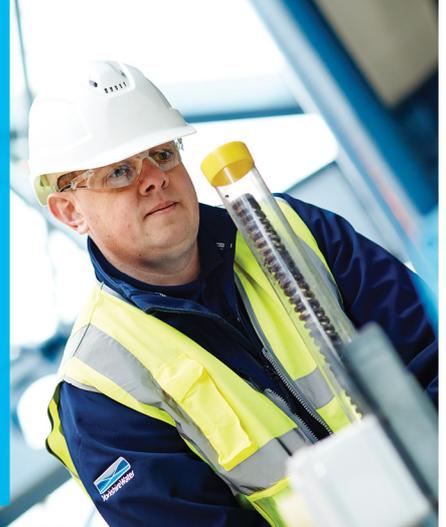


Business retail price review 2016

Yorkshire Water submission

20 July 2016

It's part of our
Blueprint for Yorkshire



YorkshireWater

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Foreword

This is Yorkshire Water's submission for the business retail price review 2016. The purpose of this document is to support the tables submitted for the review and to demonstrate the approach we have taken to review the data and assumptions made at PR14. It includes the approach we have taken to assure the review submission and the engagement we have had with our business retail customers during the review process.

The review has been comprehensive and subject to internal and external assurance. We have taken the same robust approach in relation to costs understanding, tariffs creation, customer and Customer Forum engagement as with previous submissions to Ofwat. We can confirm that the costs included within our PR14 plan and our approach to customer service will remain unchanged, and that whilst there are adjustments to cost and profit margin allocations within our default tariff bands, these adjustments are minor and have not led to any incidence effect for our customers.

We are confident that our submission provides a set of default business retail tariffs for Yorkshire that are fair, transparent, easy to understand and supported by our customers. We have also ensured that our default tariffs follow the guidance and will allow the bands to be assessed in the common structure as proposed in the business retail price review 2016.

Board assurance statement

The Yorkshire Water Board (the Board) members confirm that Yorkshire Water (the Company) has produced a high quality submission for the business retail price review 2016. The Board confirms that sufficient, transparent governance has been put in place to develop this plan.

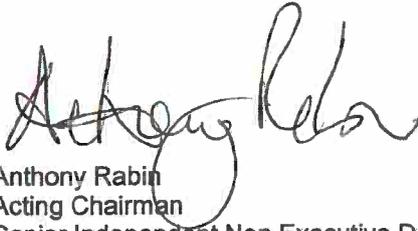
To satisfy ourselves that our plan is complete, accurate and efficient, we have instigated an extensive process of assurance. We have mirrored the approach used in our annual reporting process, which is ISO9001 certified. This represents best practice as it is both long-established (since 2007) and externally verified. In particular, the Board has also noted that:

- The assurance process undertaken includes audit checks and challenges by data providers, senior managers, Executive Directors, the Regulation team, external independent auditors and the Yorkshire Water Non Household Retail Price Re-Opener Steering Group (the Steering Group).
- Feedback from the Customer Forum and findings from customer engagement have been fully considered and have been satisfactorily resolved.
- Findings from the assurance processes have been reviewed by the Steering Group and any matters arising have been satisfactorily resolved.
- The text within this submission adds explanation to and explains the assumptions behind the data submitted where necessary.

The Board can specifically confirm that, in its opinion:

- The information provided in the submission is consistent with legal obligations (including, where relevant, the prohibitions on undue discrimination or preference in licence condition E, the licence condition R and the charging scheme issued by Ofwat under section 143B of the Water Industry Act 1991) and competition law.
- Our proposals have been reasonably informed by customer engagement and have been discussed with the Customer Forum.
- The allocation of costs and margins to the default tariff caps are reasonable and robust.
- Data tables have been completed accurately and are consistent with Ofwat guidance.

Signed by
Yorkshire Water Services Limited
Board of Directors



Anthony Rabin
Acting Chairman
Senior Independent Non Executive Director
Chair of the Audit Committee



Richard Flint
Chief Executive



Liz Barber
Director of Finance, Regulation & Markets



Charlie Haysom
Director of Service Delivery



Nevil Muncaster
Director of Asset Management



Martin Havenhand
Independent Non Executive Director



Raymond O'Toole
Independent Non Executive Director



Kath Pinnock
Independent Non Executive Director



Chantal Forrest
Company Secretary

Our approach to assurance

We have made sure throughout the business retail price review process that the data and information we have used to construct our submission is fully assured and built on robust data to provide confidence to the Board, Customer Forum and Regulators in the processes we have followed.

