

July 2019

Trust in water

PR19 draft determinations

Yorkshire Water – Securing confidence and assurance actions and interventions

PR19 Draft Determinations: Yorkshire 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 ‘YKY’ denotes the company Yorkshire 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 ‘YKY’ denotes the company Yorkshire 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 Yorkshire Water draft determination, please see the [draft determinations webpage](#).

Table 1 – Yorkshire 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	YKY.CA.A1	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 original statement did not provide assurance of all large investments, their deliverability, that an options assessment had taken place and that the chosen options are the best for customers.	1 April 2019	Yorkshire Water provides the following updated Board assurance statement: "The Board assures that all investment, including large investment projects, is robust and deliverable and an assessment of options has taken place to ensure the company is delivering the best solutions available to customers."	No intervention required. The Board of Yorkshire Water provides a compliant assurance statement.	N/A
	YKY.CA.A2	Required	Provide restated Board assurance that the company's business plan is financeable on both the notional and actual capital structure and the plan protects customer interests in both the short and long term. The original statement did not provide assurance	1 April 2019	Yorkshire Water provides the following updated Board assurance statement: "The Board assures that both notional and actual capital structures remain financeable in the long-term, and that key financial ratios are at a level that retain sufficient headroom to maintain investment grade	No intervention required. The Board of Yorkshire 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
			that the plan protects customer interests in the short and long term.		ensuring that resilience and customers interests are maintained in the short and long term."		
	YKY.CA.A3	Required	Provide restated Board assurance that the Board's governance and assurance processes will deliver resilience in the round and the long-term. The original statement did not provide assurance on the Board's governance and assurance processes.	1 April 2019	Yorkshire Water provides the following updated Board assurance statement: "The Board is confident that its governance and assurance processes will ensure that the outcomes and benefits of the plan are sustainable and efficient and will maintain long term resilience in the round and meet the needs of its customers."	No intervention required. The Board of Yorkshire Water provides a compliant assurance statement.	N/A
	YKY.CA.A4	Required	On gearing outperformance sharing the company has not included our default sharing mechanism from our 'putting the sector in balance: position statement' or an alternative proposal which provides equivalent customer benefits, despite forecasting high gearing over 2020-25. We propose to include our default mechanism in the company's draft determination in the absence of company action to include it in its resubmitted business plan, so that customers will receive bill reductions if gearing in any year is above the 70% threshold.	1 April 2019	Yorkshire water provides the following statement in its initial assessment of plans response: "As explained earlier in this chapter, our intention is to reduce gearing to below 70% before the end of the first financial year (i.e. March 2021). In the event that Yorkshire Water were to have gearing above the 70% trigger level in the default mechanism at any financial year-end in the price control period, the deemed benefit to be shared will be calculated as the difference between our actual gearing and 65%, multiplied by the difference between our actual cost of debt and the cost of equity required by Ofwat as part of the PR19 methodology. As suggested by Ofwat, the position for this mechanism will be assessed at the end of 2024-25 period. Any resulting benefit will be shared 50-50 with customers as a bill reduction from April 2025".	No intervention required. Yorkshire Water confirms that it will apply the default sharing mechanism from our 'putting the sector in balance: position statement' if gearing rises above 70%.	N/A
	YKY.CA.A5	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: position statement' to include: <ul style="list-style-type: none"> • clear Board commitment to publish detail on dividend policies in the APR and to signal changes to stakeholders; and • commitment to transparency about how the dividend policy in 2020-25 takes account of obligations and commitments to customers 	1 April 2019	Yorkshire Water confirms that it is committed to adopting all of the expectations on dividends for 2020-25 as set out in 'putting the sector in balance: position statement'. Its Board is committed to publishing detail on dividend policies in our APR, signalling changes to stakeholders and being transparent about how dividend policy is applied in 2020-25. It also confirms it will adjust its base dividend to reflect and recognise company performance and delivery to customers, in particular performance above or below that assumed in the determination of price limits.	No intervention but further action needed by Yorkshire 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"> i) the specific obligations and commitments to customers; 	We expect Yorkshire 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. We expect the company to respond to this issue in its response to our draft determination. We expect Yorkshire Water to demonstrate that its dividend policy for 2020-25 takes account of obligations and commitments to customers and

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
			<p>for the dividend policy that is applied in 2020-25 and when determining dividends.</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>ii) the level of performance delivery they will be considered against; and</p> <p>iii) how they will impact on dividends.</p>	<p>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.</p>
	YKY.CA.A6	Required	<p>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: position statement' to include:</p> <ul style="list-style-type: none"> commitment to report how changes, including the underlying reasons, are signalled to customers; and commitment to publish the executive pay policy for 2020-25 once it has been finalised. <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>	1 April 2019	<p>Yorkshire Water confirms that it is committed to publishing the details of its executive remuneration policy for the period 2020-25 in 2020 when it has been finalised. In addition, the company commits to signalling the reason for of any changes to the policy for 2020-25 and how they are in the best interests of customers.</p> <p>Yorkshire Water is currently reviewing the long term incentive and states that the final details and weightings of both the annual and long incentives will be agreed with the remuneration committee once the draft determination response from Ofwat, with details of any interventions, has been received.</p>	<p>No intervention but further action needed by Yorkshire Water.</p> <p>The company's proposed policy demonstrates the company's commitment to move in the direction set out in 'Putting the sector in balance.'</p>	<p>There remain a number of details to be finalised, for example the final weightings of the target metrics and review of the long term incentive plan. Once finalised, we expect Yorkshire 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>
	YKY.CA.A7	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>Yorkshire 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

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	YKY.CA.A8	Required	<p>Retail margins: gross margin increases for wastewater 5-50ML users in 2020/21 cause average forecast bills to increase by more than 1.0%, as applied at PR16. The company should reprofile the increase in this year to ensure this threshold is not breached.</p> <p>Financial model inputs: the notional cost of debt allowance input used is 4.37%. The company should amend the notional cost of debt allowance input to 4.36%, as per our final methodology 'early view.'</p>	1 April 2019	Please refer to YKY.RR.A1 and YKY.RR.A2 for details of the company's response to this action and our assessments and rationale.	No intervention required.	N/A
	YKY.CA.B1	Advised	Provide an updated financial model and/or tables App8 and R7 in which business retail revenue and opening RCV balances reconcile. The updated financial model should also calculate notional dividends within the model itself and follow our user guide when notionalising i.e. include zero values for the 'Index linked debt drawdown' override that was included by the company.	1 April 2019	Yorkshire Water confirms that its revised financial model is notionalised in accordance with Ofwat guidance and that inconsistencies between the model and the data tables are corrected.	<p>Intervention required.</p> <p>We confirm that the RCV balances reconcile between the business plan tables and the financial model. However, differences exist in business retail revenues which appear to be the impact of competition on allocation of wholesale charges.</p>	To ensure that the PR19 financial model correctly calculates the company's business retail revenues we have populated an additional tariff in the model. This tariff is used to model the wholesale charge passed on to other business retail companies. We have applied zero cost and margin to this tariff band to ensure we do not overstate the company's business retail revenues.

Table 2 – Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
N/A	N/A	N/A

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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