

Water 2020  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham  
B5 4UA

Yorkshire Water  
Western House  
Halifax Road  
Bradford  
West Yorkshire  
BD6 2SZ

T: 01274 804455  
M: 07790 616409

By email to: [rcv.allocation@ofwat.gsi.gov.uk](mailto:rcv.allocation@ofwat.gsi.gov.uk)

31 March 2017

Dear Sir / Madam,

**Consultation on economic asset valuation for the bioresources RCV allocation at PR19**

Thank you for inviting Yorkshire Water to contribute to the consultation on the economic asset valuation for the bioresources RCV allocation at PR19, published on 2 March 2017.

We have considered the proposals in the consultation and reviewed the supporting report from Reckon LLP. We agree that the focused bioresources RCV allocation should be based on the economic value of assets conducted at a site-specific level

We provide responses to each of the consultation questions appended to this letter.

Should you have any queries regarding any elements of our response, please contact me at: [colin.fraser@yorkshirewater.co.uk](mailto:colin.fraser@yorkshirewater.co.uk)

Yours faithfully,



Colin Fraser  
Regulatory Strategy Manager

**Yorkshire Water Services response to the consultation on economic asset valuation for the bioresources RCV allocation at PR19**

**Q1. Do you agree that the focused RCV allocation should be based on the economic value of assets as set out in section 3?**

**If you disagree, please explain what variations to this approach, or alternative approach, you prefer and why it would be more desirable than our preferred approach. Please include in your explanation how it would meet the objectives of the focused allocation of pre-2020 RCV to the bioresources control.**

We agree the focused bioresources RCV allocation should be based on the economic value of assets conducted at a site-specific level, as set out in section 3.2 of the consultation document.

In order to construct the required future net cash flows, companies need to understand the sludge gate price (the income to be received for processing the sludge after it crosses the bioresource price control boundary). This gate price being based on what a hypothetical new entrant would be willing to accept to build assets.

We note the observation made by Reckon that there is potential for a degree of inconsistency between the use of hypothetical new entrant/new build assumptions for the purposes of economic value in this exercise, and the price controls Ofwat may set in practice for PR19 through the totex allowances and incentives. We look forward to understanding how the interactions between the market-based RCV valuation and the regulatory-based totex approach will be addressed in the PR19 July methodology consultation.

**Q2. Do you agree that companies should consider impact on customers and markets and propose an alternative RCV allocation if this will better protect customers, including by promoting a level playing field for markets?**

We agree that companies should consider the impact on customers and markets from the economic approach followed.

We value consistency in the economic approach across all companies and note Ofwat's comments that "Discussions with companies, in particular at the sludge working group, welcomed an approach that would allow consistency in valuation method to be established".

We therefore support Ofwat's position that companies provide information on a consistent basis so an appropriate allocation for the bioresources control is set. This will help to manage the possible subjectivity of the economic approach; an issue identified as a problem in RAG1.05.

A company should only propose an alternative RCV allocation where there is clear evidence revealed through robust cross-checking, that there would otherwise be an unintended

consequence that, adversely impacts customer bills, or would be inconsistent with the company setting charges in line with charging rules and competition law.

**Q3. Do you agree that the assumptions in table 4.1 are appropriate for companies to use for the valuation exercise? We welcome any comments on these assumptions; suggestions of further assumptions you consider all companies should use; or requests for clarification. If you disagree that any of the above assumptions are appropriate to be used by all companies please explain why and if relevant suggest an alternative.**

We agree with the assumptions provided in table 4.1 for the following definitions:

- Boundary for assets;
- Location of facilities;
- Level of valuation;
- Choice of technology;
- Ownership of assets;
- Treatment of sludge liquors.

We focus our response on the two remaining assumptions; capacity of facilities and sub-site processes, where we provide comments.

### **Capacity of Facilities**

We believe that some recognition of the economic value of genuine excess capacity is needed. Otherwise economic value of spare sludge capacity will be transferred to the Wastewater Network Plus residual RCV, with possible consequences for fair pricing and competition.

By including it in the bioresources RCV there could be a financial incentive to recover the economic value via resale, reuse or scrapping, especially if this creates a high gate price that encourages inefficient entry. Ultimately this incentive may depend on whether this genuine spare capacity is fully remunerated as part of PR19.

### **Sub-site Processes**

Preparing the valuation to sub-site processes (typically 5-7 processes per site) will place an increased level of administration on companies. It is not clear, given this allocation exercise is being undertaken for the purpose of setting price limits at a company level, if this activity and cost deliver the best value for customers.

