



Official

Ref: 2340-TDWAY-TTTUN-990-ZZ-CO-700070

Mr Keith Mason

Senior Director
Ofwat
Centre City Tower
7 Hill Street
Birmingham
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29 August 2019

Dear Keith

TWUL'S DRAFT DETERMINATIONS – TIDEWAY FEEDBACK

Following our trilateral on 9 August, I am writing to you with Tideway's views on TWUL's PR19 draft determinations (DDs).

We welcome Ofwat's careful scrutiny of TWUL's business plan and willingness to consider representations from Tideway. In our view this scrutiny has resulted in DDs that contain a considerably improved set of commitments and incentives relating to the TTT project.

We are concerned however that certain elements of the DD package do not align TWUL's behaviour with the overall interests of the project and customers, and in some cases may act against it. In particular:

- **Incentives should be designed to maximise overall customer value from the TTT project.** We are particularly concerned that the proposed land sales incentive, ET06, could have a perverse effect by discouraging TWUL from pursuing collaborative solutions with Tideway, for example in relation to timing of land handback and removal of temporary works. We estimate that this could lead to [REDACTED] of customer detriment (see page 7 of this document for calculation) and ask that Ofwat consider adopting the changes proposed in Appendix 1 in order to mitigate this impact.

Appendix 1 sets out two potential approaches. Of these, we continue to believe that our previously proposed incentive is the best approach to driving the right behaviours from TWUL in relation to land. In case Ofwat does not consider this appropriate, however, we have set out an alternative approach. While in our view this alternative would be less beneficial to the project and customers than Tideway's proposal, it is more closely based on the DD incentive and mitigates some of the identified concerns.

We also consider that the penalty strength for ET04 (and potentially ET05) should be increased to reflect the project impacts of any delay to System Commissioning caused by TWUL.

- **Commitments, incentives and resourcing should align with and support the Joint Approach** to Handover and System Acceptance, as agreed between Tideway and TWUL and as discussed by and reported to Liaison Committee. In Appendix 1 we highlight several areas where the DDs do not appear to be aligned with the Joint Approach and make proposals to improve alignment, including:
 - Alignment between targets and agreed early site handback schedule;
 - A requirement in the price control for TWUL to report annually to Liaison Committee on progress towards System Commissioning readiness under ET04 and ET05; and
 - Flexibility in target dates where there are changes to the Tideway Project Master Programme.

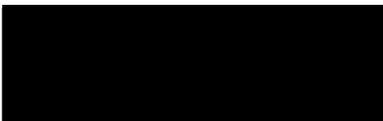
Appendix 1 to this letter sets out Tideway's comments on each of the proposed performance commitments and on levels of resourcing allowed for TIG and the System Operator. Appendix 2 (contained in the PDF file sent with this letter) is a version of the TWUL outcome performance commitment appendix published by Ofwat, marked up with proposed drafting changes

As indicated at our trilateral, we have held constructive discussions with TWUL since publication of DDs during which we have identified a number of changes to commitments ET01, ET04 and ET05 that we agree would be beneficial. These changes are highlighted in both Appendix 1 and Appendix 2.

Appendices 3-5 contain information on land hand back as requested by Ofwat.

This letter has been shared with TWUL.

Yours sincerely



Matt Parr

Director of Strategy and Regulation

Appendix 1: Detailed comments on TWUL's performance commitments and incentives

We have highlighted where the views presented have been discussed and agreed between Tideway and TWUL.

To assist Ofwat in understanding Tideway's (and where relevant TWUL's) proposed changes we have provided marked up versions of each commitment in an accompanying document (referenced in Appendix 2).

