

July 2019

Trust in water

PR19 draft determinations

**Thames Water – Securing cost efficiency
actions and interventions**

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PR19 Draft Determinations: Thames Water – Securing cost efficiency 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 'TMS' denotes the company Thames 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 'TMS' denotes the company Thames 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 Thames Water draft determination, please see the [draft determinations webpage](#).

Table 1: Thames 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 cost efficiency | TMS.CE.A1 | Required | We provide our view of efficient costs for the company along with our reasoning. We expect it to address areas of inefficiency, or lack of evidence, in the revised business plan. Where appropriate, we expect it to withdraw investment proposals if either: the need for investment is not compelling; or there is no need for a cost adjustment claim beyond our existing cost baseline. | 1 April 2019 | Thames Water is inefficient at a company level. It reduced its costs across all areas in the April resubmission, but it still has one of the largest gaps between requested expenditure and our allowed expenditure. Thames Water is particularly inefficient in wholesale water and retail. Thames Water removed three of its cost adjustment claims which we rejected at initial assessment of plans, one of which was subsequently resubmitted as enhancement expenditure. It retained five claims covering retail, water network plus and bioresources controls. | Intervention required. Some of the additional supporting evidence failed to provide convincing cases for reducing our challenge or accepting a claim. While the company reduced costs in all areas, it did not respond sufficiently to our efficiency challenge in its resubmitted costs. The company's bioresources costs are efficient. | We provide our view of efficient costs for the company along with our reasoning. We expect the company to continue to address areas of inefficiency and lack of evidence. |

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| | | | | | <p>Thames Water significantly reduced its proposed water security expenditure since initial assessment of plans.</p> <p>Thames Water provided additional business case evidence across many areas, including metering, CRI and unplanned outage improvements, resilience, and the water and wastewater WINEP programmes, some of which allowed us to reassess and revise allowances.</p> <p>It also provided additional evidence on frontier shift, real price effects, econometric modelling and outcomes.</p> | | |
| TMS.CE.A2 | Required | <p>Metaldehyde Ban.</p> <p>There may be significant impacts in terms of investment or type of investment as a result of the metaldehyde ban. The company should investigate and agree with the DWI the scale and timing of any potential changes compared to its submitted plans. Significant changes and uncertainty may require an outcome delivery incentive to protect customers in the instance of expenditure not being required. Should the company propose a performance commitment and outcome delivery incentive, the company should provide evidence to justify the level of the performance commitment and the outcome delivery incentive rates proposed, in line with our Final Methodology. We expect to receive evidence of customer support for outperformance payments, where proposed, and that the incentive rates proposed are reflective of customer valuations.</p> | 1 April 2019 | <p>The company has revised its submission in relation to metaldehyde treatment. The company has removed £5m over 2020-25 due to not installing monitors on high risk raw water sources.</p> <p>The company does however intend to continue other catchment measures to ensure there is protection for customers.</p> <p>The company is continuing to propose two performance commitments for CRI, one for metaldehyde and one for all other parameters.</p> | <p>No intervention required for Draft Determination but further action needed by the company.</p> <p>We support the proactive catchment management activities and acknowledge these cover multiple drivers.</p> <p>Due to legislative change, metaldehyde will diminish as a factor in CRI, we do not consider two bespoke performance commitments, as proposed by the company, are appropriate. We are therefore intervening to remove them and set final incentives for the common performance commitment for CRI.</p> | <p>Company to provide evidence to confirm DWI agreement with its submitted plans/revised undertakings and that no metaldehyde specific treatment or product substitution costs are included in the requested allowance.</p> | |
| TMS.CE.A3 | Required | <p>Strategic regional solution development - We have identified from the plans that at least one strategic supply solution is required over the next 5-15 years to secure drought resilience in the south-east. The strategic regional solution development allocation is to allow the delivery of consistent and transparent investigations, planning and development of strategic options with the overall aim of optimum solutions being construction ready by 2025.</p> <p>The company's allocation is made on the basis of having clear deliverables and customer protection for the gated delivery of the development of an eastern regional solution/transfer. The following actions are required to ensure the efficient delivery of this development programme.</p> | 1 April 2019 | <p>The company's strategic regional water resources submission includes a joint statement by six companies via Water Resources South East. This joint statement considers: the principles for joint working; timing of the gateways; increased detail of the work between the proposed gates; the principles of a change protocol to manage changes to schemes in the proposal and to change the current list of schemes when required; development of the principles of an outcome delivery incentive type mechanism to allow</p> | <p>Intervention required.</p> <p>We have assessed the revised submissions (both joint and company specific) to intervene for the draft determinations. This includes updates to cost allowances for this development programme, gate delivery updates and the end of period reconciliation mechanism to protect customers. The detailed assessment and rationale is provided in the 'Strategic</p> | <p>Company to present joint solutions consistently with solution partners and clearly set out the costs related to strategic regional water resource solutions in its representation to the draft determination.</p> | |

