

July 2019

Trust in water

PR19 draft determinations

Bristol Water – Securing confidence and assurance actions and interventions

PR19 Draft Determinations: Bristol Water – Securing confidence and assurance actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised actions, a summary of the company’s response to the action, our assessment of the company’s response, and any further interventions we are making as part of the draft determination.

Each action has a unique reference. The prefix ‘BRL’ denotes the company Bristol Water. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Actions whose numbers are preceded with an ‘A’ denote required actions and actions whose numbers are preceded with a ‘B’ denote advised actions.

Table 2 below sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix ‘BRL’ denotes the company Bristol Water. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Intervention numbers are preceded with a ‘C’.

For all other documents related to the Bristol Water draft determination, please see the [draft determinations webpage](#).

Table 1 – Bristol Water’s response to required actions and interventions for draft determinations

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Securing confidence and assurance	BRL.CA.A1	Required	Provide restated Board assurance that the business plan will enable the company to meet its statutory and licence obligations, now and in the future and take account of the UK and Welsh Government’s strategic policy statements. The Board’s original statement did not contain an explicit statement of assurance on this topic.	1 April 2019	Bristol Water’s Board provides the following updated Board statement: "The Board is satisfied that the business plan allows the company to continue to meet its statutory and licence obligations, and takes into account the Government’s Strategic Policy Statement, including the provision of long term resilience and customer protections."	No intervention required. The Board of Bristol Water provides a compliant assurance statement.	N/A
	BRL.CA.A2	Required	Provide restated Board assurance that large investment proposals are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers. The Board’s original statement did not confirm that large investment proposals are deliverable or that the options chosen are the best for customers.	1 April 2019	Bristol Water’s Board provides the following updated Board statement: "We are satisfied that large investment proposals are sufficiently well assured, robust and deliverable, that a full assessment of options has taken place and that the options proposed are in the best interests of customers, have	No intervention required. The Board of Bristol Water provides a compliant assurance statement.	N/A

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
					customer support, and provide value for money."		
	BRL.CA.A3	Required	Provide restated Board assurance that the Board's governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term. The Board's original statement did not provide assurance that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term.	1 April 2019	Bristol Water's Board provides the following updated Board statement: "The Board confirms that the Board's governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term. The Board has a specific committee in place which oversees and applies assurance and governance, in addition to the processes undertaken by the company management."	No intervention required. The Board of Bristol Water provides a compliant assurance statement.	N/A
	BRL.CA.A4	Required	On dividend policy the company is required to confirm that it is committed to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' to include: clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders. Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.	1 April 2019	Bristol Water confirms its commitment to adopt the expectations on dividends for 2020-25 as set out in 'Putting the sector in balance' position statement including a clear Board commitment to signal changes to stakeholders. It also confirms that it will publish details of how the dividend policy has been applied in its Annual Performance Report and other documents, including any changes to the dividend policy. The company's dividend policy states that the base dividend will be adjusted to reflect the actual outcome and expenditure performance of the business, with reference to its agreed business plan.	No intervention but further action needed by Bristol Water. The company provides sufficient evidence of its intention to meet the expectations on dividends as set out in 'Putting the sector in balance' position statement but its response lacks detail on how it will demonstrate annually to stakeholders that it has met them. It provides insufficient transparency as to: <ul style="list-style-type: none"> the specific obligations and commitments to customers, the level of performance delivery they will be considered against: and how they will impact on dividends. 	We expect Bristol Water to be transparent about how the dividend policy in 2020-25 takes account of obligations and commitments to customers and to demonstrate that in paying or declaring dividends it has taken account of the factors we set out in our position statement and we expect the company to be clear about how it will take account of the particular risks to its long term financial resilience, set out in the securing long-term resilience actions and interventions tracker. We expect the company to respond to this issue in its response to our draft determination. We expect Bristol Water to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and other stakeholders, including performance in delivery against the final determination. In doing so, the company should refer to the examples of best practice we have identified among companies.
	BRL.CA.A5	Required	On executive pay the company is required to confirm that it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' to include:	1 April 2019	Bristol Water states that it will adopt the expectations on performance related pay as set out in 'Putting the sector in balance', and that its policy is currently being amended by their remuneration committee.	No intervention but further action needed by Bristol Water. The company's proposed policy demonstrates the company's commitment to move in the	There remain a number of details to be finalised, for example the exact structure and weightings of the measures within the annual and long term bonus schemes, and how they demonstrate a linkage to substantial