ET01 - Readiness to receive tunnel flow at Beckton STW

- Tideway supports the proposed commitment and incentive.
- We agree with TWUL that Ofwat's proposal to include a mechanism for flexing the target date if there is a delay on Tideway's side is likely to be beneficial for customers. We (and TWUL) consider that the drafting that introduces this flexibility could be clearer and propose revised drafting for the 'Purpose' and 'Specific exclusions' section of this commitment in the accompanying document. These changes are in line with proposals for ET04 and ET05.
- Any change to the baseline System Commissioning Commencement Date (SCCD) would be initiated by Tideway and would need to be agreed via Liaison Committee. This process eliminates any opportunity for TWUL to unilaterally change the target date, which would create additional risk to customers and the project.

ET02 - Effective stakeholder engagement

- Tideway supports this commitment, which provides an important reputational incentive on TWUL to engage constructively with key stakeholders on issues (such as revenue collection and sewer access) that are not covered by other performance commitments.
- We support Ofwat's proposed target score of 5.0, which in light of TWUL's AMP6 performance (including a 2018/19 score of 4.8) appears stretching but achievable.
- TWUL's concern about a single poor mark dragging down its overall performance appears to us misplaced. The scoring criteria provided by survey firm Populus encourage stakeholders to review TWUL's performance in the round and discourage the award of low scores based on weak performance on certain specific issues.
- Should Ofwat wish to address TWUL's concern about anomalously low scores, however, we suggest introducing a requirement for TWUL to report individual questions scoring below 4.0 to the Liaison Committee for discussion. This would help to promote rapid resolution of identified issues, while incentivising stakeholders to robustly justify any low scores.

ET04 - Critical asset readiness for the London Tideway Tunnels

- Tideway welcomes the shift in this performance commitment to focus on critical asset readiness, which we consider an important and measurable component of TWUL's preparation for System Commissioning. We support the target and overall structure of the commitment.
- We consider however that there are several areas in which this commitment should be improved in order to better align with the interests of customers and the project.

The penalty strength should be increased to reflect the impact of delays on customers

- We consider that the penalty set out in the DD should be increased to reflect the impact of delays to System Commissioning on customers.

[Redacted]

[Redacted]	[Redacted]

- [Redacted]

- [Redacted]

- [Redacted]

- [Redacted]

- [Redacted]

- In our comments below, we propose that the ET05 incentive could be financial rather than reputational. To avoid double counting between ET04 and ET05, we suggest that a 20% portion of the impact 'pot' calculated above could be allocated to ET05. The [Redacted] month penalty that we propose for ET04 represents the remaining 80% of the total 'pot'. Should Ofwat not accept Tideway's proposal that ET05 should be a financial incentive, we consider that the ET04 penalty should be [Redacted], representing the full impact on customers of a delay to SCCD.

- Changes from the indicative figures previously shared with Ofwat are due to the following updates:

- [Redacted]

[REDACTED]

- We would be happy to discuss our analysis with Ofwat.

Incentive allocation between TTT and WWN+ controls is appropriate

- We support Ofwat's proposal to split this incentive 50:50 between the TTT and WWN+ controls.
- In our view there is a low risk of double counting with other incentives in the WWN+ control, as the above calculation is based on Tideway cost impact and TWUL has not indicated to us that it has included these impacts in its proposals for the strength of other incentives.

Annual reporting should form part of the commitment

- We consider that annual reporting to the Liaison Committee should form part of this performance commitment. This would not introduce any additional requirements to those set out in the Joint Approach but would reinforce the approach by independently specifying a minimum standard and frequency of reporting to be met by TWUL. It would also ensure that TWUL's progress towards achieving ET04 is subject to ITA oversight. We set out proposed wording for the reporting requirement in the accompanying document (referenced in Appendix 2).

Some minor changes to the definition would help to improve clarity and workability

- We have agreed with TWUL that a number of minor changes to the definition for this commitment would be appropriate. These are marked up in the accompanying document. In summary:
 - If the SCCD is moved using the process set out in our comments on ET01, above, the target should flex accordingly. This could for example be achieved by modifying the 'Purpose' and 'Specific Exclusions' sections of the commitment as indicated in the accompanying document; and
 - Section 2 – changes intended to simplify/clarify the list of critical assets.

