

# **Response to the Provisional Findings (PF) from the Competition and Markets Authority (CMA) for Yorkshire Water from the Yorkshire Forum for Water Customers**

## **1. Introduction**

1.1 As previously noted, the Yorkshire Forum for Water Customers (the Forum) is an independent group of customer and stakeholder representatives brought together under an Independent Chair to challenge Yorkshire Water in developing its business plan for the PR19 Price review. In particular, the Forum challenged the company to ensure its business plan fairly and accurately reflected the views of customers in the Yorkshire and Humberside region gained through high quality research and engagement and would result in high quality services supported by ambitious performance commitments (PCs).

1.2 Members of the Forum are drawn from: Citizens Advice; the Consumer Council for Water; the Environment Agency (EA); the National Farmers Union; Natural England; Pennine Prospects; and The Rivers Trust, together with independent experts on the environment, local government and affordability/vulnerability issues.

1.3 The Forum submitted a response to Ofwat on the Initial Assessment of Plan (IAP) in March 2019. It also provided responses to Ofwat on the Draft and Final Determinations which it subsequently made available to the CMA. It made a written submission to the CMA and took part in a virtual hearing on 25 May 2020, with the Chair and three members of the Forum providing evidence. Members of 3 other Customer Challenge Groups were also present in the hearing as a total of 4 companies asked Ofwat to refer their price control determinations to the CMA.

1.4 The Forum communicated to the CMA that the Final Determinations proposed by Ofwat would result in:

- \* constrained investment in infrastructure and resilience, thereby compromising levels of service for future generations of customers;
- \* a fluctuating bill profile when customers had asked for stable bills.

The Forum advised that, whilst it was willing to support lower bills for customers, this should not result in high priority customer-supported schemes being compromised because of financial constraints.

1.5 At the time of the Draft Determination, the Forum concluded that the resources to be made available to the company appeared insufficient to deliver the high level

of service proposed by Ofwat and would place Yorkshire Water and its customers at an increased – and inappropriate – degree of risk. It was not convinced that the plan proposed by Ofwat was financeable and deliverable and believed there would be a significantly increased risk of penalty payments and a potential negative impact on bills and services in the next AMP. Although there was some movement on both sides prior to the publication of the Final Determination, the Forum did not expect this to be enough to 'bridge the gap'. It therefore considered Yorkshire Water's challenge of the PR19 Final Determination to be an inevitable outcome given the issues which it raised for limited investment in infrastructure, resilience and innovation and the likely impact on levels of service for customers.

1.6 The Forum commented that there had been contact with the Board and shareholders throughout the price review process (and indeed PR14). It was clear about the Board's objectives and the balanced view adopted by investors who had shown willingness to be open and transparent about the company's corporate and financial structures and dividend policy. The Forum was satisfied that it was the Board's ambition to have oversight for providing a high-quality service to customers in the region at the lowest possible cost, including protecting those who were most vulnerable.

## **2. Summary of CMA's Provisional Findings (PFs)**

2.1 In summary the Forum understands that the CMA is in agreement that Yorkshire Water (and the other companies who appealed) should be subject to a challenging set of performance targets, reinforced by financial incentives, but that it has provided limited additional funding to allow for more resilient networks as well as enabling the companies to achieve substantial reductions in leakage.

2.2. The CMA has made adjustments to Ofwat's allowed rate of return to reflect market evidence and best regulatory practice with a view to ensuring continued investment in the sector; and reduced, to some extent, the companies' exposure to financial risk to achieve what it considers to be the right balance between incentivising out-performance and ensuring that the companies can finance themselves and comply with all relevant statutory duties.

2.3 In summary, the key components of the PFs for Yorkshire Water are to:

- Seek to find the right balance between risk and reward;
- Increase revenues by £212 m;
- Provide a more equitable sharing mechanism of 55:45;
- Allow £93 m additional investment to tackle leakage;
- Remove the accelerated revenues in Ofwat's Final Determination;
- Adopt a cost of capital allowance of 3.50%;
- Produce overall lower bills for customers.

