

# IAP response executive summary



## Executive summary

We are pleased to provide Southern Water's response to Ofwat's Initial Assessment of our 2020-2025 business plan.

Our Board and Executive recognise the significant challenges to our Business Plan set out in the IAP. We have reviewed thoroughly the concerns and challenges raised and developed a comprehensive, constructive response which addresses all actions.

The enclosed response accepts the majority of challenges levelled at our plan, presents new evidence and analysis to provide greater confidence that we will efficiently deliver our environmental and customer commitments.

Our Board and Executive believe this response is a significant movement in our Plan and a clear commitment to continuous improvement, efficiency and long-term resilience. In summary we have:

- Reduced the TOTEX funding in our plan by c.£360 million
- Provided new evidence and analysis in support of the remaining c.£400m funding required to deliver the customer priorities and broader performance commitments in our Plan
- Committed to business improvement plans for past performance, incident management and operational resilience with our delivery of these plans being independently assured and reported regularly to our Board, Ofwat, the Southern Water CCG and other key stakeholders
- Accepted the challenges on ODI's in all but two areas, where we have assessed the targets to be undeliverable in the proposed timeframes
- Recommitted to full collaboration with other water companies to explore alternate strategic water resources
- Committed to adopting the expectations set out in 'Putting the sector in balance', outlining best practice on executive pay and dividend policy.

The actions outlined in this response are intended to reassure our regulators, customers and stakeholders we will meet our regulatory, environmental and societal obligations and deliver on the promises we made while reducing customers' bills by over 5%.

The rest of this summary provides an overview of how we are meeting Ofwat's concerns and the remainder of this document provides specific detail against all actions.

### Accounting for past delivery

We are two years into a transformation programme which is delivering tangible improvements across our business. We accept there is still work to do to address historical issues.

We have identified the root causes of past performance failures and are taking steps to rectify them – the recognised improvements in our customer services is testament to this. Our Pathway to PR19 programme is coordinating improvements across our organisation to ensure we start the next AMP on a sound footing. Our Operational Excellence, Water First and Environment Plus programmes are increasing efficiency, reducing risk, improving compliance and reinforcing operational resilience.

We are committed to delivering an independently assured set of action plans which further addresses the underlying issues leading to poor performance. Our delivery against these plans will be reported to Ofwat, our Board, CCG and key stakeholders to enable transparent scrutiny.

## Securing cost efficiency

We acknowledge we are not currently an efficient business and our Board and Executive Leadership Team understand the need to challenge our plans harder to deliver better value for customers.

We have used the time between submission and the IAP to undertake further optioneering and refine our approach to scheme delivery. As a result, we have reduced our Totex requirement by £366 million, and we have provided new evidence and analysis to support the £402m funding required to deliver the customer priorities and broader performance commitments in our Plan.

As we move from planning into delivery, we will continue looking for ways to deliver outcomes customers expect more efficiently.

## Securing long-term resilience

We commit to developing an action plan to implement a systems based approach to resilience. A draft will be shared with Ofwat in May 2019 – ahead of the August deadline. As with our business transformation plan, this will be independently assured and progress against it will be reported to Ofwat, our Board, CCG and other interested stakeholders.

Water resources in the South East face significant resilience challenges – intensified by the changes to our abstraction licences on the Rivers Test and Itchen in Hampshire. Meeting this challenge requires urgent, considered, action. We are working intensively with colleagues, regional and national, to identify the most appropriate strategic resource solutions. This includes undertaking additional analysis to determine the role of the Fawley desalination plant as part of a mix of regional solutions.

## Securing confidence and assurance

We support fully the expectations outlined in “Putting the sector back in balance”. In our plan we embraced Ofwat’s executive pay expectations and are introducing clear commitments for the year 2019/20.

Our revised policy will see between 64% and 68% of executive pay linked to performance and 73% of annual bonus targets directly linked to delivering for our customers, stakeholders and communities. The policy and executive pay will continue to be closely monitored by our Board Remuneration Committee.

We are committed to revising our dividend policy to align it with Ofwat’s expectations and “Putting the sector back in balance”. Our policy will be published annually, alongside a transparent explanation of how it has been applied, highlighting how any payments reflect our promises, obligations and commitments to customers. Rather than complex rules, we will share a simple set of principles which embody our commitment to ensuring a fair deal for all in line with ethical business practices.

Our Board approved revised governance terms of reference in February 2019. A copy of these is attached and will be shared on our website so customers and stakeholders can view them. Additionally, our Board has approved three revised assurance statements, on resilience, cost assessment and risk and reward, and one further statement specific to this response.

## Delivering outcomes for customers

We have rebalanced our ODIs based on the IAP feedback, but are challenging where we feel some are undeliverable in the proposed timeframes.

We have increased the rewards and penalties for key metrics including interruptions to supply, pollution incidents and leakage. Additionally, we have included ODIs for two specific WRMP schemes and to have at least 7% of households on our Priority Services Register by 2025.

### Aligning risk and return

We have provided additional evidence and benchmarking analysis, to support our financeability, cost of capital and explain our decision to update bill profiles.

This is informing our analysis of how best to use of PAYG, RCV run-off, and bill re-profiling to reduce the distance between average water and wastewater bills and to smooth annual bill profiles in line with the clear preference expressed by our customers.

### Targeted controls, markets and innovation

We are working with regional partners to develop innovative solutions to the collective challenges we face. We have expanded our approach to identifying potential bio-resources trading opportunities and are exploring innovative and market-driven options as part of our work to secure strategic water resources. We will share information about our approach to bio-resources trading and our delivery plan for our Drainage and Wastewater Management Plan (DWMP) by August 2019.

Our transformation programme is driving cultural change across our business, embedding a culture of innovation, championed by our Commercial and Innovation directorate and facilitated by our expanding bluewave innovation lab.

### Engaging customers and Addressing affordability and vulnerability

We have worked closely with our CCG throughout the development of our plan and asked them to review their previous assessments which reaffirmed they find our plan to be affordable.

We have undertaken additional customer research through which we engaged more non-household and vulnerable stakeholder groups to ensure their views are reflected in our revised commitments.

### Moving forward together

We recognise that outside of the PR19 process there is an enormous amount of change and challenge in the water and environmental sectors. To say the least we are in a period of dynamic transformation.

Our customers have asked us to invest in the future to protect and improve the environment – with Ofwat's support we can ensure that catchment-based and natural capital approaches become a more established way of sustainably improving resilience.

We are delighted to say that in the last few days we have signed an MOU with our region's three Wildlife Trusts to enter into a Strategic Partnership which will help support the delivery of a range of tangible outcomes to benefit residents, communities and the natural environment. We are also in advance discussions with the Rivers Trust and National Parks regarding signing a similar MOU in order to further expand our partnerships.

There are some exciting possibilities emerging from work done, not least at Fawley, which we believe will be significant contributors to delivery of the 25 year Environment Plan and to assist in managing future water resources in Hampshire.

We look forward to continuing to work closely with Ofwat between now and the final determination in December, in particular to explore how we can take forward catchment-based investment and innovative approaches to environmental stewardship.



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