



**Our response to Ofwat's
initial assessment of our plan**

INTRODUCTION TO OUR IAP RESPONSE

This document forms part of our regulatory price review process (PR19). In September 2018 we submitted our PR19 business plan to Ofwat, our economic regulator. Our PR19 business plan contains our proposed service levels and costs for the period 2020 to 2025 and is set in the context of our long-term strategy. You can find our [PR19 business plan](#) and our [long-term strategy](#) on our website.

Ofwat reviewed all companies' business plans and published its initial assessment of plans (IAP) in January 2019. Depending on its view of the overall quality of each plan, Ofwat placed each company into one of four categories: exceptional, fast track, slow track

and significant scrutiny. We were placed in the slow track category. Ofwat found that parts of our plan were high quality and that other parts needed further work or additional evidence.

This assessment resulted in a series of actions that we needed to complete by 1 April 2019. This document summarises our response to those actions.

We value the feedback provided by Ofwat and have considered it carefully with our Board and our customers' independent challenge group, the Yorkshire Forum for Water Customers (the Forum).

IN OUR RESPONSE WE HAVE MADE A NUMBER OF IMPORTANT CHANGES:

- We have adjusted our plan so that we are now able to propose a stable bill. Before inflation, the bill will not increase from 2019/20 prices, meaning that our customers will benefit from a decade of stable or falling bills.
- We have increased the company-funded support for customers who are struggling to pay their bills.
- We are starting work to reduce our gearing and plan to keep it below 70% from 31 March 2021.
- We have highlighted that it may become possible to re-phase our large environmental programme, which may lead to a bill reduction.

Our response also explains that there were two important areas in which we did not agree with all of Ofwat's feedback:

COSTS

We were surprised by the extent of what Ofwat considered was inefficiency. Having looked in detail at Ofwat's feedback, we believe that the approach it used did not completely recognise the impact of our ambitious targets to improve performance and our large environmental programme. So, we have provided additional high-quality evidence to Ofwat to explain these issues and suggest ways to better separate efficiency from activity.

PERFORMANCE COMMITMENTS AND FINANCIAL INCENTIVES

We have shared with Ofwat our concerns that its approach risks creating a disconnect between the targets set and the costs allowed, as well as reducing the importance of what our customers have told us. It is simply not possible

for any company to deliver major changes in performance without incurring additional costs. So, where Ofwat wants to change its policy and requires companies to meet different performance standards, this must be considered alongside the efficient costs of doing so. Again, we have provided additional high-quality evidence to help explain these issues.

As with the development of our PR19 plan, we have engaged actively with the Forum throughout and would like to thank Forum members for their ongoing involvement and support.





WE HAVE RE-TESTED OUR PLAN WITH CUSTOMERS AND ARE PLEASED TO REPORT:

88%

SUPPORT OUR PLAN

2%
↑

IMPROVEMENT FROM OUR ORIGINAL PLAN.

84%

FIND OUR PLAN AFFORDABLE

18%
↑

INCREASE FROM OUR ORIGINAL PLAN.

Our response has been developed with the active involvement of our Board. Changes to the plan have been fully assured and the Board has updated its Board assurance statement.

ABOUT THIS DOCUMENT

This document explains how we have developed our IAP response and what it contains.

It covers:

- The role of our Board and the assurance of our IAP response.
- How we have approached our review of the feedback, the changes we have made and areas where we have provided additional evidence to support our plan.
- The steps needed to finalise our Water Industry National Environment Programme (WINEP).
- How our response provides the best plan for our customers and the environment.

BOARD SUPPORT AND ASSURANCE

As with our PR19 plan, our Board's aim is to produce a high-quality IAP response that meets the expectations of customers in delivering the services they need, now and in the future, at a price they can afford to pay.

Our Board has been accountable for the leadership and preparation of our IAP response.

To lead the discussion on the development of the plan, our Board conducted several workshops. The workshops were used to challenge management and satisfy

our Board that the IAP response met the expectations of customers and stakeholders. Our Board used the workshops to ensure the IAP response continued to follow its strategy for addressing the long-term challenges of climate change, population growth, all-round resilience and affordability.

Our Board has applied robust assurance in the preparation of the IAP response. Our assurance approach is risk-based and aligned to the 'three levels of assurance' framework. This is best practice and is set out in our published [Assurance Plan](#).



