

The Yorkshire Forum for Water Customers: Comments on Ofwat's Initial Assessment (IAP) of Yorkshire Water's PR19 Business Plan and the company's response

1. Introduction

1.1 The Yorkshire Forum for Water Customers (the Forum) is an independent group of customer and stakeholder representatives brought together under an Independent Chair to challenge the company in developing its business plan for the PR19 Price review. In particular the Forum has challenged Yorkshire Water to ensure its business plan fairly reflects the customers views gained from high quality research and engagement and that it delivers on its performance commitments.

1.2 Members of the Forum are drawn from: Citizens Advice; the Consumer Council for Water; the Environment Agency (EA); the National Farmers Union; Natural England; Pennine Prospects; and The Rivers Trust, together with independent experts on environmental issues and affordability/vulnerability.

1.3 Ofwat has reviewed the business plans of all of the companies and in January 2019 published its initial assessment, with companies being placed in one of four categories: exceptional; fast track; slow track; and significant scrutiny. Yorkshire Water, like the majority of companies, was placed in 'slow track', which means that some parts of the plan have been assessed as high quality but other areas need to be revisited. No company was considered to have submitted an exceptional plan.

1.4 This document reflects the Forum's response to the Initial Assessment of Plan (IAP) by Ofwat; and Yorkshire Water's response to the IAP observations and results. Since the production of the IAP the Forum has met on three occasions – 7 February and 5 and 22 March 2019. A meeting of the Affordability and Vulnerability sub-group took place on 21 February 2019; and a meeting of the Environment sub-group took place on 28 February 2019.

1.5 The areas that the Forum is commenting on in this supplementary report – to a lesser or greater degree dependent on the relevance to customers – are:

- * Efficiency and Costs;
- * Gearing and the Sharing of Outperformance;
- * Asset Health;
- * Support for Customers in Vulnerable Circumstances.

1.6 The Forum has concluded that it should comment on **all** areas as highlighted by Ofwat in the IAP as they all have a bearing on customer bills, and that it should not restrict itself to commenting solely on the quality and influence of customer engagement. It is clear from Ofwat's observations, and those of the Forum, that the company provided high quality customer research to underpin the production of the business plan but this has been strengthened by additional research.

1.7 The Forum's response is based upon the information available up to and including the meeting on 22 March 2019, and feedback from the Board meeting on 26 March 2019. Forum members are critical of the tight timescale set by Ofwat for company and Forum responses to the IAP, not least because the suggested changes and new engagement were substantial.

1.8 Yorkshire Water advised the Forum that in its response to the IAP it will:

- * address those areas where it accepts Ofwat is correct, or where the original plan could have been clearer;

- * provide a targeted response, where other companies have made more fully developed or innovative proposals and where the company will adopt the position of "fast learner"; or areas where the company's plans can be strengthened, for example support for customers struggling to pay their bills;

- * provide a strong defence where it does not share Ofwat's evaluation but where additional evidence is required.

1.9 The IAP has required further customer testing in three specific areas: to demonstrate how the proposed social tariff was determined through customer testing; to demonstrate how the company tested and gained customer support for multiple bill profiles between 2025 and 2030; and to demonstrate support for carbon outperformance. Forum members were consulted on the research methodology, sample sizes and the company's proposed approach in each of the three areas, and on the further acceptability testing requested by the Forum. This input included commenting on the discussion guide, the draft on-line questionnaire, the research stimulus and the presentation materials. Ofwat's deadline on the date of re-submission for the IAP resulted in "ambitious" deadlines for Forum members who nevertheless provided comprehensive and supportive responses on the proposed research. Forum members have seen the final summary report from the research.

1.10 The results of the customer research and acceptability testing reveal that the overall level of acceptability has increased to 88%, an increase of 2%; the overall affordability of the plan has increased to 84%, an increase of 18%; the overall level of long-term affordability (2026 to 2030) is 72%; the affordability of the bill profile, with smooth bills from 2020 to 2030, is 78%; the level of support for rewards and penalties is 77%; and the level of support for carbon rewards and penalties is 86%. The Forum commends Yorkshire Water on delivering high quality customer research within a very demanding timescale and for the extent of the consultation with the Forum. Debt prevention remains a priority, however there is also an increase in the numbers being able to access the social tariff and the flexible payment arrangements available to support customers.

1.11 The Forum is satisfied that the company has been fully transparent in its discussions and that it has been through a rigorous internal process. It was clear in identifying to members those areas which were 'commercial in confidence'. The Forum believes that it has had enough information to reflect upon. It has been able to influence the content of the re-submission and has proposed that a final

round of acceptability testing of the proposed bill profile should take place with customers after the development of proposals for the phasing of WINEP.