2.4 The Totex sharing mechanism provides protections to customers and the company. Under the revised sharing ratio, if the company overspends the

company will carry 55% of any overspend and 45% would be recovered through customer bills in AMP 8. If there is outperformance and the company spend less than it has been allowed, then 55% would be returned to customers.

### **3. Observations from the Forum**

3.1 The Forum has discussed these headline proposals from the PFs for Yorkshire Water at two virtual hearings and makes several observations.

3.2 The Forum particularly welcomes the recognition that has been given to its own observations around the balance between risk and reward, reinforcing its view that Ofwat's Final Determination would expose Yorkshire Water to too great a level of risk. This was a central theme in the Forum's written submissions to both Ofwat and the CMA and its oral evidence to the CMA. The Forum understands that the CMA had two options in reducing exposure to risk – either to reduce the cost of capital, or to reduce targets, and it has opted for a WACC of 3.5%, which is 0.54% higher than that proposed in Ofwat's PR19 decision.

3.3 The Forum also supports the additional funding to be made available to address the risk of flooding in Hull and Haltemprice; and the £9 million for phosphorus removal. Whilst £93 million will be allowed to address leakage over 5 years, there will be an increased penalty to protect customers if the PC is not achieved which the Forum considers appropriate.

3.4 The Forum believes the result of these adjustments will be a more stable company, with more equitable sharing rates between the company and its customers, but with investors still finding Yorkshire Water an attractive financial proposition in a difficult economic climate.

3.5 Under the PFs, Yorkshire Water will have additional revenues of c £212 million spread over the AMP. There will still be high service targets which the Forum supports. There are some concerns from the Forum about the lack of additional funding for internal sewer flooding, but with the same target, as this is an area which customers see as a high priority for investment and where there has been historic underperformance. The Forum would like to see efficient costs allowed in this area, with increased investment and improved performance. It understands that Yorkshire Water will be asking for additional funding for this area in its response to the CMA, together with an enhanced penalty rate that would return the investment to customers if the company fails to meet the target. It considers the existing target of Upper Quartile performance to be fair but challenging.

3.6 The Forum understands that the bill profile will be an average stable bill of £379 each year and knows that customers welcome steady and stable bills, rather than significant fluctuations. This was supported by the PR19 research where 88% of customers supported the business plan, with 96% support for bills and 97% support for investment in the environment. In contrast the Final Determination from Ofwat proposed a bill profile over the 5 years of £379 > £372 > £364 > £357

> £349 (an average of £364). The Forum has concluded that this bill reduction would only be short term and would harm longer term resilience.

#### **4. Conclusion**

4.1. The Forum has been aware from its contact with Yorkshire Water that the company regarded the referral to the CMA as being necessary because they had concluded that Ofwat's Final Determination did not protect the long-term resilience of the area supplied by Yorkshire Water and would result in the cost of vital infrastructure investment being passed on to future generations.

4.2 The Forum believes that the CMA has recognised that the needs of current and future customers are best served by encouraging investment in infrastructure, including leakage, to mitigate the impact of climate change and reduce exposure to risk and provided a more balanced investment profile. It welcomes and supports the Provisional Findings. It hopes that this will result in high quality services and improve long-term investor confidence.

4.3 Members acknowledge that some customers would prefer lower bills, however the results of high-quality research confirm that the majority support investment in the areas the company has prioritised. The Forum, and the CMA, note this is a difficult financial climate because of COVID, however the bespoke PCs which the company has developed for vulnerable customers are very much supported by the Forum and acknowledged by the CMA. The Forum expects Yorkshire Water to continue to identify and meet the needs of customers struggling to afford to pay their bills and welcomes the range of 'offerings' to assist them to do so. The Forum will continue to play a key role in monitoring the achievement of the PCs in this area through its Affordability and Vulnerability sub-group.

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