OUR RESPONSES TO OFWAT'S FEEDBACK

WE VALUE THE FEEDBACK WE HAVE RECEIVED FROM OFWAT AND HAVE CONSIDERED IT VERY CAREFULLY WITH OUR BOARD AND THE FORUM.

We have thought carefully about what is in the best interests of our customers and is in line with the promises that we have agreed with them in our PR19 plan.

In accordance with Ofwat's feedback, we have focused on the following themes:

- Increased support for customers who are struggling to pay their bills.
- Further improving our financial resilience and building trust and confidence in the sector.
- Delivering best value for customers through cost efficiency.
- Managing the health of our assets.
- Our performance targets and the associated package of incentives.
- Our approach to Direct Procurement for Customers.

THIS SECTION STEPS THROUGH EACH OF THESE AREAS, PROVIDING AN OVERVIEW OF OUR ANALYSIS AND THE RESPONSE TO THE ACTIONS RAISED.

INCREASED SUPPORT FOR CUSTOMERS WHO ARE STRUGGLING TO PAY THEIR BILLS

OFWAT'S FEEDBACK

Ofwat noted that our PR19 plan contained high-quality initiatives to address overall affordability but asked us to look again at the levels of support for customers who are struggling to pay their bills. Ofwat also challenged us to be clearer about how we tested our long-term bill profile with our customers to ensure that they found it acceptable.

OUR RESPONSE

We have shared the feedback with our Board and the Forum, reflecting very carefully and challenging ourselves to do more for customers who find themselves in vulnerable situations. We are amending our plan with the following actions:

SUPPORT FOR CUSTOMERS STRUGGLING TO PAY THEIR BILLS

WE WILL INCREASE THE NUMBER OF HOUSEHOLDS RECEIVING DIRECT SUPPORT BY 2025 FROM OUR CURRENT POSITION OF 26,000 HOUSEHOLDS TO 83,000.

This will be made possible by increasing the company contribution to the social tariff from the current level of £2.5 million between 2015 and 2020 to £10 million between 2020 and 2025. We also asked customers if they were willing to increase the level of support funded through our prices, but they preferred not to.

An additional 60,000 households will be helped through flexible payment options, third party advice and targeted home visits.



PLAN ACCEPTABILITY AND OUR LONG-TERM BILL PROFILES

We have carried out additional customer acceptability testing.



FIND IT AFFORDABLE



SUPPORT THE PLAN

We have carried out additional customer research regarding our long-term bill profiles.
72% of customers find the bill profile up to 2030 affordable.

OUR 2020 TO 2025 BILL PROFILE

Our average bill profile has been adjusted as part of the IAP review process in response to new information regarding some of our targets. This has moved the average bill from a proposed increase of around £3 a year to no real increase (excluding inflation) over the period.

**THIS IS EXCELLENT NEWS FOR CUSTOMERS, WHO
WILL RECEIVE BETTER SERVICES FOR THE SAME
AVERAGE COST AS NOW.**

FURTHER IMPROVING OUR FINANCIAL RESILIENCE AND BUILDING TRUST AND CONFIDENCE IN THE SECTOR

OFWAT'S FEEDBACK

Ofwat instructed us to carry out a number of actions to ensure we meet the expectations set out in its 'putting the sector back in balance' publication.

Ofwat challenged us to be even more transparent about our corporate and financial structures. We publish information in our annual performance report (APR) but Ofwat seeks further information about how our financial and corporate structures affect our financial resilience.

OUR RESPONSE

We are committed to helping improve trust and confidence in the sector and have looked hard at what more we can do in this area. We have made the following adjustments to our PR19 plan:

EXECUTIVE PAY POLICY

Ofwat states that our plan 'demonstrates high quality in the round' in respect to executive pay. We confirm that any future changes to the policy will be published in our annual performance report.

DIVIDEND POLICY

We have confirmed that we are committed to adopting all the expectations on dividends

for 2020-25 as set out in Ofwat's 'putting the sector in balance' publication. This will build even greater confidence that our dividend policy is fair, transparent and considers the long term.

