p> <p>We expect South East 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.</p>

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	SEW.CA.A2	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: position statement' 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; - clearer explanation of how the policy will be rigorously applied and monitored; 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>South East Water says that it strongly believes the current executive pay arrangements reflect an appropriate balance between outcomes customers have told them are important and financial performance, and that they intend to use a similar approach in the design of the 2020-25 arrangements.</p> <p>The company has told us it has revised its policy from that submitted in the business plan and has indicated that at a high level it will now consist of the following principles:</p> <ul style="list-style-type: none"> • the award will be made based on performance in five business areas: 1) customer satisfaction, 2) operational performance, 3) delivery of responsible business commitments, 4) financial performance and 5) individual objectives. • both schemes (i.e. annual bonus and long-term bonus) will be based on the following principles c. 60%+ on operational targets including customer service and personal performance and c. 40% on financial performance. • both schemes following similar principles ensuring they are focused on short-term and long-term performance. • the annual bonus being more explicit on setting targets and assigning reward in relation to responsible business commitments including broader stakeholder considerations including employee engagement, community impacts, environmental performance etc. • the long-term bonus having a portion of the award deferred in a manner similar to the existing long term incentive plan in 2015-20. • performance thresholds typically set using targets set out in the regulatory determination, but in 	<p>No intervention but further action needed by South East 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 a number of details to be finalised, for example the finalisation and approval of the policy including the details of the underlying metrics and associated weightings for both the annual and long term bonus schemes. Once finalised, we expect South East 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>

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
					<p>some cases the target being triggered at a level that outperforms the final determination.</p> <ul style="list-style-type: none"> the remuneration committee having the responsibility for designing, monitoring and reporting executive pay in accordance with its terms of reference. commitment to report the details of the performance related pay schemes, including the awards made, transparently in the annual report. 		
Securing confidence and assurance	SEW.CA.A3	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	South East 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>South East Water provides a satisfactory response to this action.</p>	N/A
Securing confidence and assurance	SEW.CA.A4	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 clarify the scope of the assurance work that was undertaken and the outcome of that work.	1 April 2019	South East Water engaged a third party to review its tax forecasts in data table App29. In its revised submission, the company includes a report which summarises the scope of the work performed. The report confirms that the company's approach to preparing App29 is reasonable and in line with our methodology.	<p>No intervention required.</p> <p>South East Water provides sufficient evidence in response to this action.</p>	N/A
Securing confidence and assurance	SEW.CA.B1	Advised	Provide an updated financial model or business plan tables that contain consistent information in relation to trade receivables and income accruals. In addition the company should not overwrite our CPI(H) + RPI wedge calculation in 2020/21.	1 April 2019	<p>South East Water provides an updated financial model based on version 17z (as communicated to companies since the initial assessment of plans action was set) that removes inconsistent information in relation to trade receivables and income accruals.</p> <p>South East Water does not overwrite the CPI(H) + RPI wedge calculation.</p>	<p>No intervention required.</p> <p>South East 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.

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