



Protecting customers where there are very material differences between companies' re-submitted plans and Ofwat's wholesale cost assessment

Ofwat has today written to Bristol Water, Thames Water and United Utilities to inform them that it is already clear that, for individual price controls, very material differences remain between the companies' re-submitted plans and our assessment of efficient wholesale costs.

Relevant companies re-submitted their business plans on 27 June following our risk-based review. In their re-submitted plans, many companies included a number of claims for wholesale costs which they argued were not accounted for in our cost models. We have carefully assessed each of these claims on a consistent basis as part of our wider assessment of efficient costs.

There are three companies where, for individual price controls, our current assessment suggests there will be a very material 'gap' between the expenditure sought by the companies and Ofwat's view of efficient expenditure – **well above 20%, and markedly above the gaps observed for other price controls**. While our assessment of all companies' plans is not final, and further refinement of our own modelling could result in changes, in Ofwat's judgement this is unlikely to result in changes sufficient to address the scale of the gap for these price controls.

As a result, we have decided to give those companies affected as much time as possible to review the relevant parts of their plans relating to these price controls ahead of the deadline for re-submitting evidence for our final determinations in December 2014. The three price controls affected are:

- Bristol Water – the wholesale water price control;
- Thames Water – Thames' costs in respect of the Thames Tideway Tunnel; and
- United Utilities – the wholesale wastewater price control.

We are focusing on the differences in future planned wholesale costs at this point in the process because:

- wholesale costs are very important to the prices consumers pay and the services that companies deliver. Overall wholesale costs comprise more than 90% of the value chain;
- our assessment of cost claims is different from other areas of the price control as it is very reliant on specific information from companies; and
- it is important to establish a robust wholesale cost 'baseline' in order to calibrate incentives (particularly for the delivery of the outcomes which companies proposed to provide to their customers in their business plans).

Below we summarise the information that we have sent to the affected companies.

Table 1 Summary of overall wholesale cost assessment

Company	Company business plan AMP6 totex	Ofwat preliminary assessment of efficient costs AMP6 totex	Remaining gap for draft determination
Bristol Water – Water	£562m	£359m	£203m (57%)
Thames Water – Thames Tideway Tunnel Costs¹	£655m	£324m	£331m (102%)
United Utilities – Wastewater	£3,414m	£2,645m	£769m (29%)

Note:

1. We have assessed these costs separately as Thames Water's business plan was based on its willingness to have a licence that supports a separate price control for Thames Tideway costs.

Table 2 Summary of wholesale water cost assessment for specific claims – Bristol Water (£m)

Company proposal		Assessment ¹				Draft determination allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
Cheddar Two Reservoir	43.7	0	Fail	Partial pass	Fail	Reject	0
Replacement of Bedminster Reservoir	6.5	1.4	Fail	Fail	Partial pass	Reject	0
Opex part 1: Water treatment modelling	13.1	2.9	Fail	n/a	Fail	Reject	0
Opex part 2: Canal water	14.7	3.2	Fail	n/a	Fail	Reject	0
Opex part 3: Canal & River Trust payments	8.1	1.8	Fail	n/a	n/a	Reject	0
Opex part 4: Bristol traffic congestion	6.0	1.3	Fail	Partial pass	Fail	Reject	0
Asset reliability – unplanned customer minutes lost	3.5	0.8	n/a	n/a	n/a	Reject	0
National Environment Programme	11.9	0	Pass	Pass	Partial pass	Partially accept	3.2
Capital maintenance costs (net)	81.1	17.9	Fail	n/a	Fail	Reject	0

Company proposal		Assessment ¹				Draft determination allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
Southern Resilience Scheme	30.8	8.4	Pass	Pass	Partial pass	Partially accept	3.2
Asset Reliability – discoloured water contacts	12.3	4.8	Pass	Pass	Partial pass	Partially accept	2.0
Cheddar Treatment Works raw water deterioration	23.0	10.1	Pass	Pass	Partial pass	Partially accept	5.7
Growth expenditure	14.4	10.1	Fail	Fail	n/a	Reject	0

Note:

1. For the wholesale cost assessment, if material, company special factor/cost exclusion claims were evaluated against the following criteria: (1) the extent to which the costs in question have already been allowed implicitly in our cost modelling; (2) a clear need has been demonstrated; (3) the proposed solution is the most cost beneficial or most cost effective; and (4) there is a robust cost estimate with a clear breakdown and methodology that demonstrates an efficient level of costs. We are also still reviewing other matters, including the customer safeguards associated with companies' proposed outcomes associated with its planned expenditures. This note also applies to table 3 and table 4 below.

