



**Proposed modifications to condition B of
Thames Water's licence to enable its
Thames Tideway Tunnel activities to be
regulated under a separate price control:
A consultation under section 13 of the
Water Industry Act 1991**

An Ofwat consultation paper

Introduction

The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales.

We welcome the opportunity to respond to Ofwat's consultation on its proposed amendments to Thames Water's Licence which are designed to:

- enable a separate price control for the Thames Tideway Tunnel (TTT) for the period 2015-20; and,
- set a bespoke materiality threshold for any uncertainty mechanisms that Ofwat may set out in their final determination of price limits.

The consultation also raises the issue of the potential for bill smoothing during the next price control period.

Executive Summary

The consultation sets out the potential benefits of having a separate price control for activities related to the construction of the TTT carried out by Thames Water. We support these conclusions and argue that this arrangement should remain in place until the TTT is fully constructed and commissioned. We do however accept Ofwat's proposal to review this at the end of the next price control period (2019) in the context of the next price review.

We also accept the arguments for allowing an IDOK and the substantial effects mechanism to apply to the TTT price control, as well as the other opportunities for a significant change in circumstances to be reflected in price controls or through a logging up mechanism. However we flag our concerns over the ability to challenge such potential cost pass through applications and their potential to have a significant direct and cumulative effect on customers' future sewerage bills.

We continue to support the phasing in of the costs associated with TTT during the next price control period and beyond as this will smooth any increase in customers' bills. This proposal was tested with customers and showed there was strong support for this approach. We do however stipulate that TTT revenue must be clearly ring-fenced.

We note that this is one of a series of Ofwat consultations related to the TTT and appointment of the Infrastructure Provider (IP) and that a further planned consultation addressing additional customer protection measures is expected next month.

Enabling a separate price control

We support the proposal to modify Condition B of Thames Water's licence to allow a separate price control for the company's TTT related activities. We believe this is appropriate given the differing risk profiles associated with the TTT and the company's other business activity. Clear boundaries are needed between Thames Water and the IP and Thames Water's expenditure on its general wholesale sewerage activity and that related to the TTT. This separation will in our view assist with Ofwat's regulatory requirements and provide a level of transparency that will satisfy our own and other stakeholders' requirements.

Time limiting the TTT Price Control

Given the stated benefits of the separate price control for TTT we would support Ofwat's view that this should be maintained beyond 2020 until such time that the TTT is fully commissioned and integrated into the local sewerage network. This is a highly complex sewerage project and the first to be delivered through an IP. There needs to be transparency over the costs related to this project in its entirety. Separate accounting will ensure that a full and proper analysis can be undertaken.

We do however agree with Ofwat's proposal to review the situation in the context of the next Price Review (PR19).

Uncertainty Mechanisms

We accept that IDoK and substantial effects mechanisms are standard and therefore applicable to the price control for TTT. Ofwat expect that a change to the Preparatory Work Notice, or to the Project Specification Notice, could comprise a relevant change of circumstance in relation to the TTT price control. In their draft determination Ofwat proposed a bespoke mechanism that would allow certain, specified costs to be logged up at the next price review in defined, limited circumstances. This mechanism is defined in the price determination itself and so does not require a licence amendment.

Under the existing licence conditions, companies, including Thames Water, may apply for an IDoK if they experience material relevant changes of circumstances or material costs arising from notified items (items notified by Ofwat as not having been allowed for either in full or in part in final determinations). It is Ofwat's intention to set out the notified items that will apply to a price control in the final price determination in December 2014.

Although we note, and take some comfort from, the commitment in the draft determination that only specified costs would be logged up at the next price review in "defined, limited circumstances" we are concerned over the potential impact on customers bills should any one or a combination of these mechanisms come into play.

Ofwat has proposed that the materiality threshold for the TTT price control be set at 10% of the TTT RCV. And while this would appear to provide a meaningful threshold for future price controls we would call on Ofwat to ensure that any such applications are carefully scrutinised and robustly challenged on behalf of Thames Water's sewerage customers.

Bill smoothing mechanism

The current timetable envisages that the IP will be appointed late next year with construction starting in 2016. There are a number of factors that might delay this timetable however the agreed costs associated with the project are still likely to be recovered during the price control period.

In research conducted by the company, customers favoured the phasing in of TTT related bill increases from the start of the period, thereby smoothing the impact on their annual bills. This was in preference to an initially flat bill with more significant increases following the price review in 2019, part way through the project. This latter option also resulted in a higher bill level

at the end of the project's completion, albeit the overall amount paid by customers would be roughly the same.

Any TTT related revenue collected must be ring fenced for that purpose and this would again reinforce the need for separate and transparent accounting arrangements.

We therefore continue to support this proposed approach and look forward to the detailed consultation on this later in the year.

Enquiries

Enquiries about this consultation response and requests for further information should be addressed to:

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