Assurance is essential to establishing confidence in our submission and we have continued to seek this through both internal and external challenge during the planning and submission process. We have mirrored the approach used in our annual reporting process, which is ISO9001 certified. This uses a 'three lines of defence' principle and is representative of best practice.

We have assigned a named data provider for the information required to support this submission. They have specific roles and responsibilities for providing the information. The information used to compile this submission is subject to internal review by senior managers before being presented to the responsible Director.

Assurance statements are required from senior managers involved in regulatory reporting. These statements are used to provide the Board with evidence and confirmation that data is true and accurate and has been produced in a manner consistent with reporting requirements. This provides our first level of assurance (also known as a first line of defence).

A peer review / internal quality assurance review of the information is undertaken by experts within the business. This provides our second level of assurance (also known as a second line of defence).

Our information and the process to obtain this information is reviewed and challenged by external independent technical auditors. External advice has been provided by First Economics and external independent assurance has been provided by Ernst and Young. PwC have audited our annual performance report which has provided the financial information used within this submission. This provides our third level of assurance (also known as a third line of defence).

Our ongoing customer engagement has informed our submission and we have an established process with the Customer Forum to ensure that we are held to account for meeting the promises we make to our customers.

As well as following a 'three lines of defence' principle, there are a number of other common principles that we apply to our regulatory reporting assurance processes. We apply these principles at all stages in our process. The common principles applied to our assurance processes are:

- Evidence based
- Risk based
- Having clear accountabilities
- Based on honesty and transparency
- Regularly reviewed

Our assurance processes have been approved by the Board Audit Committee, providing additional assurance to the Board. The Board Audit Committee and the Board review and approve the overall submission.

Assurance is about providing confidence, and a level of certainty that information or data is correct. While we can state some information with absolute certainty, the majority is always subject to some margin of error. What matters to us is that the information is reliable and accurate enough to give our stakeholders and customers confidence that they have a view of our performance that they can trust and understand. The amount of assurance activity we carry out is determined by balancing what we need to do to meet these needs against any risks or areas of weakness we identify through our assurance processes or in conversation with our customers and stakeholders.

Listening to our customers and stakeholders

Customer engagement

At PR14, 87% of our business retail customers supported our business plan. During the price review engagement programme, business retail customers asked us to re-engage with them on our retail default tariffs prior to the retail market opening in 2017, particularly if the retail tariff structures were to change. We wanted to discuss these with our business retail customers and the Customer Forum. We therefore commissioned research to consult with a representative sample of our business retail customers to:

- Explore business retail customers level of understanding of the retail market opening
- Understand business retail customers level of interest in the retail market opening
- Explore business retail customers understanding of our current default tariff structures
- Explore business retail customers thoughts on a potential new default tariff structure

To do this we conducted 15 face to face in-depth interviews and 200 interviews via an online survey.

Overall, 74% of business retail customers stated that it was important that we discussed these changes to the retail tariff structures with them. This was also evident in the face to face interviews as the majority of business retail customers told us it was important for us to test these changes with them despite only being considered minor adjustments.

Overall, 42.5% of business retail customers told us that the minor adjustments to the retail tariff structures were 'fair'. Only 5.5% of business retail customers told us they were 'unfair'. In the face to face interviews, business retail customers did not have a lot to say on the tariff structures. This view is observed in the results of the online survey with 36.5% of business retail customers saying the proposed changes were 'neither fair/nor unfair' suggesting they do not have a strong view either way. The remaining 15.5% of business retail customers said they didn't know if the proposed tariffs were fair or unfair. The table below provides the overall results, as well as a breakdown of results by size of business. Table 1 below provides further analysis of responses by size of business.

	Overall	Size of Business		
		Small	Medium	Large
Fair	42.5%	34%	48%	68%
Neither Fair/Nor Unfair	36.5%	44%	30%	19%
Unfair	5.5%	5%	6%	6%
Don't Know	15.5%	18%	16%	6%

Base: Overall 200 respondents (Small 119, Medium 50, Large 31)

We observed no inconsistencies between our qualitative and quantitative results. The overall findings conclude that the majority of retail business customers were either in favour or felt that they had no strong opinion on the movements.

