



Summary of responses to the consultation on modifications to Thames Water's Instrument of Appointment required to give effect to the Thames Tideway Tunnel project

On 16 February 2015 Ofwat published a consultation to seek [comments on a proposal to modify Thames Water's Instrument of Appointment](#) to enable Thames Water to implement the Thames Tideway Tunnel project (the Project).

This consultation ended on 16 March 2015 and must be seen in the context of our other consultations on the Project.

In October 2014 we consulted on the [regulatory framework that will regulate an infrastructure provider](#) (IP) appointed to deliver the Project. In October 2014, we also consulted on a [first set of modifications to Thames Water's licence](#) necessary to give effect to the Project.

[Those modifications](#) came into effect on 8 December 2014 and enabled Ofwat to determine a separate Thames Tideway Tunnel price control for those costs that will be incurred by Thames Water in connection with the Project over the next five year period.

On 26 January 2015 we started consulting on a [proposal to amend guidance](#) that we issued in July 2014 on the factors we will take into account in specifying a project as an infrastructure project.

This consultation closed on 23 February 2015 and the [amended guidance](#) was published on 8 May 2015.

Background and reasons for the modifications

The Thames Tideway Tunnel

The Project is of unprecedented scale, size and complexity in the water sector in England and Wales and will be the first project to be delivered under a new regulatory framework. That framework allows for certain large and complex infrastructure projects to be delivered by infrastructure providers that are:

- appointed by the incumbent undertaker following a competitive procurement; and
- regulated by Ofwat under a project licence.

The Project is the first to be delivered under this new regulatory framework and an IP is currently being procured by Thames Water to deliver the Project.

Reasons for the modifications

The modifications are considered necessary to give effect to the Project, in particular, in that they will enable Thames Water to charge customers for the activities of the IP.

The amount the IP can charge Thames Water will be regulated by the project licence that is intended will be issued to the IP (IP Project Licence) and by an agreement that will be entered into between Thames Water and the IP (the Revenue Agreement). The Revenue Agreement may not be amended without our consent.

In addition, the proposed modifications introduce a new condition T (Thames Tideway Tunnel Project) to regulate various Project-specific issues, including: the collection of revenue for the IP where the award of the IP Project Licence is delayed

(to effect bill smoothing); the treatment of Project land; the resolution of disputes relating to mandatory variations to the construction works; and the consequences of the Project being de-specified by the Secretary of State, of the IP Project Licence being revoked, or of the Revenue Agreement being terminated.

Responses received to the consultation

We received four responses to this consultation and we received a letter from Thames Water confirming that it has agreed the amendments. We have published these [responses](#), from the Consumer Council for Water (CCWater), the MP for Chelsea and Fulham and two private individuals.

We discuss respondents' views on the consultation below.

CCWater

CCWater confirmed its acceptance of the proposed modifications and supported the requirement in Condition D for Thames Water to include the IP Charge in its Charges Scheme each year. We will continue to engage with CcWater on the Project.

The MP for Chelsea and Fulham

The MP for Chelsea and Fulham raised concerns about the impact of the Project on his constituents' sewerage bills. He asked Ofwat to do what it can to ensure that the increase in Thames Water customers' sewerage bills will be as small as possible and that customers get value for money. He also asked Ofwat to ensure that the costs of the Project are itemised separately on customers' bills.

Ofwat's response

The MP's concerns about the costs of the Project being itemised separately on customers' bills will be relayed to Thames Water as it is Thames Water that is responsible for determining what goes onto its customers' bills.

Ofwat has played an active role over the last few years in reviewing and challenging the costs of the Project in order to ensure that bills are kept as low as possible and that the Project is carried out in a way that provides value for money for customers.

We will continue to do this by exercising oversight over the procurement of an IP by Thames Water in the expectation that the competitive process will lead to a value for money outcome for customers; and by monitoring the role of the IP and Thames Water in carrying out the Project, including in respect of costs.

Individual 1

One of the individual responses received was concerned that the amendments will have the effect of compromising the independence of the IP as a separate 'undertaker'. He also expressed concern at the IP assigning rights to collect revenue from customers to Thames Water. He supports customer bills being transparent and setting out separately the costs due to the IP. This individual also wants the Revenue Agreement to be put into the public domain.