ET05 - Establish an effective system operator for the London Tideway Tunnels

A financial incentive would better align TWUL's interests with those of the project and customers

- Tideway considers that a financial incentive for ET05 could help to ensure that TWUL allocates appropriate resources to this important element of preparedness for System Commissioning. To avoid double counting, the incentive strength could be taken from the total impact 'pot' calculated in relation to ET04 above.
- We acknowledge the greater difficulty, compared with ET04, in setting specific and measurable targets for this commitment that align closely with readiness for System Commissioning. We would therefore suggest a smaller incentive penalty, for example 20% of the amount calculated for ET04. Our suggested penalty is [REDACTED] month, representing 20% of the impact 'pot'.

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- We suggest that this penalty could be applied monthly should TWUL fail to demonstrate to the satisfaction of an independent auditor that it has met the target. In the accompanying document (referenced in Appendix 2) we have marked up some suggested changes to the performance commitment definition and parameters for ET05, detailing how the penalty could be calculated and applied.

Annual reporting should form part of the commitment

- We consider that annual reporting to the Liaison Committee, supporting the Joint Approach and Progressive Assurance Workstreams (in this case number 5), should form part of this performance commitment. As for ET04, this will reinforce the Joint Approach while ensuring that TWUL's reporting is subject to ITA scrutiny. We set out proposed wording for the reporting requirement in the accompanying document.
- Should this incentive remain reputational (rather than becoming financial as proposed by Tideway) we suggest that TWUL should also be required to make a public statement on the status of System Management implementation in its annual report, to increase the power of the reputational incentive.

Some minor changes to the definition would help to improve clarity and workability

- We have agreed with TWUL that a number of minor changes to the definition for this commitment would be appropriate. These are marked up in the accompanying document, referenced in Appendix 2. In summary:
 - The target date should read 31/3/22;
 - We propose introducing flexibility into the target date in line with ET04; and
 - This commitment should reflect deliverables that are both TWUL responsibilities, and due before SCCD. We therefore propose three modifications to 'System set up and procedures' list.

ET06 - maximising the value of land sales

In its current form, this incentive may have damaging consequences for the project and customers.

- We set out below the properties of an effective and appropriate land-related incentive which we previously shared with Ofwat (and TWUL) at the recent trilateral. We use this to evaluate both the DD and our May proposal for a land-related incentive.
- *Aim:* In Tideway's view an effective land-related incentive would have the following properties:
 - **Scope:** Covers all project sites;
 - **Timing:** Aligned to early site handback schedule set out in Joint Approach. Incentivises TWUL not to delay Handover; and
 - **Customer value:** Maximises overall customer value, balancing the RCV-linked benefits of a higher land sale price and the impact of TWUL's action/inaction on the costs of Tideway's scope (including temporary works costs, compensation costs and prolongation costs). Helps to drive collaboration between TWUL and Tideway.

- **Current concerns on DD:** We are concerned that the incentive proposed in the DD does not have these properties:
 - **Scope:** The incentive covers only 3/21 Tideway sites (Carnwath Road, Kirtling St and Chambers Wharf) plus Camelford House; all 12 plots of land listed in the DD are part of these sites. For these sites, the combination of ET06 and Ofwat's assumed totex profile for land sales may effectively drive TWUL to receive and dispose of land in a timely manner and at the best price. For the remaining 18 sites, [REDACTED] we see a risk that TWUL is not adequately incentivised to facilitate hand back, leading to overall delays to Handover and associated costs.
 - **Timing:** It is unclear how Ofwat's assumed land sales profile aligns to the Joint Approach. Handover delays are not covered by this incentive.
 - **Value:** Even if TWUL is successful in achieving Ofwat's assumptions on land sale values, we see a risk that the incentive will increase overall customer bills by creating conflict with the Joint Approach and increasing the costs of Tideway's scope. In particular, we are concerned that TWUL may insist on temporary works being removed even where the cost of doing so would far outweigh any resulting increase in land value.