OUR PROJECTED GEARING FOR 2020 TO 2025

We will take steps to reduce our gearing and will **target gearing of below 70% by 31 March 2021**. We will also include Ofwat's default financial sharing mechanism in our PR19 plan. Following receipt of draft and then final determinations, we will review the package in the round and, if necessary, fine tune our financing plan to reflect the determinations and financial market conditions.

WE BELIEVE THAT THESE ACTIONS WILL RESOLVE THE CONCERNS RAISED BY OFWAT AND DEMONSTRATE OUR CONTINUED DRIVE TO IMPROVING TRUST AND CONFIDENCE IN THE SECTOR.

DELIVERING BEST VALUE FOR CUSTOMERS THROUGH COST EFFICIENCY

OFWAT'S FEEDBACK

According to Ofwat's historical cost efficiency modelling we have been the second most efficient company in our water price control and the fourth most efficient in our wastewater price control. This is in line with the results of the regular benchmarking that we undertake and confirms we are an efficient company.

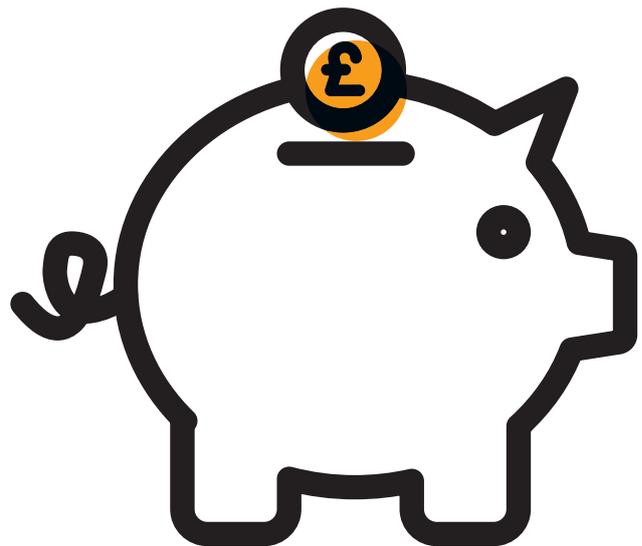
In contrast, Ofwat's PR19 cost analysis suggests that our forecast costs are about 18% more than Ofwat's view of an efficient company for our wholesale area.

Ofwat found our residential retail price control to be 27% more efficient than its baseline, making us the frontier company in that area.

OUR RESPONSE

We were very surprised by this feedback because of our strong track record for efficiency built up over 20 years. Our average bill has been consistently below the industry average level. We have also applied the same stretching efficiency targets for PR19 as we have for our previous plans.

Our long track-record of cost efficiency has been achieved by responding to all changes based on good evidence, following sound economic principles and tailored to specific circumstances. We are concerned that Ofwat's approach may put the promises we have agreed with our customers at risk. Placing efficient companies



in a position where they cannot meet commitments due to insufficient funding is not in the interests of customers.

Having looked in detail at the feedback, we believe that the approach used has not completely recognised the impact of our ambitious targets to improve performance and our large environmental programme. So, we have provided additional evidence to explain

these issues and suggest ways to better separate efficiency from activity.

We have provided Ofwat with detailed, high quality evidence to support the position that, our costs to meet the requirements are efficient, and therefore should be allowed.

Our response to the feedback in the IAP on costs has been considered very carefully with the Board and the Forum. We have provided additional evidence and adjusting our costs where we have robust evidence to do so and where we firmly believe that it is in the best interests of our customers.

We will continue to challenge ourselves to provide the best service at the lowest possible costs. We are concerned that the IAP assessment methods have penalised an efficient company with an ambitious service improvement plan and a large environmental programme. These penalties jeopardise our ability to deliver on those plans.



MANAGING THE HEALTH OF OUR ASSETS

OFWAT'S FEEDBACK

Ofwat found that overall, we provided performance commitments that were appropriate and well evidenced, with stretching service levels.

Ofwat has asked for more evidence to support some of our proposed service levels.

OUR RESPONSE

We have long-term plans in place to maintain the health of our assets. We take the health of our assets extremely seriously and ensure that our assets are maintained in the most cost-effective way for our customers. After engagement with our Board and the Forum we are taking the following actions:

INVESTING AT THE RIGHT TIME

To ensure that we invest in the right places, at the right time, we consider the impact of potential asset failures on the services our customers receive. For example, we are repairing many more leaks – this does not impact directly on the service customers receive. However, interrupting the water supply does impact on our customers, so even though we are repairing many more leaks, we are reducing the number of times we interrupt supplies by working differently.