Customer Forum statement

“The role of the Customer Forum has been to challenge Yorkshire Water’s customer research and engagement activity and to comment on the extent to which these have met the expectations and requirements set by Ofwat. The Customer Forum has been able to consider the approach Yorkshire Water has taken to engage with its business retail customers, as well challenge the assumptions and conclusions presented in its submission document. These challenges have been fully considered and responded to by the company in a transparent manner.

As Chair of the Customer Forum, I can confirm that Yorkshire Water has attended the Customer Forum to discuss with members the methodology and approach to customer engagement and the proposals within the Business Retail Price Control Re-Opener submission. We are fully satisfied with the level of transparency and the approach adopted.”

Andrea Cook
Chair of the Customer Forum
July 2016

Our review

2015/16 Outturn Reconciliation

Table 2 below shows an extract of 'table 2C – operating cost analysis' from the Annual Performance Report (APR). In addition to the outturn figures for the year ended March 2016, additional columns have been included to show the original PR14 submission, a variance column between the two and an explanation for the variances.

Table 2: APR Table 2C – Operating costs analysis – retail

For the 12 months ended 31 March 2016							Reason for Variance		
Line description	Units	DPs	Non-household	PR14 Submission	Variance	Economic Factors	Preparation for market opening	Change from PR14	
Operating expenditure									
1	Customer services	£m	3	2.012	1.937	0.074	0.074	-	-
2	Debt management	£m	3	0.365	0.428	-0.063	-0.063	-	-
3	Doubtful debts	£m	3	1.062	1.418	-0.356	-0.356	-	-
4	Meter reading	£m	3	0.277	0.253	0.024	0.024	-	-
5	Services to developers	£m	3	0.072	0.371	-0.299	-	-	-
6	Other operating expenditure	£m	3	1.368	0.507	0.862	0.025	0.837	-
7	Total operating expenditure excluding third party services	£m	3	5.156	4.914	0.241	-0.296	0.837	-
8	Third party services operating expenditure	£m	3	0.000	0.000	0.000	-	-	-
9	Total operating expenditure	£m	3	5.156	4.914	0.241	-0.296	0.837	-
10	Depreciation	£m	3	0.875	0.608	0.267	-	-	0.267
11	Total operating costs	£m	3	6.031	5.522	0.508	-0.296	0.837	0.267
12	Debt written off	£m	3	1.062	1.418	-0.356	-	-	-
PR16	Total Operating costs excluding Developer Services	£m	3	5.959	5.151	0.808	-0.296	0.837	0.267

Overall the company has seen a cost increase in the year of £808k against the original PR14 submission. This excludes the cost of services to developers as they are not included in the review.

Table 2 has categorised these cost increases into the following areas:

- Economic factors
 - This is where there has been no change to the methodology, but the outturn is different to PR14. This category shows inflation increases along with a lower value of doubtful debts both as a result of the economy at this present time.
- Preparation for market opening/decisions made by the company
 - This category shows that we have made a decision to spend more than allowed in PR14. These costs are mainly due to a dedicated team who are planning and implementing the requirements for market opening, including understanding the implications as an incumbent retailer, separating processes, and aligning people to the relevant market codes.
 - There was an assumption £300k for market opening within 2015/16; to date we have seen an overspend £127k. These costs are associated with separating processes and people to align with the relevant market codes.
- Change from PR14
 - We have reviewed the level of depreciation charge in 2015-16 which has resulted in an increase of £267k. This review will not impact on future years depreciation charges.

The methodology and governance for the outturn figures stated above are included within the APR document for Yorkshire Water, table 3 below shows the retail household/non household methodology from the APR.