- [REDACTED]

The incentive should be modified to remove or at least mitigate these consequences

- In our May 20 letter to you we set out a proposal for a land-based incentive, which is summarised in the next paragraph. If this approach is not acceptable, we ask Ofwat to consider amending its DD proposals as set out in the 'Potential alternative' paragraph below. We believe however that even with the changes listed under the potential alternative, there would still be considerable gaps between ET06 and the scope, timing and value aims set out above. The table on page 10 summarises these issues.
- **Tideway proposal (preferred):** In our 20 May letter commenting on TWUL's resubmitted business plan, we set out a proposal for the (then) ET03 land sales incentive that we consider meets the criteria set out above. The proposed commitment would require TWUL to accept land back by the target date for each site set out in the early site handback schedule agreed via the Joint Approach. We proposed the following incentives, which are intended to recognise the benefits to the project of early site handback (by de-risking Handover) and the risks of delays to Handover:
 - **Reward:** If land is handed back by the target date, TWUL keeps the value of the land in its RCV until 2025 (including after it is sold). TWUL receives no reward if Handover is delayed due to its actions.

[REDACTED]

- **Penalty:** For any site not handed back by the target date, TWUL pays a monthly penalty (per site) reflecting the increased risk of delays to Handover.

[REDACTED] This reflects the fact that a delay to hand back at any one site causes an increase in risk that Handover will be delayed and/or that additional spending will have to be incurred to avoid a delay. We believe that this approach is consistent with that taken in ET01, as while a delay to the Beckton works may not on its own cause a delay to System Commissioning, it is an indicator of increased risk.

[REDACTED]	[REDACTED]

- **Potential alternative (not preferred):** We continue to believe that a commitment and incentive of the type outlined above would best balance scope, timing and customer value considerations. If, however Ofwat considers it critical to include an incentive based on land sale price, we consider that there are a number of 'patches' that could mitigate (but not eliminate) the downsides of this incentive. These include:

- **Value:** the DD should be modified to require that temporary works identified in the Joint Approach as candidates for being left in place, will in fact be left in place unless TWUL can demonstrate to Ofwat's satisfaction that removing them delivers better overall customer value (taking into account environmental and community impacts). In making its decision Ofwat will consider any representations from Tideway. This would reduce TWUL's ability to insist that temporary works are removed, in order to improve its outcomes under ET06.
- **Scope:** a penalty for delayed handback (relative to the agreed early handback schedule) on any site, not just the three included in ET06, equal to that set out under the preferred alternative above. [REDACTED]
- **Timing:** To help align TWUL's interests with the aims of the Joint Approach, Ofwat's assumed land sales profile should align with the early site handback schedule set out in the Joint Approach – current view set out at Appendix 4.

Ofwat suggested at our 9 August trilateral that a mechanism which removed any reward to TWUL from this incentive if Handover were delayed could help to mitigate the disadvantages of the current drafting. While we believe that such a mechanism could have merit, we consider that it cannot on its own remove the issues identified above. This is based on the current expectation [REDACTED]

It appears plausible that TWUL will not stand to earn any reward during AMP7 and will instead face a penalty and hence there would be no reward to lose.

- *Summary of options:* The following table sets out our assessment of the incentive in the DDs, Tideway's proposal and a 'patched' version of the DD incentive, against the above criteria.
- ***Tideway recommendation:*** Our strong preference is that the incentive should be modified to align with the Tideway proposal, which we consider would drive TWUL behaviours that align most closely with customers' interests. If Ofwat does not consider this appropriate, we ask that the incentive is modified to include the identified 'patches' to mitigate the most damaging potential consequences of this incentive.
- To assist Ofwat in considering the 'patched' alternative above, we have set out some potential drafting changes in the accompanying PDF document (referenced at Appendix 2). Should Ofwat be open to considering an incentive in line with Tideway's recommendation, we would be happy to discuss the detail with Ofwat and provide suggested drafting.

