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Trust in water

# **PR19 initial assessment of plans: Bristol Water company categorisation**

## About this document

In '[Delivering Water 2020: Our final methodology for the 2019 price review](#)' (the methodology) we said that we wanted all 17 regulated water and wastewater companies to produce high-quality, ambitious and innovative business plans, pushing forward the performance and efficiency of the sector for customers. To encourage this we developed the initial assessment of business plans (IAP) process. The IAP was designed to incentivise all companies to produce well-evidenced plans that reflect their customers' preferences and priorities and are efficient.

We explained that the IAP would:

- assess company business plans against nine key test areas that reflect our PR19 themes and the strategic policy statements of the UK and Welsh Governments and help make sure companies deliver for customers, the environment and wider society;
- assess company business plans against three key characteristics (quality, ambition, and innovation); and
- categorise company business plans into four categories (significant scrutiny, slow-track, fast-track, or exceptional).

Following the submission of companies' business plans on 3 September 2018, we have carried out an extensive and detailed review of these plans. This review has been carried out in accordance with our methodology. Our assessment approach for each of the nine test areas is set out in the 'PR19 initial assessment of plans: Summary of test area assessment' document. The overall results of the review of all 17 business plans are summarised in the 'PR19 initial assessment of plans: Overview of company categorisation' document. Our assessment is based on the information the company submitted to us as part of its business plan for the period 2020-25. The documents we have published are available on our [website](#).

This document sets out our assessment of Bristol Water's business plan submission under the IAP. It explains our assessment of the company plan in the round at an aggregate level and our assessment across each of the nine test areas as set out in our methodology.

This document and the actions in the 'Bristol Water: Actions summary table' should be read in addition to the 'PR19 initial assessment of plans: Overview of company categorisation' document.

# 1. Overview of Bristol Water categorisation

## Our assessment of the plan

We set high expectations for water companies at PR19. We pushed them to go further than ever before, improving efficiency, customer service and resilience. We asked them to share financing gains with customers and to ensure that dividend and executive pay policy is aligned to delivering for customers. We asked them to look well beyond the five-year price review period to meet the needs of future customers and protect and improve the natural environment. We indicated in our PR19 methodology that the bar is high, and our Initial Assessment of Plans is the categorisation of company plans against those high expectations at this stage of the price review process. Where our expectations have not been fully met, we will continue to work closely with companies towards the draft and final determination stages.

Overall, we categorise Bristol Water as slow-track. This categorisation is made after an in the round consideration of our assessment of Bristol Water's business plan across the nine test areas and the overall level of intervention in the plan required to protect the interests of customers. Our grades for each of the test areas are set out in Table 1 below.

Bristol Water's plan has been developed on the basis of high quality customer engagement. The company applies a wide range of customer engagement techniques, with a mixture of 'business as usual', traditional and innovative approaches and use of business as usual customer contact data for identifying trends. It uses a robust, balanced and proportionate evidence base, and the company has demonstrated a clear line of sight from the results of its customer research and engagement to the outcomes its business plan will deliver for customers. It provides evidence of behavioural change campaigns, and the company effectively engaged with its customers on both the business plan and on longer-term issues.

The company also proposes a real bill reduction of 6% in the 2020 to 2025 period.

However, the plan falls significantly short of high quality in terms of the evidence for the deliverability of improved performance on outcomes set out in the plan, as well as on customer complaints handling, given past performance. We also have concerns in a number of areas. Our concerns include:

- **securing cost efficiency** – its company level costs are 15% above our view of efficient and justified costs;
- **delivering outcomes for customers** – it provides insufficient evidence for financial incentive rates and we have concerns on whether the overall outcomes delivery incentive package will sufficiently incentivise improved performance;
- **aligning risk and return** – it provides insufficient evidence to justify its proposal for a company specific uplift to our early view cost of capital, and does not provide convincing evidence to support the choice of target credit rating for the notional and actual structures. It provides insufficient evidence to support its regulatory capital value (RCV) run-off rates;
- **addressing affordability and vulnerability** – while bills are proposed to fall between 2020 and 2025, the company did not engage customers sufficiently on its approach to long-term affordability. It demonstrates a lack of ambition on addressing vulnerability and on its proposed increase in the reach of its Priority Services Register (PSR);
- **securing long-term resilience** –there is a lack of evidence on long-term resilience (including a lack of evidence of a systems-based approach); and
- **securing confidence and assurance** – a number of requested Board assurance statements are not provided in full.

Given the scale and scope of these concerns, the plan requires a level of material intervention to protect customer interests. We therefore give the plan slow-track status.

An overview of our assessment of the nine test areas and our grades for each test area are set out below. Our detailed assessment of the test areas is provided in 'Bristol Water: Test area assessment' and 'Bristol Water: Test question assessment'.

**Table 1: Overall test area assessments**

Test Area	Our assessment
Engaging customers	B
Addressing affordability and vulnerability	C
Delivering outcomes for customers	C
Securing long-term resilience	C
Targeted controls, markets and innovation	C
Securing cost efficiency	C
Aligning risk and return	C
Accounting for past delivery	D
Securing confidence and assurance	C

A = High quality, ambitious and innovative plan with evidence that overall is sufficient and convincing

B = High quality plan, not sufficiently ambitious and innovative to be exceptional with evidence that overall is sufficient and convincing

C = Concerns with the plan: Plan falls short of high quality and/or evidence is insufficient and/or unconvincing in some areas  
D = Substantial concerns with the plan: Plan falls significantly short of required quality and/or little or no evidence, or no convincing evidence

### **Engaging customers**

The company's plan demonstrates high-quality engagement with customers. It uses a robust, balanced and proportionate evidence base, and the company has demonstrated a clear line of sight from the results of its customer research and engagement to the outcomes its business plan will deliver for customers. It uses a wide range of techniques, effectively including a mix of traditional and innovative approaches such as including longitudinal engagement, co-creation, gamification and use of business as usual customer contact data to identify trends. It provides evidence of behavioural change campaigns, such as "Beat the Bill" to encourage the use of meters. The company effectively engaged with its customers on both the business plan and on longer-term issues, including the formation of a youth board and deliberative events to engage with its customers and stakeholders on resilience.

However, the company's falls short in some areas. Its approach to triangulation was not consistent with industry best practice. The company also largely determined the needs of vulnerable customers from engagement with stakeholder groups, rather than robust primary research with a diverse range of vulnerable customers.

### **Addressing affordability and vulnerability**

The company's plan demonstrates high quality on some aspects of affordability and vulnerability. It proposes a real bill reduction of 6% between 2020 and 2025, and customer support for the affordability of the bill is relatively high (although acceptability is low). The company also proposes to help customers who cannot afford to pay their bills, offering a good range of schemes and undertaking high quality engagement with customers.

However, the company's plan falls short because it proposes weak reach for the number of customers on its PSR. The plan also falls short where it forecasts a bill increase of 2.1% for 2025-30 without providing evidence that it tested the bill profile with customers.

### **Delivering outcomes for customers**

The company's plan includes some aspects of high quality. For instance, it provides evidence of a high quality approach to its performance commitments, with appropriately stretching performance commitments – in particular its service levels for 2020 to 2025 are forecast upper quartile for supply interruptions and leakage.

However, the company's plan provides insufficient evidence to support its package of outcome delivery incentives. It proposes deadbands for a large number of performance commitments, such as those on asset health, without sufficient evidence. The company's plan provides insufficient evidence as to how the outcome delivery incentive package aligns the interests of management and shareholders with customers and incentivises it to deliver on its performance commitments.

### **Securing long-term resilience**

The company engaged with customers on a range of resilience risks and preferred mitigation options and customers collaborated through approaches such as gamification. The company proposes a stretching package of resilience-focused performance commitments.