Table 3: APR methodology of retail household and non-household methodology

Activity	Company	2015/16 Cost Driver	2015/16 Why considered appropriate	2014/15 Cost Driver
Retail household / non-household				
Customer Services - Billing	LCML	Number of bills	Per Ofwat RAG 2.05	Number of bills
Customer Services - Payment	LCML	Number of payments	Per Ofwat RAG 2.05	Number of payments
Customer Services - Charitable trust donations	YW	N/A	N/A	N/A
Customer Services - Vulnerable customer schemes	LCML	100% household	Per Ofwat RAG 2.05	100% non-household
Customer Services -Non-network enquiries and complaints	YW / LCML	Volume of contacts	Timesheets are not available so Ofwats second preference has been used	Volume of contacts
Customer Services - Network enquiries and complaints	YW / LCML	Volume of contacts	Timesheets are not available so Ofwats second preference has been used	Volume of contacts
Customer Services First time investigatory visits - Retail	YW	Volume of visits	Timesheets are not available so Ofwats second preference has been used	Volume of visits
Customer Services - Other customer services	YW / LCML	N/A	N/A	N/A
Debt management	YW / LCML	Debt o/s over 30 days	Per Ofwat RAG 2.05	Debt o/s over 30 days
Doubtful debts	YW	Direct allocation	Per Ofwat RAG 2.05	Direct allocation
Meter reading	YW	Number of meter reads	Timesheets are not available so Ofwats third preference has been used	Number of meter reads
Services to developers	YW	100% non-household	Per Ofwat RAG 2.05	100% non-household
OOE - Disconnections and reconnections	YW/ LCML	100% non-household	Per Ofwat RAG 2.05	100% non-household
OOE - Demand side water efficiency initiatives	YW	Direct allocation		100% household
OOE - Customer side leaks	YW	Direct allocation		100% household
OOE - Other direct costs	YW / LCML	Appropriate cost driver (based on nature of cost)		Various
OOE - General and support - IT	YW	Headcount used to allocate to retail activity then activity cost driver used.	Ofwat RAG 2.05 allows the choice of an appropriate cost driver	FTEs used to allocate to retail activity then activity cost driver used.
OOE - General and support - IT	LCML	Customer numbers	Ofwat RAG 2.05 allows the choice of an appropriate cost driver	Customer numbers
OOE - General and Support - motor vehicles	YW/ LCML	N/A	N/A	N/A
General and support, Finance, HR etc	YW	FTEs used to allocate to retail activity then activity cost driver used	Timesheets are not available so Ofwats second preference has been used	FTEs used to allocate to retail activity then activity cost driver used
General and support, Finance, HR etc	LCML	Customer numbers	Timesheets are not available so Ofwats third preference has been used	Customer numbers
General and support - Executive director's remuneration	YW	FTEs used to allocate to within retail activity	Timesheets are not available so Ofwats second preference has been used	FTEs used to allocate to retail activity then activity cost driver used
General and support - Non- Executive director's remuneration	YW	FTEs used to allocate to retail activity then activity cost driver used	Timesheets are not available so management judgement has been applied	FTEs used to allocate to retail activity then activity cost driver used
General and support - facilities	YW	FTEs used to allocate to retail activity then activity cost driver used	Timesheets are not available so Ofwats second preference has been used	FTEs used to allocate to retail activity then activity cost driver used
General and support - facilities	LCML	Customer numbers	Timesheets are not available so Ofwats third preference has been used	Customer numbers
General and support - insurance	YW	FTEs used to allocate to retail activity then activity cost driver used	Per Ofwat RAG 2.05	FTEs used to allocate to retail activity then activity cost driver used
General and support - insurance	LCML	Customer numbers	Due to the efficient working of Loop FTE's are not specifically allocated between HH & NH. Therefore a more consistent approach is customer numbers.	Customer numbers
General and support - other	YW	FTEs used to allocate to retail activity then activity cost driver used	Per Ofwat RAG 2.05	FTEs used to allocate to retail activity then activity cost driver used
General and support - other	LCML	Customer numbers	Per Ofwat RAG 2.05	Customer numbers
Regulation and licence fee	YW	Customer numbers	Per Ofwat RAG 2.05	Customer numbers
Local Authority Rates	YW	FTEs used to allocate to retail activity then activity cost driver used	Ofwats second preference has been used	FTEs used to allocate to retail activity then activity cost driver used
Local Authority Rates	LCML	Customer numbers	Per Ofwat RAG 2.05	FTEs
Third party services	YW	N/A	N/A	N/A

A significant proportion of the activities identified within retail are performed by a separate company, Loop Customer Management Limited (LCML), which is a UK based company, and are charged to Yorkshire Water via an annual contract fee. Both Yorkshire Water and LCML companies are wholly owned subsidiaries of Kelda Group Limited.