Additional information requested by Ofwat

- *Overall Joint Approach to land.* See slides at Appendix 3.
- *Timing of site handback per the Joint Approach* – See table at Appendix 4
- *Identified opportunities to leave temporary works in place.* These are detailed in an appendix to the Joint Approach document agreed between Tideway and TWUL (see pages 55-58 of that document). For convenience the relevant pages are reproduced as Appendix 5 to this document.

	DD incentive	Tideway proposal	DD incentive with 'patches'
Summary	<p>TWUL takes/bears 20% of any net profit/loss on land sales.</p> <p>Land value falls out of RCV according to specified schedule.</p>	<p>Reward: If land is handed back by the target date, TWUL keeps the value of the land in its RCV until 2025 (including after it is sold).</p> <p>Penalty: If land is not handed back by the target date, TWUL pays a penalty (per site) reflecting increased risk of delays to Handover</p>	<p>As DD incentive plus:</p> <ul style="list-style-type: none"> - Scope: incentivisation for all sites - Timing: penalty for delay on any site; potential 'backstop' removing any TWUL reward if Handover is delayed due to its actions - Value: assume temporary works remain in place unless TWUL can demonstrate that removing them delivers better overall customer value (taking into account environmental impact)
Scope: covers all project sites	<p>Covers only 3/21 sites used for the TTT project (plus Camelford House)</p> <p>No penalty for missing deadlines at the majority of sites.</p>	Penalty for delay on any site with potential upside on those with realisable value	Penalty for delay on any site with potential upside on those with realisable value
<p>Timing: Aligned to schedule set out in Joint Approach</p> <p>Incentivises TWUL not to delay Handover</p>	<p>It is unclear how Ofwat's assumed land sales profile aligns to the Joint Approach.</p> <p>Handover delays not covered by this incentive</p>	<p>Both penalty and reward are linked to the Joint Approach schedule. Incentivises TWUL to meet agreed deadlines for land handback while allowing flexibility in the schedule if agreed with Tideway</p> <p>TWUL receives no reward if Handover is delayed due to its actions</p>	<p>Penalty (but not reward) linked to the Joint Approach schedule. Incentivises TWUL to meet agreed deadlines for land handback while allowing flexibility in the schedule if agreed with Tideway.</p> <p>Potential for any reward to be withheld if Handover is delayed due to TWUL's actions</p>
Value: Maximises overall customer value. Helps drive collaboration between TWUL and Tideway	Helps maximise value of land sales but any benefit may be more than cancelled out by increased cost of Tideway scope e.g. if uneconomic to remove temporary works.	Helps minimise costs of Tideway scope. Incentivises TWUL to maximise sale price.	Reduced risk of uneconomic approach to temporary works but risks of prolongation/compensation costs associated with delays to Handover remain

Resourcing

- Tideway would be concerned if the level of Ofwat challenge led to insufficient resources for TWUL to support project delivery and operation.
- As TIG already exists, and existing resources can therefore act as a benchmark, we consider that the profile proposed by TWUL appears reasonable. Furthermore, TWUL have explained to us how the resources will evolve over AMP7 to meet the needs of the project and we are satisfied that they are both sensible and appropriate.
 - We have also been briefed on the operational resources that are required to support the project and are satisfied that they would be adequate.
- In general, we do not think that Tideway is well placed to comment on the extent to which operational resources could (or could not) be drawn from the existing organisation. We see this as a matter for discussion between TWUL and Ofwat.

Appendix 2: Drafting proposals

See attached PDF document, "PR19-draft-determinations-Thames-Water-Outcomes-performance-commitment-appendix Tideway markup".

Please see comment boxes adjacent to yellow highlighted text. We have included a mark up to the DD land-based incentives (ET06) although our preference would be for it to be replaced with our May proposal.