We believe reporting information at a site level will achieve the required granularity and provide opportunities for comparisons between sites and companies.

**Q4. Do you agree that the assumptions in table 4.2 are appropriate for companies to use for the valuation exercise? We welcome any comments on these assumptions; suggestions of further assumptions you consider all companies should use; or requests for clarification. If you disagree that any of the above assumptions are appropriate to be used by all companies please explain why and if relevant suggest an alternative.**

We agree that the assumptions in table 4.2 are appropriate for use in the valuation exercise.

In regards to the provision of all information universally at site level, we make a couple of observations.

For shared services and management and general costs these are not applied at site level but rolled up at the price control level. In practice we allocate these assets to Wastewater Network Plus, in line with Ofwat's principal use guidance. We would then recharge the depreciation of these assets to the bioresources price control using an appropriate proportionate allocation driver. In order to allocate these costs down to a site level we would need to identify and apply additional allocation assumptions by a relevant cost driver.

In general we do not record valuation information on infrastructure assets related to the bioresources business. Where we do have infrastructure associated with the asset these would be on site and included within the sludge assets for that part of a scheme. We propose to consider the valuation of infrastructure assets within the sludge asset on the asset register.

**Q5. Do you have any further suggestions of potentially useful cross checks, beyond those presented in table 4.4 that companies may want to consider?**

We have no further suggestions of potentially useful cross checks.

## **Q6. Do you have any comments on our timetable?**

We believe the timetable for companies to complete robust and assured bioresources valuations and RCV allocations is challenging.

Following this consultation exercise Ofwat will publish final guidance on the economic asset valuation approach at the end of April 2017. The final guidance may lead to companies needing to change their current assumptions, data gathering, or modelling work.

There are a number of essential stages within the exercise that require addressing appropriately before we can submit the proposed RCV allocation, which include:

- Information and data gathering and collation;
- Economic evaluation and modelling;
- Performing cross checks to provide assurance that the RCV allocation will not lead to unintended consequences, such as adverse impacts on customer bills;
- Undertaking independent assurance reviews of the information and data;
- Engaging with our Yorkshire Forum for Water Customers (Customer Challenge Group) to gain their views and challenges throughout the process;
- Providing an assurance statement from our Board.

We would welcome an opportunity to discuss if there are any options to extend this time, for example to more closely align to the timetable for the water resources RCV allocation.

## **Q7. Do you have any comments on our assurance expectations?**

We recognise the importance of providing assurance in support of the RCV allocation exercise and we are supportive of each of the areas of assurance outlined in table 6.1 within the consultation document.

As part of our assurance framework we plan to undertake comprehensive data assurance activities, which will include the provision of evidence from independent reviews of our data sources and approach to the allocation evaluation.

It is critical to the validity of this RCV allocation exercise that all parties, be that incumbents, new entrants, or customers, can have trust and confidence in the quality and transparency of information and data provided.

**Q8. Do you agree that companies should publish information on their websites to allow other stakeholders to comment, and when this could happen?**

It is important that stakeholders have visibility to the information related to the RCV allocation in order to provide comment on our proposals, and to help inform our plans.

Providing such information also increases the opportunities for customers and other stakeholders to understand the key components of our PR19 plans and could help engender improved public trust and confidence in the sector in general.

We believe companies should publish the information after Ofwat have provided companies with feedback on their respective valuation and proposed RCV allocations, expected in January 2018. In this way companies would have an opportunity to make required changes before wider publication. This would also provide stakeholders with the clearest position at that stage.

It should be noted this information would still be prior to companies submitting their business plans in September 2018

**Q9. At what level of detail do you think that this information should be published at? Please comment as to what you consider the benefits or disadvantages to companies publishing information at a site level?**

We believe it is appropriate to publish RCV allocation proposals at a company level and at a time when the information has been suitably assured by the company and reviewed by Ofwat (please see our response to question 8).

However we believe publishing information on a site by site basis provides no benefit to the development of the future bioresources market. Commercially sensitive information could be exposed if there is a blanket requirement to publish detailed cost allocation and revenue information at that level.

**Q10. Do you have any comments or require any clarification on the proposed tables? Where you have alternative proposals, please set out how this meets the objectives of the asset valuation for the purposes of allocating the legacy wastewater RCV to the bioresources control.**

We have no further comments or points requiring clarification on the proposed data tables.

End