Using the above methodology and revised internal business plans, we have revised the cost allocations within business retail operating expenditure.

These revised allocations reflect the latest information the Company has on current operating costs and have been used to feed into the tariff model for the submission of the business retail price review. Table 4 shows the revised cost allocation against the PR14 submission.

Table 4: PR16 revised cost allocation

Line description	Units	DPs	2015/16			2016/17			2017/18			2018/19			2019/20		
			Non-household	PR14 Submission	Variance												
Operating expenditure																	
1 Customer services	£m	3	2,012	1,937	0.075	2,229	1,938	0.291	2,428	1,938	0.490	2,395	1,938	0.457	2,425	1,938	0.487
2 Debt management	£m	3	0.365	0.428	-0.063	0.387	0.428	-0.041	0.424	0.428	-0.004	0.421	0.428	-0.007	0.428	0.428	0.000
3 Doubtful debts	£m	3	1.062	1.418	-0.356	1.233	1.418	-0.185	1.356	1.418	-0.062	1.343	1.418	-0.075	1.322	1.418	-0.096
4 Meter reading	£m	3	0.277	0.253	0.024	0.331	0.253	0.078	0.353	0.253	0.100	0.339	0.253	0.086	0.334	0.253	0.081
5 Services to developers	£m	3	0.072	0.371	-0.299	0.071	0.445	-0.374	0.078	0.571	-0.493	0.078	0.643	-0.565	0.079	0.699	-0.620
6 Other operating expenditure	£m	3	1.368	0.507	0.861	0.907	0.731	0.176	1.284	1.579	-0.295	1.190	1.607	-0.417	1.246	1.659	-0.413
7 Total operating expenditure excluding third party services	£m	3	5.156	4.914	0.242	5.158	5.213	-0.055	5.924	6.187	-0.263	5.765	6.287	-0.522	5.834	6.395	-0.561
8 Third party services operating expenditure	£m	3	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
9 Total operating expenditure	£m	3	5.156	4.914	0.242	5.158	5.213	-0.055	5.924	6.187	-0.263	5.765	6.287	-0.522	5.834	6.395	-0.561
10 Depreciation	£m	3	0.875	0.608	0.267	0.256	0.574	-0.318	0.282	0.512	-0.230	0.263	0.306	-0.043	0.262	0.321	-0.059
11 Total operating costs	£m	3	6.031	5.522	0.509	5.413	5.787	-0.374	6.206	6.699	-0.493	6.028	6.593	-0.565	6.096	6.716	-0.620
12 Debt written off	£m	3	1.062	1.418	-0.356	1.233	1.418	-0.185	1.356	1.418	-0.062	1.343	1.418	-0.075	1.322	1.418	-0.096
PR16 Total Operating costs excluding Developer Services	£m	3	5.959	5.151	0.808	5.342	5.342	0.000	6.128	6.128	0.000	5.950	5.950	0.000	6.017	6.017	0.000

It can be seen from these variances that:

- The company is expecting to spend more resources in customer services as it separates processes from wholesaler and household activities.
- Operating costs are expected to increase due to MOSL fees and increased queries to the retailer as processes are embedded.
- These two increased costs will be offset by a decrease in depreciation as existing legacy assets will no longer be used by this part of the business and replaced with more agile systems.

Default tariffs

We have followed the same methodology as our PR14 submission. We have ensured our tariffs are cost-reflective and recover no more than our business retail costs and our proposed net margin.

Default Tariff structures

In our PR14 methodology we confirmed that our preferred approach to determine the different customer types, in line with the guidance provided by Ofwat and with the aim of minimising incidence effects, was to rollover our existing tariff bands as part of our default tariff proposal.

We have updated our default tariff structure to include a split of the “Measured 0-50ML/a” bands to be shown as two separate bands, “Measured 0-5ML/a” and “Measured 5-50ML/a”, this follows the guidance and will allow the bands to be assessed in the common structure as proposed in the “Business retail price review 2016: Statement of method and data table requirements”. This has resulted in a net increase of 3 default tariffs from 11 tariffs to 14 default tariffs. Table 5 overleaf shows these tariffs.

