



# Securing Confidence and Assurance

Draft Determination Representations



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# Representations within this document

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# Our approach to assuring our response to the draft determination

We, the Southern Water Services Board has continued to be actively engaged in the further development and refinement of the Business Plan since publication of the Draft Determination in July. Southern Water Services has fully considered all aspects of our plan that have been subject to challenge by Ofwat and has provided further evidence as part of our representations and intervention responses. The evidence presented in the representations and intervention responses has been subject to peer review, robust internal and independent external technical assurance as outlined in Table 1, below.

On this basis we confirm that our proposals continue to represent a high quality and ambitious business plan which ensures the right approach to deliver our customers' and stakeholders' priorities, providing value for money, sustainable and resilient services to customers.

			
<b>Richard Manning</b> Company Secretary	<b>Mike Putnam</b> Independent non-executive director	<b>Sebastiaan Boelen</b> Chief Financial Officer	
			
<b>Wendy Barnes</b> Non-executive director	<b>Sara Sulaiman</b> Non-executive director	<b>Kevin McCullough</b> Independent non-executive director	<b>Ian McAulay</b> Chief Executive Officer
			
<b>Paul Sheffield</b> Senior independent non-executive director	<b>Rosemary Boot</b> Independent non-executive director	<b>Keith Lough</b> Chairman	<b>Gillian Guy</b> Independent non-executive director

We developed an assurance plan covering amendments being submitted as part of the draft determination response. Details of the assurance undertaken and findings can be found in letters from our assurers at technical annexes TA\_CA\_Jacobs Letter of Assurance Southern Water DD Response Cost Assurance, TA\_CA\_Jacobs Letter of Assurance Southern Water DD Response Data Tables, TA\_CA\_PwC Letter of Assurance\_DD Non-financial Data Tables and TA\_LR\_Financeability of Southern Water’s Business Plan following Draft Determination.

**Table 1. Summary of external technical assurance**

Third Party Assurer	Activity	New/Repeat Activity
PwC	Review of Representations and Interventions	New
	Assessment of PCs/ODIs	Repeat
	Amended data tables (non financial)	Repeat
Jacobs	Changes to cost estimation/investment plan	Repeat
KPMG	Financeability & PAYG	Repeat

# Executive Pay

## Ofwat action reference: SRN.CA.A5

### 1. Ofwat Actions

There remain some details to be finalised, for example the finalisation of the policy for 2020-25 including details of the underlying metrics and 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'.

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. 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.

### 2. Southern Water Response

As you note we are in the process of finalising our executive performance related pay for the AMP7 period. Whilst we have already set out examples of our intent based on targets for the financial year 2019-20 you understandably would like to review final Board approved metrics. Our process and remuneration committee dates are, however, aligned with the final determination, and not the draft determination.

We would be happy to discuss further any specific queries you have based on our IAP response but will submit to you our final proposed metrics once our Remuneration Committee have met following the final determination. We intend to demonstrate that these stretching targets will be aligned with service delivery for our customers. This will then be reported annually to stakeholders through a transparent and assured performance scorecard within our annual reporting.

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# Dividend Policy

## Ofwat action reference: SRN.CA.A4

### 1. Ofwat Actions

#### 1.1 Ofwat Assessment and Rationale

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:

- 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.

#### 1.2 Ofwat Further Action

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.

## 2. Southern Water Response

Southern Water's dividend policy is set out at the end of this paper.

We can commit to a transparent application of our dividend policy that will be published annually as part of our annual reporting process. Our most recent Annual Report contained significant information in relation to our dividend policy, financial flows, and dividend payments that we will continue to build on.

The overarching principle of our dividend policy is that discretion around any dividend payments rests solely with the Southern Water Services Board operating as if it were a standalone public company. We do not believe that a prescriptive approach would be more beneficial to customers and would likely result in larger dividend payments being made; recent practice has meant the discretion applied by our Board reduces any calculated potential payments as we incorporate potential risk factors in the context of current and potential company performance.

As an example, having undertaken its assessment for financial year 2018-19 the Board has decided to make a total of £28.6 million of cash payments from Southern Water. From an accounting perspective these payments are classified as preference share interest and principal repayments, however they are considered under the dividend policy. The potential level of base dividend was calculated as £65.7 million. In addition, in reducing our preference share principal outstanding, this is consistent with our continued simplification of Southern Water's capital structure.

This potential level of base dividend is calculated as per step 1 of our Dividend Policy (see 3, below). In discussing this potential base dividend and taking into account the remainder of the dividend policy it was decided by the Southern Water Services Board that it would not make the full potential dividend payment at this time. This decision was a result of a combination of issues that will resolve over the next three to six months with a particular emphasis on our continued preparations for the Business Plan 2020–25, legacy wastewater compliance issues and ongoing financial resilience.

Going forward, in taking into account financial and non-financial performance, the Southern Water Services Board will pay specific attention to the customer promises contained within our PR19 business plan. This will specifically address our actual and forecast performance against all ODIs. As a principle we would anticipate forecast rewards to increase dividend potential, and forecast penalties to reduce dividend potential. In making any adjustment we would not only consider the potential ODI reward/penalty but also the necessary investment required to improve, or the efficiency savings we have benefitted from in performing better. For the avoidance of doubt, this considers all ODIs including those that are reputational only.

## 3. 2020-2025 Dividend Policy consistent with Annual Report 2019

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To deliver on our vision for the successful delivery of our Business Plan for 2020–25 all stakeholders must share in success: customers benefitting through enhanced service and lower bills and shareholders earning a fair return on the near £2 billion of equity invested.

When proposing payment of a dividend the directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and in accordance with the company's licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account our financial and non-financial performance. This would reflect our overall financial performance as compared to the final Business Plan for 2020–25 as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.
3. We will consider our financial resilience ahead of any dividend decision, and whether any financial outperformance should be re-invested to benefit our customers. This consideration will also include taking into account the interests of our employees, other stakeholders, and our pension schemes.

Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three we carry out an assessment of:

- Headroom under debt covenants
  - The impact on the company's credit rating
  - The liquidity position and ability to fulfil licence conditions
  - Key areas of business risk.
4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.
  5. We will publish our Dividend Policy annually (as part of the Annual Report) and highlight any changes.

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