Ofwat's response

We will convey this person's view to Thames Water that bills should itemise the Project separately and that the Revenue Agreement should be put into the public domain.

On his concern about the IP assigning rights to collect revenue from customers to Thames Water, the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 only allow the IP to charge for services provided and during construction of the tunnel, it is Thames Water that will be receiving a service from the IP rather than end user customers. In operations, the IP has the right to charge end users or Thames Water but as the IP provides an upstream service it is not considered appropriate for the IP to also create a retail function for charging end user customers.

Individual 2

One of the main concerns raised by the other individual respondent was what he sees as the cumulative regressive impact on customer bills of the Project combined with the implementation of Thames Water's progressive metering programme. He suggests that Thames Water consult on a plan as to how it will charge customers for the Project and he proposes that customers who are most able to pay and will see most benefit from the Project should pay the most.

On condition B he asks that consultations be held prior to price reviews and interim determinations being finalised. On the new condition T, he proposes that the 'no pain/no gain' principle around the disposal of Project land "be extended to include restoration to customers of any work or expenditure incurred unnecessarily," and to guarantee that any fines imposed by the European Union (EU) will not be recovered through customer charges.

This individual also considers that the Thames Water licence or the IP licence should deal with the Government Support Package (GSP), ring-fencing any benefit from the GSP so that customers rather than shareholders benefit from that Package.

Ofwat's response

We will convey his views on how customers should be charged for the Project to Thames Water as it is Thames Water that must determine the most appropriate way of allocating costs across its customer base.

On condition B, in line with our normal practice, we will issue a draft price determination for public comment, before issuing a final price determination and similarly with interim determinations, we will issue a draft for comment ahead of issuing a final interim determination.

The respondent also proposed that the no gain/no pain principle that applies to the disposal of Project land should "be extended to include restoration to customers of any work or expenditure incurred unnecessarily". The no pain/no gain principle that applies to Project land has been put in place to ensure that customers, rather than shareholders, benefit from the sale of Project land when it is no longer required by the Project.

Consistent with the application of an incentive based regulatory regime in water and other utility sectors, all other expenditure incurred by Thames Water will be subject to an ex-ante incentive mechanism whereby customers will receive 50% of the benefit of outperformance against the costs allowed in the final determination and shareholders will bear 50% of the pain of underperformance.

This mechanism provides a robust incentive on Thames Water to deliver its activities efficiently, to avoid unnecessary expenditure and avoid unnecessary regulatory intrusion.

While Thames Water has and will continue to undertake a significant element of the Project, as reflected in the separate price control for the Project, it does not have access to the benefits afforded by the GSP. Only the activities of the IP in delivering the Project will be covered by the protections of the GSP and only in respect of such low probability events which would, if they arose, have a very high impact on both the delivery the Project and on customer bills. The GSP has thus been structured to ensure that customers rather than shareholders benefit from the package.

We presume the reference to fines imposed by the EU is a reference to potential fines which may be imposed on the UK government for failing to ensure compliance with the Urban Waste Water Treatment Directive. One of the main reasons for building the tunnel is to avoid such fines. If, notwithstanding the Project, fines are imposed, those fines will be imposed on the UK Government.

Although the Localism Act gives the UK Government the right to pass on a proportion of EU fines to public bodies responsible for the relevant breach, it is only bodies which have been specifically designated by the Government to which that applies and Thames Water has not been so designated¹.

Conclusion

On the issue of customer charging, including separately itemising the Project on customer bills, we will forward the relevant comments to Thames Water.

Having considered the responses to the consultation, we have [modified Thames Water's Instrument of Appointment](#) to enable Thames Water to implement the Project. The modifications are being made with the consent of Thames Water under section 13 of the Water Industry Act 1991.

These modifications became effective on 1 April 2015.

End

¹ Section 48 of the Localism Act 2011 allows Government to require certain public authorities to make payments in respect of certain EU financial sanctions. This only applies public authorities that are designated under section 52 of the Act. Section 51 sets out the meaning of public authority. Although it does not expressly include water undertakers, undertakers may be covered to the extent they are carrying out public functions. However, to date, Thames Water has not been designated under the Act.