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| | | | <ul style="list-style-type: none"> In conjunction with the other companies involved, jointly propose methods for collaborative working including setting up the joint working group for individual schemes, and how consistent assumptions and decisions will be made within these groups and between them. Provide more detail on the gated process, the deliverables, timings and expenditure allocations at each gate. Propose outcome delivery incentive-type mechanisms to allow allocated funding to be recovered by customers in the event of the scheme not progressing through each gate and for the non-delivery or late delivery of outputs. <p>Intervention updates and clarifications: We sent clarification of our expectations for information relating to this action that we expected information submitted on 1 April to be as accurate and complete as possible, but accepted that given the timescales and joint working implications this may be in draft form. However, we wanted clarity on the costs relating to strategic regional water resource solutions and the solutions this relates to be summarised by 12 April, with the final information covering the action by 3 May.</p> | | <p>funding to be recovered by customers in the event of the scheme not progressing and for the non-delivery or late delivery of outputs.</p> <p>In an addendum to the joint statement, submitted on 3 May 2019, the same companies specify key principles for a 'hybrid approach' outcome delivery incentive mechanism.</p> <p>Thames Water also submitted scheme specific reports on 3 May for the Abingdon reservoir (SESRO), River Severn to River Thames transfer, transfer to Affinity Water, transfer to Southern Water and London re-use.</p> | regional water resource solutions appendix'. | |
| | TMS.CE.A4 | Required | <p>It is not clear to us that the information that Thames Water provides in the Annex 1's of documents 'CSD005-ES02-PR19-Environmental Measures Delivered (Wastewater)' and 'CSD005-EW02-PR19-Environmental Measures Delivered (Water)' is sufficient to enable the cost of each of the 64 Amber WINEP the company has included in its investment programme to be determined. So that we may form a view on the reasonableness of the company's proposals for a cost adjustment mechanism for unconfirmed Amber WINEP schemes the company should provide costs (capex and opex) assumed in its investment programme for each of these Amber schemes and indicate to which lines in tables WS2 and WWS2 these costs are allocated.</p> <p>Of the total of 92 Amber lines in WINEP3, 58 relate to P removal schemes at 56 sewage treatment works. The company should the population equivalent figures assumed for each of these sites in its calculation of the unit costs shown in Table 13 in Annex 1. Finally, clarity is required on the boundary values between "normal", "tight" and "very tight" permit limits in this table. Permit limits falling in the ranges 0.3-0.4mg/l P and 0.7-0.8mg/l P do not fall into any of these descriptors as they are defined in paragraph 4.20.</p> | 1 April 2019 | <p>Thames Water has provided the capex and opex for each of the Amber phosphorus removal schemes in its environmental programme and confirmed which lines in WWS2 the costs are allocated to. Design population equivalent figures used to calculate the proposed unit rates for the cost adjustment mechanism have also been provided.</p> <p>Thames Water has also clarified the boundary values between "normal", "tight" and "very tight" permit limits in Table 13.</p> | <p>Intervention required.</p> <p>Though the information provided for P removal schemes is fairly comprehensive, further detail on the sub-set of these schemes that are not listed in WINEP is required before final determination.</p> | <p>We provide our view of the unit rates to be used in the cost adjustment mechanism.</p> |

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| | Advised actions | Advised | There are no advised actions. | N/A | | | |
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Table 2: Further interventions for draft determinations

| Intervention reference | Our assessment and rationale | Interventions |
|---|------------------------------|---------------|
| <p>We explain our approach to cost assessment, including the allowances we set for each control, assumption on revenue recovery from grants and contributions, opex-capex split and totex profiling, in 'Securing cost efficiency technical appendix'. We set out other company specific interventions, and the allowances we set for each control, in section 3 of the company's draft determination summary and its cost efficiency appendix.</p> | | |

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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