

Yorkshire Water: Test area assessment

All company test area grades								
Engaging customers	Addressing affordability and vulnerability	Delivering outcomes for customers	Securing long-term resilience	Targeting controls markets and innovation	Securing cost efficiency	Aligning risk and return	Accounting for past delivery	Securing confidence and assurance
B	C	C	C	B	C	C	B	C

Yorkshire Water - test area results				
	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Engaging customers	B	<p>Overall Yorkshire Water's business plan is high quality with convincing evidence in the areas set out below, but not sufficiently ambitious or innovative to be considered exceptional.</p> <p>The company provides sufficient evidence of a high quality approach in the following areas:</p> <ul style="list-style-type: none"> Effective use of a wide range of customer engagement techniques including more innovative approaches such as charrettes and behavioural experimental methods, in many cases meeting best practice as evidenced by independent assurance. The company approach to implementing customer valuation techniques including the use of behavioural economics techniques (e.g. context, framing etc.). Convincing evidence that the company has customised its delivery of services to customers based on segmented preferences. The company approach to adopting the four themes of customer participation set out in the Tapped In report, including co-creation for strategic planning, behaviour-led campaigns like 'Fats To Fuels', wider community engagement through international partnerships and participation techniques used across a broad range of customers, including vulnerable audiences. <p>The company provides mostly convincing evidence of its engagement with its customers on both the business plan and on longer-term issues, including engagement with current customers on willingness to pay and resilience through both quantitative and qualitative studies. However, there is insufficient evidence of customer research underpinning longer term priorities, risk appetites, or the needs of future customers.</p>	EC1	B
Addressing affordability and vulnerability	C	<p>Overall Yorkshire Water's business plan falls short of high quality with insufficient evidence of its approach to affordability and vulnerability. The plan demonstrates an aspect of high quality because the company proposes a high quality approach to addressing vulnerability, including proposing two stretching performance commitments (PCs).</p> <p>The business plan falls short of high quality in three areas because:</p> <ul style="list-style-type: none"> The company is proposing to increase bills by 3.5% in the 2020 to 2025 period. There are some inconsistencies on how it has reported data on whether customers find its proposed bill affordable. The company is proposing to increase bills in the 2025 to 2030 period but the scale of the increase is not clearly outlined in the business plan. The company states it has tested long term bill profiles but provides insufficient evidence to support this. As the company proposes a modest increase in social tariff recipients and has yet to confirm the level of cross-subsidy available, the evidence provided did not sufficiently demonstrate a high quality approach to helping customers who cannot afford to pay their bills. 	AV1	C
			AV2	D
			AV3	C
			AV4	B

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	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Delivering outcomes for customers	C	<p>Overall, across the delivering outcomes for customers test area, the evidence Yorkshire Water provides to support its proposed PCs and outcome delivery incentives (ODI) within its business plan falls short of high quality. The company has provided some evidence of high quality with regards to its proposed PCs and package of ODIs, however evidence is insufficient or unconvincing in some areas.</p> <p>The company provides sufficient evidence to demonstrate that its PCs are appropriate and stretching. The company proposes targets for supply interruptions that are forecast upper quartile. It also proposes a high level of stretch relative to historical performance for leakage, internal sewer flooding and per capita consumption over the period 2020-25. The company also provides sufficient evidence to demonstrate that, in general, its ODI rates are based upon robust customer valuations, cover different business areas and will provide incentives for service delivery.</p> <p>Key areas where the business plan falls short of high quality are:</p> <ul style="list-style-type: none"> The company's relative performance on asset health is poor amongst the industry and it has provided insufficient evidence that it will resolve these issues in an appropriate timeframe. Evidence to support its proposed approach to protecting customers falls short of high quality. The company provides insufficient evidence regarding how it would limit the impact of outperformance payments that exceed expectations. Demonstrating compliance with the PR19 Final Methodology requirements for common PCs. It does not sufficiently evidence its approach to ODI deadbands, caps and collars. Insufficient evidence to justify its enhanced outperformance payments and penalties, which exceed customer willingness to pay in some instances. 	OC1	B
			OC2	B
			OC3	C
Securing long-term resilience	C	<p>Overall, Yorkshire Water's plan falls short of high quality and the company has not provided sufficient and convincing evidence of securing long term resilience in certain areas.</p> <p>The company provides a high quality plan in certain areas relating to risk identification and assessment. The company presents high quality evidence of a systems-based approach to the assessment of risks. The plan covers aspects of operational, financial and corporate resilience and provides sufficient evidence in its identification of interdependencies. There is sufficient evidence that its framework includes all parts of the value chain, explaining the internal and external risks that affect each part of the business and other systems to evaluate their ultimate external impacts. The company also presents a good approach in relation to the natural environment, particularly in relation to its plan to embed a natural capital approach into its resilience framework. The plan contains high quality evidence in respect of the process it has undertaken for its assessment of financial resilience, however there is insufficient evidence that it has considered all relevant issues.</p> <p>We consider that the company plan does not provide sufficient and convincing evidence of a commitment to resilience in the round in the following areas:</p> <ul style="list-style-type: none"> There is insufficient evidence that it has considered the impacts of all risks in its assessment of financial resilience. In particular, the company has not assessed the risks around the refinancing of subordinated debt, which is a feature of its highly geared structure and it has not considered possible impacts of the mechanism for sharing financing outperformance for companies with actual gearing levels of 70% and above. There is insufficient evidence the company has considered the risk that capital raised by group companies above the level of the ring fence might place on the financial resilience of the Appointee. There is insufficient evidence that the company has adequately considered the risks that maintaining a credit rating one notch above the minimum for investment grade, is consistent with maintaining long term financial resilience. . While the company provides a baseline resilience assessment, we consider there is insufficient evidence in some areas to explain how this informs decision making. There is also insufficient evidence of engagement with customers around resilience risks and options to mitigate these The company provides insufficient evidence of how the outcomes and performance targets it proposes fully support its resilience challenges, particularly in relation to asset health. 	LR1	B
			LR2	C
Targeting controls, markets and Innovation	B	Overall, Yorkshire Water's plan is of high quality across the Targeting Controls, Markets and Innovation test area. The company provided strong evidence to support their bioresources strategy.	CMI1	C
			CMI2	C