1.12 The Forum understands that Draft Determinations will be made available on 18 July 2019, with representations by 30 August 2019 – another ambitious timescale for comment. Final Determinations will be provided on 16 December 2019. The Forum will submit written responses to both Draft and Final Determinations.

2. Efficiency and Costs

2.1 The Forum is aware that Yorkshire Water does not accept Ofwat's assessment of the efficiencies it could make of 18% (£900 million) for its wholesale costs and that it was surprised by this. This results in a wholesale cost baseline of £4085 million. In contrast, the residential retail price control is 27% more efficient than Ofwat's baseline, making it the frontier company in that area. The Forum has concluded that it does not have the expertise to make an independent assessment of this in the time available, although it notes that it has seen no evidence to support such a level of efficiency being possible and is concerned that it could undermine some of the service improvements the company intends to make to reflect customer priorities.

2.2 Historically Yorkshire Water has always been an efficient company and at the start of the PR19 process the Forum highlighted that in assessing bill reductions Ofwat should take into consideration the differing costs of companies' environmental obligations and avoid over-ambitious efficiency savings as a means of achieving bill reductions. The Forum considers this to be more likely to result in weakening financial resilience than the level of gearing (see section 3).

2.3 Yorkshire Water has shared with the Forum its observations on IAP feedback on forecasted costs, particularly on leakage and WINEP, but notes the concerns the company has on its ability to deliver both an ambitious service plan and a large environmental plan if it is to deliver efficiencies of this magnitude. The proposals for the phasing of WINEP will reduce costs by circa £100 million but make limited in-roads into what Ofwat is seeking. The position paper which Yorkshire Water has commissioned, together with an industry paper from First Economics, have been shared with the Forum and provide scope for reflection.

3. Gearing, Transparency and the Sharing of Outperformance

3.1 The overall totex in the PR19 plan is circa £5.52 billion, an increase of 23% on PR14. The main drivers for this are the increase in the WINEP and the commitments to Upper Quartile performance.

3.2 Yorkshire Water has responded positively by forecasting a reduction in gearing below 70% (currently 76%). The Forum notes that current gearing has not raised issues about resilience. The company has nevertheless acknowledged that reducing gearing will further increase financial resilience and may also help to build trust and confidence in the sector. High gearing also results in adverse publicity. The Forum understands that the IAP submission will include a revised forecast that reduces the gearing of Yorkshire Water to below 70% by the end of

2021, with debt being raised by the holding company thereby ensuring no risk to customers.

3.3 It is further proposed that the costs of the WINEP should be re-phased, with some of these – circa £100 million - moved into AMP 8. This is linked to the designation of rivers in Yorkshire as eutrophic Sensitive Areas under the Urban Wastewater Treatment Directive (UWWTD), however these designations, which were expected in December 2018, have not yet occurred. Assuming these designations occur in 2019, the new phosphorus standards must be met by 2026. Forum members have some reservations in that phasing, or delay, is akin to “kicking the can down the road” in terms of investment in environmental obligations. It proposes further exploration of other options, for example well-designed catchment interventions could bring a wide range of benefits while some small lengths of rivers wait longer for phosphorous improvements. The discussions on WINEP will not be concluded by the time of the re-submission and therefore the full impact on customer bills cannot be taken into consideration at this stage, although overall the Forum is aware that the impact would be positive in terms of reduced bills.

3.4 With regard to transparency and strengthening trust and confidence in the water and sewerage industry, the company has confirmed to the Forum that any future changes to Executive pay will be published in the Annual Performance Report; and that it will ensure that it has adopted Ofwat’s expectations on dividends, as set out in “Putting the sector in balance”, and that these are more clearly demonstrated. The Forum regards these developments as being in the interests of openness and transparency and also supports moves to be more transparent about the company’s corporate and financial structures and dividend policy. The Forum does not feel able to comment on Ofwat’s observations on Direct Procurement but notes that the company intends to embed a long-term improved process.

3.5 In its initial report, the Forum highlighted that Yorkshire Water has consistently invested outperformance in areas identified as a priority by its customers, most recently leakage, supply interruptions and sewer flooding, and it does not appear to have been given full credit for this by Ofwat. Historically the company has done this with the support of customer representative bodies and not because it has been a regulatory target, and at a time when very few other companies were prepared to adopt such an approach.

4. Asset Health

4.1 The company’s performance on asset health was described as poor amongst the industry and Ofwat made the observation that Yorkshire Water had provided insufficient evidence that it would resolve the issues in an appropriate timeframe. The company was asked to set out its long-term plans to address its asset health challenges and propose appropriate service levels for asset health performance commitments (PCs); it was also suggested that the company did not provide sufficient evidence of customer support for outperformance payments on asset health. Comparisons with other companies do not necessarily compare ‘like for like’ in terms of approach.