REPORTING CONSISTENCY

As an example, Ofwat has asked us to exclude proactively found sewer collapses, as other companies do not include these in their reporting. We have adjusted our reporting, putting it in line with other companies. We have also supplied additional evidence to support our long-term targets.

ABSTRACTION INCENTIVE MECHANISM (AIM)

Ofwat has asked us to provide further evidence to prove that we do not have any water abstraction sites that would qualify under AIM. We have worked closely with the Environment Agency to supply additional evidence confirming that we do not have any abstraction sites that require AIM.

Yorkshire Water is a resilient company, evidenced by our performance during the extreme cold and the prolonged drought experienced in 2018. Ofwat notes our preparation for and response to the 'Beast from the East'. The prolonged drought conditions experienced in Yorkshire did not impact on the service our customers received.

OUR PERFORMANCE TARGETS AND THE ASSOCIATED PACKAGE OF INCENTIVES

OFWAT'S FEEDBACK

Overall, Ofwat concluded that our performance commitments and outcome delivery incentives (ODIs) are 'appropriate, well evidenced and stretching' and make for a 'high quality plan'. However, Ofwat has requested a significant number of amendments to our performance commitment and ODI package and we have reviewed these carefully.

OUR RESPONSE

We are concerned that Ofwat's approach risks creating a disconnect between the targets set and the costs allowed, as well as reducing the importance of what our customers have told us. It is simply not possible for any company to deliver major changes in performance without incurring additional costs. So, where Ofwat wants to change its policy and requires companies to meet different performance standards, this must be considered alongside the efficient costs of doing so. Again, we have provided additional high-quality evidence to Ofwat to help explain these issues.

If we were to implement all of Ofwat's changes, the performance commitment and ODI package would no longer reflect what our customers have asked of us. It would be harmful to customers and the company because it materially changes the balance of the package as evidenced by our 'return on regulated equity' range modelling. If you would like to read more about this please go to our ['Delivering outcomes for customers'](#) supporting document.

DIRECT PROCUREMENT FOR CUSTOMERS

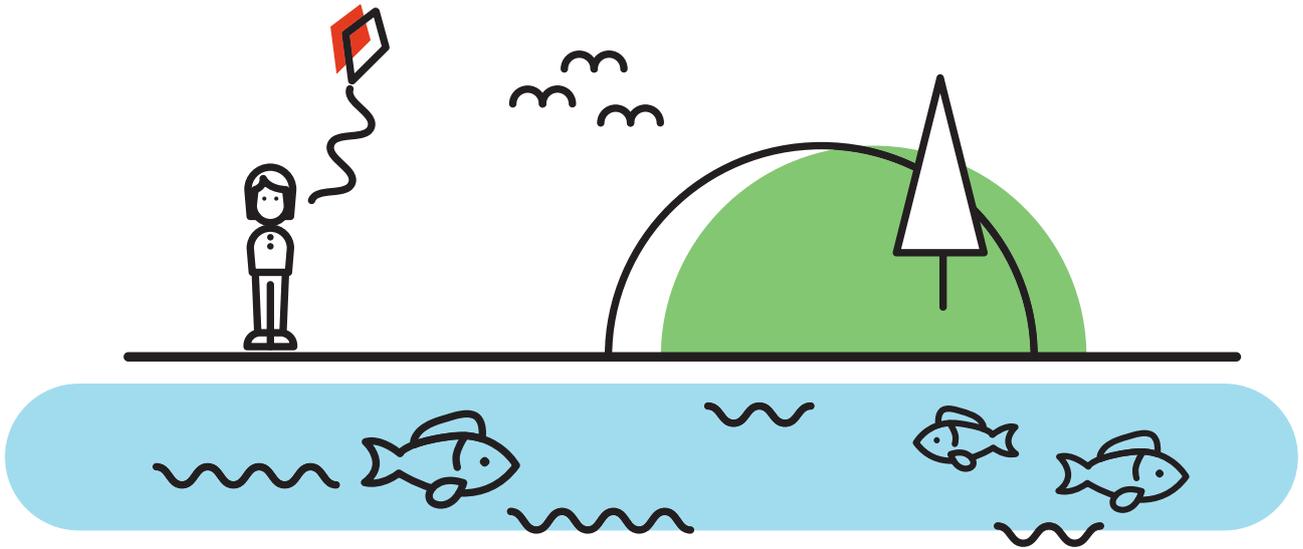
OFWAT'S FEEDBACK

Ofwat stated that we provided limited evidence to demonstrate we have fully considered Direct Procurement for Customers.