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		There is strong evidence of the use of markets across network plus for both water and wastewater, with a variety of innovative examples demonstrating a long-term approach to managing drainage and wastewater. For RCV Allocation the evidence is complete. The company's Bid Assessment Framework meets all best practice recommendations.	CM3	B
		On water resources, despite an ambitious approach to engaging with third party providers and high quality evidence included related to the enablement of bilateral markets, concerns identified by Ofwat with the company's draft WRMP have not been addressed. The company's plan falls short of high quality with insufficient evidence that it has the right culture of innovation to allow it, through its systems, processes and people, to deliver results for customers and the environment through innovation. Many of the systems and processes are either still in development or as yet unproven with insufficient evidence supporting their implementation. Although it has some elements of high quality approaches, there is not sufficient evidence overall for the plan to be high quality for innovation culture. There is less convincing evidence about how either its environment and space or its leadership and support help facilitate an innovation culture. The company had included details of schemes that met the threshold for DPC. However these schemes were rejected on technical grounds and the company's technical assessment does not provide sufficient evidence of a high quality review of the suitability for DPC, with no assurance provided for this process.	CMI4	B
			CMI5	B
			CMI6	B
			CMI7	D
Securing cost efficiency	C	Overall, we consider Yorkshire Water's 2020-25 costs are not efficient when compared to our view of efficient costs. At the company level its costs are 18% above our view of efficient cost. Its wastewater costs are further away from our view of efficient costs than its water costs, and they are inefficient in both base and enhancement costs. In residential retail, its costs are around 27% more efficient than our baseline making it the frontier company in this area. We take this into account when considering the company's overall cost efficiency IAP result. The company proposes an ambitious leakage reduction programme, reducing leakage by more than 15%. However its leakage reduction unit costs are less efficient than the industry benchmark. We have allowed benchmark costs only for the reduction above 15%, our view of stretching performance. The company proposes three cost adjustment claims, one of which is of reasonable quality and we assess as a partial pass. The remaining two are not of high quality and we assess them as fail. This gives the company a grade of C for its cost adjustment claims.	CE1	D
			CE2	D
			CE3	A
			CE4	C
Aligning risk and return	C	Despite some aspects of Yorkshire Water's plan which are high quality, shortcomings in one aspect means that it overall falls short of providing convincing and high quality evidence to support its approach in the area of aligning risk and return. The following areas of the plan are high quality: <ul style="list-style-type: none"> It is based on our Final Methodology 'early view' cost of capital and, in the round, our 'early view' of retail margins. There is convincing evidence to support the board's statement that the company is financeable on the notional structure. There is convincing evidence to support the company's choice of PAYG and RCV run-off rates. There is high quality and convincing evidence in the company's assessment of risk for the notional company in its RoRE analysis. There is one main area where the plan falls short of high quality, which is sufficiently material to affect the overall score for the aligning risk and return test question: <ul style="list-style-type: none"> The plan does not provide sufficient convincing evidence supporting the choice of target credit rating for the actual structure (Baa2 Moody's), in the context of the investment programme and debt raising needs. 	RR1	B
			RR2	B
			RR3	C
			RR4	B
Accounting for past delivery	B	Overall, Yorkshire Water's business plan demonstrates high quality accounting for past delivery. In the round we do not have concerns with the evidence for deliverability for the 2020-25 plan. The plan is high quality for deliverability in the following areas. <ul style="list-style-type: none"> It has or is forecast to deliver 78% of PCs with financial ODIs in 2015-20. The company has provided sufficient evidence that it will be able to deliver the majority of its outcomes. However, due to the high level of stretch on leakage and internal sewer flooding, we have some concerns with the evidence for deliverability of these particular PCs. However, this does not affect the overall grade. The company is forecasting to spend in line with its allowances and we do not have concerns with the evidence for deliverability of the plan on costs. 	PD1	C