4.2 The Forum notes, however, that somewhat contradictorily Ofwat concluded that the PCs and Outcome Delivery Incentives (ODIs) which were developed in conjunction with the Forum were “appropriate, well evidenced and stretching”, resulting in a high-quality plan. Yorkshire Water’s performance at a time of the “Beast from the East” would suggest that it is a resilient company and is able to deal with both extreme cold and drought conditions without having an adverse effect on customers. The Forum has emphasised to Yorkshire Water that all changes must remain consistent with customer preferences and not looked at in isolation and that the Forum would not expect to see any deterioration in service. Overall, however, there has been a limited amount of time to deal with the detail of proposed revisions to PC’s and ODI’s.

4.3 The Forum has discussed targets for mains repairs, sewer collapses, treatment works, external sewer flooding leakage, internal sewer flooding and pollution incidents. The Forum has been particularly mindful of the need to better address pollution incidents and has been well briefed at its meetings by EA representatives.

5. Support for Customers in Vulnerable Circumstances

5.1 The Forum was surprised and disappointed by Ofwat’s somewhat negative assessment of Yorkshire Water’s support for customers in vulnerable circumstances as it has long considered the company to be a leader in this area, with a wide range of “offerings”. Other companies, who have a reduced or inferior range of opportunities, appear to have been given more credit. This has led the Forum to question whether Ofwat’s observations are primarily linked to the bill profile which was in the PR19 submission, rather than company performance in this area. The Forum notes that only a small number of companies tested the affordability of their plans with customers in their initial PR19 submissions and the Forum considered this to be one of the many strengths of the company’s approach to customer engagement.

5.2 The Forum’s advice was that the company should be more “vocal” about what it does to prevent customers falling into debt, the range of payment options and the provision which will be made available to customers through its social tariff. The Forum has commented on Yorkshire Water’s revised submission for this area, which includes an overview of the company’s approach to affordability and the actions taken in response to Ofwat’s assessment. As a result of the additional investment – £2 million a year for 5 years and a total of £1.75 per customer for 5 years - the number of households receiving direct support by 2025 will increase from 26,000 to 83,000 and an additional 60,000 households will be helped through flexible payment options, third party advice and targeted home visits.

5.3 The Forum supports the revisions made as a result of the IAP. Although it does not share the initial observations, it acknowledges that Yorkshire Water could have better promoted its approach to addressing affordability and its “suite of options”, consistent with its reputation and performance with caring organisations and debt management agencies.

5.4 The Forum welcomes Yorkshire Water’s proposal to establish a ‘rotating’ panel of experts, which will move from area to area, to support the company’s work in addressing vulnerability. The panel has now met twice and this work will be

monitored and assessed by the affordability and vulnerability sub-group, reporting to the main Forum. The Forum supports the company's partnership-based approach to its work and the safeguarding arrangements put in place internally.

5.5 The Forum challenges Ofwat's view of the value of a PC linked to the numbers on the Priority Services Register. This is a minimalist approach, based solely on "number crunching" rather than the quality of provision. It is aware that Yorkshire Water is being asked to increase numbers but does not regard this as sufficiently aspirational, although it did recommend higher targets and greater ambition than those first proposed. The company has now identified three new areas that have been included in the PC for Direct Support to Customers for those on less than the minimum wage.

6. Conclusion

6.1 The Forum welcomes the improvements which have been made to Yorkshire Water's business plan and believes that customers will receive a high-quality service at a lower cost, provided the drive for efficiency savings does not override other considerations. The increase in the number of vulnerable households who will receive support through the social tariff and the range of offerings to prevent customers getting into debt or for managing the payment of bills are particularly welcomed and innovative.

6.2 The Forum has been advised that the current proposals will result in stable bills, as compared with a £14 increase over 5 years. Levels of customer acceptability are provided in para 1.10 and it is hoped there will be further acceptability testing to assess the impact of the phasing of WINEP on customer bills.

6.3 The Environment sub-group and the Forum will be consulted on the proposals to phase WINEP given that the designations due in December 2018 have not yet been issued by Defra. Initial indications are that delays to designations and associated re-phasing of the work and associated costs may result in further bill reductions. An updated WINEP will be published on 29 March 2019 and only minor changes are expected. The sub-group will also consider costs for the 8 Water Framework Directive (WFD) catchment schemes where deadlines are extended into PR24. The Forum notes that some catchment schemes are only open to higher performing companies and the EA has advised that Yorkshire Water's performance, which will not be confirmed until June/July 2019, means that no assumptions can be made on the approaches and costs for these 8 WFD schemes.

6.4 Clearly the company response to the IAP is not the end of the process. Yorkshire Water must await Ofwat's response to all of the evidence it submits and develop appropriate plans. The Forum's input therefore remains 'work in progress'. The Forum is satisfied that it is the Board's ambition to have oversight for providing a high-quality service to customers in the region at the lowest possible cost, including protecting those who are vulnerable.