OUR RESPONSE

We are committed to finding the best delivery models that keep costs low for our customers. We consider Direct Procurement for Customers to be an area where we can learn from the approach taken by other companies. We have fully reviewed our process in line with Ofwat's requirements and are embedding an improved Direct Procurement for Customers process. We have reviewed our original analysis using external experts and have re-confirmed that we do not have a qualifying scheme at this time.





THE NEXT STEPS NEEDED TO FINALISE OUR WINEP

Our original PR19 plan contained roughly £900 million of expenditure to deliver the environmental improvements required by the WINEP programme. Much of the programme was based on the expectation that a number of rivers in Yorkshire would be designated to a higher environmental standard in December 2018.

These designations are still anticipated but had not yet occurred at the point we submitted our IAP response. When designations are made, the rivers must be compliant within seven years, which is likely to go beyond the 2020-25 period.

We are working closely with the Environment Agency and Defra to establish when the designations are planned.

There is still uncertainty in this area and we are looking at how the WINEP investment should be re-phased because of the delay. We will continue to work with our Board, the Forum, Ofwat, the Environment Agency and Defra to confirm this re-phasing. **This should further reduce our average bill for the 2020-25 period** as some of these costs will move into 2026.

OUR REVISED STABLE BILL FOR 2020-25 MEANS THAT CUSTOMERS IN YORKSHIRE WILL SEE A DECADE OF STABLE OR FALLING BILLS.



HOW OUR RESPONSE PROVIDES THE BEST PLAN FOR OUR CUSTOMERS AND THE ENVIRONMENT

The development of our PR19 plan saw a step change in the nature of the conversations we held with our customers, making sure that we really understood their wants and expectations. It built on our strong track record of efficiency whilst improving the services that matter most.

We have reviewed Ofwat's feedback carefully with our Board and the Forum. We have concluded that in some areas we should provide additional evidence and in other areas we should amend our plan to make it even better for our customers.

This means that we have been able to adjust our average bill profile so that before inflation it does not increase. Additionally, the services we are offering deliver

significantly greater value for our customers. We will triple the number of households that are supported through our social tariff in addition to all the other support we already have in place. Our approach centres on using data to identify and support customers before they fall into debt.

We are targeting a reduction in our gearing and have taken steps to ensure that we comply with all aspects of the outcomes of Ofwat's work on transparency and trust. We have provided further evidence as to why we believe our costs are appropriate. We have re-tested the acceptability of our plan with our customers, now and into the long term.

OUR PLAN IS THE START OF A STEP CHANGE FOR US, MOVING INTO A SUSTAINABLE, DEMAND MANAGEMENT FUTURE, WORKING WITH OUR CUSTOMERS AND STAKEHOLDERS TO DELIVER THE BEST OUTCOMES FOR YORKSHIRE.



WE WOULD LIKE TO THANK THE FORUM FOR ITS CONTINUED ENGAGEMENT AND SUPPORT IN THE PR19 PROCESS AND ALL OUR CUSTOMERS WHO HAVE BEEN INVOLVED IN THE RESEARCH THAT SUPPORTS OUR PLAN.



WE HAVE LISTENED CAREFULLY TO OFWAT'S FEEDBACK AND FOLLOWING BOARD AND FORUM ENGAGEMENT HAVE MADE KEY CHANGES THAT IMPROVE OUR PLAN AND BRING ADDITIONAL BENEFITS TO OUR CUSTOMERS.

This document summarises the IAP response we submitted to Ofwat on 1 April 2019. It is designed to briefly provide you with the main points of our IAP response so that you can see how we have responded to Ofwat's IAP feedback.

The full IAP response is available on:

WWW.YORKSHIREWATER.COM/OURBUSINESSPLAN

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Yorkshire Water Services Limited, Western House, Halifax Road,
Bradford. BD6 2SZ. Registered in England and Wales No2366682