Table 3 Cost assessment for the Thames Water delivered element of the Thames Tideway Tunnel (£m)

Company proposal		Assessment ¹			Draft determination allowance	
Claim	Amount sought	Need	CBA	Robust costs	Assessment	Amount allowed
Resilience	109.6	Pass	Fail	Fail	Reject	0
Risk	135.9	Pass	n/a	Partial pass	Partially accept	30.3
Inflation	13.8	Pass	n/a	Fail	Reject	0
Construction	209.8	Pass	Pass	Partial pass	Partially accept	182.1
Land	83.7	Partial pass	n/a	Partial pass	Partially accept	51.0
Indirect costs	63.9	Partial pass	Partial pass	Partial pass	Partially accept	21.3
Development costs	18.0	Pass	n/a	Pass	Partially accept	18.0
Corporate overheads	21.1	Pass	n/a	Pass	Partially accept	21.1

Note:

1. We have assessed these costs separately as Thames Water's business plan was based on its willingness to have a licence that supports a separate price limit for Thames Tideway Costs. As the Tideway is outside the scope of our wholesale cost modelling the implicit allowance for this expenditure in our cost thresholds is zero.

Table 4 Summary of wholesale wastewater cost assessment for specific claims – United Utilities (£m)

Company proposal		Assessment				Draft determination allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
National Environment Programme (NEP) 3&4 – Bathing water intermittent discharge projects	180.8	77.9	Pass	Pass	Partial pass	Partially accept	92.2
NEP 5 – Shellfish schemes	35.4	0	Pass	Pass	Fail	Reject	0
NEP 3&4 – Biodiversity (P removal in Windermere)	42.7	15.2	Pass	Pass	Partial pass	Partially accept	24.6
NEP 4 – Chemical and P removal investigations	33.3	17.5	n/a	n/a	n/a	Reject	0
Trunk mains network reinforcement not subject to developer contributions	24.6	3.7	Fail	n/a	n/a	Reject	0
Base total expenditure	145.4	0	Partial pass	n/a	Fail	Reject	0
NEP5 – Water Framework Directive	235.4	0	Partial pass	Pass	Fail	Reject	0
Davyhulme wastewater treatment works	162.2	0	Fail	Fail	Partial pass	Partially accept	39.3

Company proposal		Assessment				Draft determination allowance	
Claim	Amount sought	Implicit allowance	Need	CBA	Robust costs	Assessment	Amount allowed
Oldham & Royton wastewater treatment works	104.6	0	Fail	Partial pass	Fail	Reject	0

We are sharing our findings on very material ‘gaps’ with the companies now so they have the best possible opportunity to reflect on their plans for the coming five-year period and reconsider their proposals in responding to our draft determinations. This may include submitting further compelling evidence that their wholesale cost submissions are efficient. These companies may wish to re-engage their customer challenge groups (CCGs) and engage with other regulators. We consider that this will protect customers by allowing the companies to start work on the further evidence that we will need by 3 October to ensure that our final determinations include only the efficient cost of delivering outcomes.

We will issue draft determinations for all relevant water and wastewater companies (including for these three companies) as planned on 29 August 2014.

All stakeholders will have until 3 October 2014 to make any representations on these draft determinations. We will continue to work with all our stakeholders to ensure that PR14 delivers the best possible outcome for customers and we look forward to further constructive engagement.

We will issue final determinations for all companies in December 2014.

Further information

[Bristol Water – water special costs claims](#)

[Thames Tideway Tunnel – cost claims](#)

[United Utilities – wastewater special cost claims](#)

Ofwat
6 August 2014