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			<p>clear explanation of stretching targets and how they will be applied; and</p> <p>commitment to report how changes, including the underlying reasons, are signalled to customers.</p> <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.</p>		<p>Although the company does not provide full details of the exact structure and associated weightings of the measures, it states that the targets will be stretching for customers, reflected through the service levels in the performance commitments in the business plan. In addition it states that full details of the policy and how it has been applied will be published in the Annual Performance Report together with any changes and the underlying reasons.</p>	<p>direction of the expectations set out in 'Putting the sector in balance' position statement</p>	<p>service delivery for customers. Once finalised, we expect Bristol Water to provide an update in its response to the draft determination to demonstrate that it is committed to meet the expectations we have set out in 'Putting the sector in balance' position statement .</p> <p>We expect the company and its remuneration committee to ensure its performance related executive pay policy demonstrates a substantial link to performance delivery for customers through 2020-25 and is underpinned by targets that are stretching. Trust and confidence can best be maintained where stretching performance is set by reference to the final determination and taking account of stretching regulatory benchmarks (for example delivery of upper quartile performance) and should include a commitment that it will continually assess performance targets to ensure targets will continue to be stretching throughout 2020-25.</p> <p>We expect the company to report transparently, in its annual performance report, about further updates to the development of its policy that will apply in 2020-25.</p>
	BRL.CA.A6	Required	<p>Provide a revised financial model (based on version 16z released on 31 January 2019) and data tables on 1 April 2019.</p>	1 April 2019	<p>Bristol Water provides a revised financial model based on version 17z (as communicated to companies since the initial assessment of plans action was set) and data tables.</p>	<p>No intervention required.</p> <p>The company provides a satisfactory response to this action.</p>	N/A
	BRL.CA.A7	Required	<p>The company should remove the requested company specific adjustment from its plan and associated financial modelling or provide compelling evidence following the three-stage approach set out in the PR19 methodology if it continues to request a company specific adjustment.</p> <p>There are inconsistencies in stated notional WACC inputs between main business plan</p>	1 April 2019	<p>Please refer to BRL.RR.A1 and BRL.RR.A8 for details of the company's response to this action and our assessments and rationale.</p>	<p>Intervention required.</p>	<p>We are intervening to apply our view of the sector cost of capital to the company's allowed revenues for draft determinations.</p>

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			document, business plan tables and submitted financial model. The company should ensure its subsequent submission contains a consistent set of assumptions.				
	BRL.CA.B1	Advised	Review for consistency the residential advance receipts creditor days and residential trade debtor days in the business plan tables and financial model. Provide an updated financial model that includes the notional value for the 'Bank interest rate (receivable) (post override)' rather than the company's actual value and reinstates zeros for 'Fixed rate debt issued - Override - nominal' when notionalising.	1 April 2019	<p>Bristol Water advises that it has reviewed these issues and believes it should not implement the advised changes.</p> <p>The company considers that the suggested changes to financing assumptions would lead to a higher regulatory allowance for tax which in turn would lead to higher customer bills. The company states that it's modelling aims to keep bills at a level it feels is acceptable.</p>	<p>Intervention required.</p> <p>The company has not completed the advised action.</p>	Our draft determination model for the company is based on our notionalisation and cost of capital assumptions.

Table 2 – Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
BRL.CA.C1	The company accepts the gearing outperformance mechanism, but proposes its out gearing calculation will exclude £12.5 million of preference shares, as it considers these specific historical financing arrangements can be considered an element of equity, rather than debt in some circumstances. We do not accept that treating preference shares as equity for the purposes of the calculation is in the customer interest as it is unlikely interest payments on preference shares could be reduced to reflect, for example, circumstances related to poor performance or to maintain financial resilience.	We expect the Bristol Water to apply our default benefit sharing mechanism. If the company does not apply the default mechanism set out in the 'Putting the sector in balance: position statement', we intend to make an adjustment at PR24 to ensure benefits are adequately shared with customers.

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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