However, the company's plan falls short in a number of areas. We have concerns about the evidence provided on how it prioritises risks and the clarity of its resilience assessment. The company provides insufficient evidence to demonstrate that it has an integrated and systems-based approach to resilience. There is insufficient evidence that the headroom in its financial ratios will allow it to maintain long-term financial resilience. The company provides insufficient evidence for how it would secure financial resilience if it does not receive a cost of debt adjustment.

### **Targeted controls, markets and innovation**

The company provides high-quality evidence about its approach to enabling innovation, its evidence on RCV allocation is complete and its strategy for water resources aligns with its Water Resource Management Plan (WRMP).

But, overall, the plan falls short of high quality in this area. It provides insufficient evidence on its use of water catchment management or alternative third party options for water resources. It does not set out in depth alternatives to abstracting water from the Gloucester-Sharpness Canal. Its bid assessment framework omits details on what information bidders might have to provide, and its approach to protecting third party's commercially sensitive information. It provides limited justification as why no scheme met the £100 million totex threshold for Direct Procurement for Customers.

### **Securing cost efficiency**

The company's plan falls short of high quality in this area. We do not consider the company's cost projections to be efficient, with projections in wholesale water activities 15% above our view of efficient costs and 12% above our view of efficient

costs in residential retail. Of the four cost adjustment claims it proposes, two of the claims lack compelling evidence and our modelled cost allowance already reflects three of the claims.

### **Aligning risk and return**

The company's plan includes some aspects of high quality, such as demonstrating the company's choice of pay as you go (PAYG) rates. However, the company provides insufficient evidence in the following four areas:

- the requested company-specific cost of debt adjustment, including that customers would be adequately compensated for the additional cost, or that they support funding it, based on the content of the plan;
- the choice of target credit rating for the notional and actual structures, and that its financial ratios are consistent with the actual target credit rating;
- its choice of RCV run-off rates; and
- risk and risk mitigation measures in the return on regulatory equity (RoRE) assessment for the notional company which are discussed only at a high level.

### **Accounting for past delivery**

While the plan provides sufficient evidence that for the deliverability of costs and major incident performance, it falls significantly short of high quality for evidence on the deliverability for outcomes and customer complaints handling. There is poor past performance on outcomes as the company has delivered, or is forecast to deliver, 64% of performance commitments with financial outcome delivery incentives in 2015-20. The company provides insufficient evidence that it understands the drivers of its past performance or that the plan includes appropriate measures to improve outcomes performance.

The company has a high and increasing number of complaints per customer and is not yet meeting the CCWater's 2020 household customer complaints target. But the business plan does not acknowledge this issue and so provides insufficient evidence on lessons learnt or measures to improve performance.

### **Securing confidence and assurance**

The company makes good quality proposals on gearing benefits sharing, dividend policy and executive pay. However, the company's Board does not provide assurance statements in many of the requested areas. This reduces our overall confidence in the assurance and the Board's ownership of the plan. Overall, Bristol

Water's plan falls short of providing sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.

## 2. Next steps and overall timeline

Actions for the company are set out in 'Bristol Water: Actions summary table'.

The next part of the process will be the draft determination, followed by the final determination, as set out in the table below.

Date	Milestone
1 April 2019	Revised business plans submitted
18 July 2019	Draft determinations published
30 August 2019	Representations on draft determinations due
11 December 2019	Final determinations published
1 April 2020	Price controls for 2020 – 2025 come into effect



## Appendices

The appendices below can find be found on our [website](#).

- Bristol Water: Test area assessment
- Bristol Water: Test question assessment
- Bristol Water: Actions summary table
  - Bristol Water: Delivering outcomes for customers detailed actions
  - Bristol Water: Accounting for past delivery detailed actions
  - Bristol Water: Securing confidence and assurance detailed actions

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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