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		<ul style="list-style-type: none"> The company is already meeting CCWater's 2020 household customer complaints target of resolving 95% of customer complaints at stage one, and low and falling total numbers of household customer complaints. <p>The plan falls short of high quality for deliverability in the following areas.</p> <ul style="list-style-type: none"> The company had three major incidents and did not provide sufficient evidence on the lessons learnt from these, or the measures to address this performance. We therefore have some concerns with the evidence for deliverability of improved performance on major incidents. <p>There is sufficient and convincing evidence for six out of the eight PR14 reconciliation areas and insufficient evidence for service incentive mechanism and wholesale revenue forecasting incentive mechanism. We have found major data consistency issues between the submitted tables and populated reconciliation models for the wholesale revenue forecasting incentive mechanism where the reporting and table guidance has not been followed, with insufficient evidence provided. There is a marginal difference (-1.4% of 2019-20 revenue) between expected and proposed reconciliations.</p>	PD2	B
Securing confidence and assurance	C	Overall, Yorkshire Water's business plan falls short of providing sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.	CA1	C
		The company's business plan provides some evidence of high quality:		
		The company's Board provides a compliant statement of assurance with sufficient supporting evidence to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes. There is also sufficient and convincing evidence that overall, the company's business plan tables and the assurance and commentary provided, are consistent, accurate and assured.		
		The company's plan falls short of high quality in the following areas:	CA2	D
		Although the company's Board provides the majority of the assurance statements requested to demonstrate that all the elements of its business plan add up to a plan that is high quality and deliverable, an insufficient number of them have supporting evidence of the Board's challenge and assurance process.		
In our assessment of the company in the 2018 Company Monitoring Framework (not including the elements related to the PR19 business plans) while the company exceeds expectations in 3 areas and meets expectations in 4 areas, it has minor concerns in 1 area and has serious concerns in 1 area.	CA3	D		
The company's business plan falls significantly short of high quality in the following areas:				
The Board provides a non-compliant statement of assurance to demonstrate that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term.				
On demonstrating a fair balance between customers and investors:				
<ul style="list-style-type: none"> The company falls significantly short our expectations on gearing benefits sharing. The company forecasts gearing above 70% and includes a mechanism similar to our default mechanism, but proposes benefits should be offset against claimed reinvestment in 2015-20. Therefore no benefits would be shared in 2020-25 and customers would receive no benefit from any reduced risk as a result of the company's choice of financial structure. On dividend policy, there is insufficient evidence of the company's intention to meet the expectations set out in the 'Putting the sector in balance' position statement. There is insufficient evidence of how the dividend policy in 2020-25 takes account of obligations and commitments to customers when determining dividends. Also there is insufficient evidence of a clear Board commitment to publish detail on dividend policies annually and to signal changes to stakeholders. The company's Board does not provide a compliant assurance statement that it has or will engage with customers on its corporate and financial structures and there is little evidence of transparency on corporate and financial structures and how these relate to the company's financial resilience. 	CA4	B		
	CA5	C		

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		<ul style="list-style-type: none"> The company proposes a base dividend yield less than 5%. On executive pay, the company demonstrates sufficient evidence of its intention to meet the expectations set out in the 'Putting the sector in balance' position statement, but we require a clear commitment to publish the final policy and evidence of how changes will be signalled to customers. Additionally, the company proposes a bespoke outperformance sharing mechanism on the cost of embedded debt which we assess is likely to have zero benefit to customers and donations to social tariffs and hardship funds which we assess could have a value of £1.9m per year. The scale of the proposals for voluntary sharing are very modest in the context of the company's size. However, voluntary sharing mechanisms are not a requirement of the PR19 methodology, so the proposed sharing does not impact on our assessment in this test area. 	CA6	B