Table 5: Default tariffs

Water	Wastewater	Trade effluent
Water 0-5ML/a	Wastewater 0-5ML/a	Trade effluent 0-5ML/a
Water 5-50ML/a	Wastewater 5-50ML/a	Trade effluent 5-50ML/a
Water 50-250ML/a	Wastewater 50-250ML/a	Trade effluent 50-250ML/a
Water > 250ML/a	Wastewater > 250ML/a	Trade effluent > 250ML/a
Water unmeasured	Wastewater unmeasured	

Default tariff charge elements

Our proposed default tariffs consist of the following charge elements, which apply to each tariff band:

- A fixed charge per business retail customer (£ per customer per annum)
- A variable charge (£) based on the size of the wholesale bill (pence per £ of wholesale bill per annum)

As per the guidance we have not rebalanced the retail cost allocations between the two new bands and therefore they have the equivalent retail charge as if they were still combined as the 'Measured 0-50ML/a' default tariff. The margin allocation has been calculated using the same methodology as in PR14.

Table 6 overleaf shows a comparison of PR14 to the proposed charges for 2017/18.

Table 6: 2017-18 proposed tariffs vs PR14

<u>Water 0 - 5 MI/a</u>	Unit	PR14	PR16	<u>Wastewater 0 - 5 MI/a</u>	Unit	PR14	PR16
Retail costs	£	n/a	26.85	Retail costs	£	n/a	28.93
Retail margin	%	n/a	3.54%	Retail margin	%	n/a	2.94%
Gross Margin	%	n/a	8.69%	Gross Margin	£	n/a	7.00%
<u>Water 5 - 50 MI/a</u>	Unit	PR14	PR16	<u>Wastewater 5 - 50 MI/a</u>	Unit	PR14	PR16
Retail costs	£	n/a	26.85	Retail costs	£	n/a	28.93
Retail margin	%	n/a	1.36%	Retail margin	%	n/a	1.36%
Gross Margin	£	n/a	1.48%	Gross Margin	£	n/a	1.48%
<u>Water 50 - 250 MI/a</u>	Unit	PR14	PR16	<u>Wastewater 50 - 250 MI/a</u>	Unit	PR14	PR16
Retail costs	£	42.67	44.73	Retail costs	£	42.67	44.73
Retail margin	%	1.32%	1.32%	Retail margin	%	1.32%	1.32%
Gross Margin	£	1.36%	1.36%	Gross Margin	£	1.34%	1.35%
<u>Water >250MI/a</u>	Unit	PR14	PR16	<u>Wastewater >250MI/a</u>	Unit	PR14	PR16
Retail costs	£	47.28	49.15	Retail costs	£	47.28	49.15
Retail margin	%	1.31%	1.31%	Retail margin	%	1.31%	1.31%
Gross Margin	£	1.32%	1.32%	Gross Margin	£	1.31%	1.31%
<u>Water Unmeasured</u>	Unit	PR14	PR16	<u>Wastewater Unmeasured</u>	Unit	PR14	PR16
Retail costs	£	16.15	17.67	Retail costs	£	16.32	17.79
Retail margin	%	11.88	11.70	Retail margin	%	7.19%	7.13%
Gross Margin	£	26.60	27.58	Gross Margin	£	15.37	15.98
		%	%			%	%
<u>Trade Effluent 0 - 5 MI/a</u>	Unit	PR14	PR16	<u>Trade Effluent 50 - 250 MI/a</u>	Unit	PR14	PR16
Retail costs	£	n/a	23.10	Retail costs	£	17.23	19.44
Retail margin	%	n/a	2.27%	Retail margin	%	1.32%	1.32%
Gross Margin	£	n/a	4.17%	Gross Margin	£	1.33%	1.33%
<u>Trade Effluent 5 - 50 MI/a</u>	Unit	PR14	PR16	<u>Trade Effluent >250MI/a</u>	Unit	PR14	PR16
Retail costs	£	n/a	23.10	Retail costs	£	19.25	21.60
Retail margin	%	n/a	1.36%	Retail margin	%	1.31%	1.31%
Gross Margin	£	n/a	1.45%	Gross Margin	£	1.31%	1.31%

Retail margin

We have reviewed the allocation of the 2.5% margin across the different default tariff bands and we have found no compelling reason to move away from the methodology undertaken at PR14.

Contact details

For any queries, clarification or further information relating to this submission please can you contact:

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