Appendix 3: Joint Approach to land

Slides prepared by Tideway's Property team



Joint Approach to Handover and System Acceptance

Purpose: to set out the agreed land and property element of the Joint Approach to successfully achieve Handover and System Acceptance

Joint Approach to Handover and System Acceptance - 3 Key Elements:

- Land and Property
- Design and Construction
- Operational Readiness

Supported by:

Funding, Revenue and Incentivisation (Price Review)

With:

Monthly (Interface Committee) and Quarterly (Liaison Committee) Joint Approach Reporting

Joint Approach to Handover and System Acceptance



- To deliver the complex TTT scheme through to Handover and System Acceptance:
 - 1) building on good collaboration to date
 - 2) recognising increasing complexities in current and future delivery phases
- To provide alignment on the scope of works to be delivered and inform resource requirements to meet dates and agreed timescales
- To add agreed milestones to the PMP, including for Approvals in Principle to mitigate programme risk

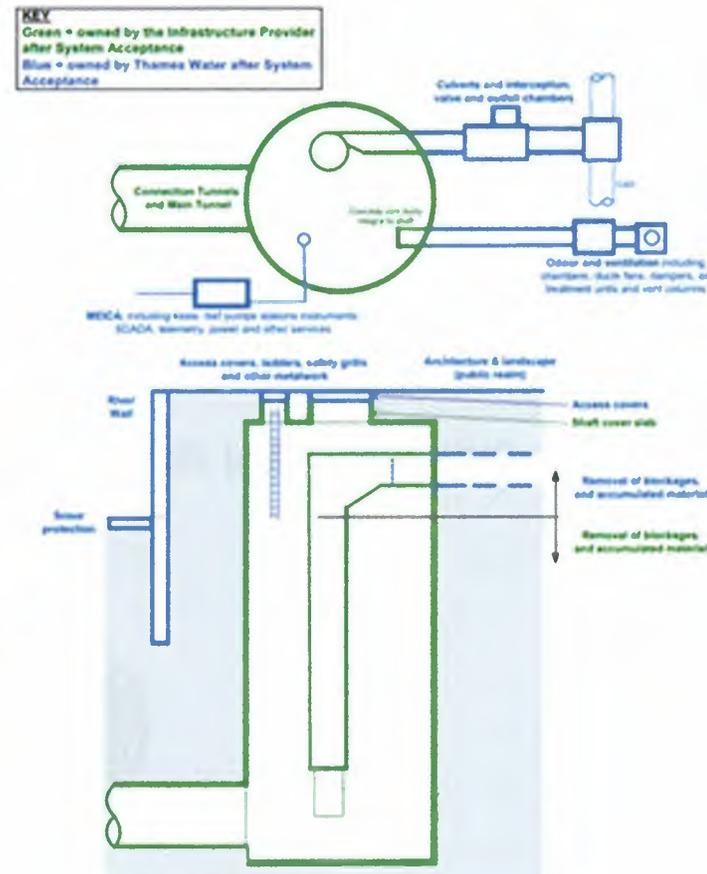
Land and Property – Access Arrangements

- Tideway access until Handover via Construction Licence in Interface Agreement*
- Tideway access for Tideway O&M via the Lease (new Project Document**)
- TWUL access for TWUL O&M also required***
- TWUL to secure future access arrangements via
 - i. compulsory purchase powers
 - ii. existing property agreement obligations
 - iii. new property agreements for TWUL land disposal

*Land and land assets revert to TWUL at latest Handover

**Requiring Defra and Ofwat approval

***Asset ownership split to be defined in Lease – maintenance obligations and therefore access for all sewer assets required by Tideway until System Acceptance unless agreed otherwise



Land and Property – Agreed Joint Approach



- Approvals in Principle for Tideway and TWULO&M requirements
- Joint engagement with third party property owners with joint record database
- Agreed Site Handback negotiation strategies
- Minimising legal costs through pragmatic approach to developing Lease/mini-Leases and property agreements for land disposal
- Jointly targeting Early Site Handback dates on all sites (integrated PMP)
- Working together at Cottons Centre where possible
- Transparency on all aspects of property workstreams throughout
- Progress with 10 principles agreed by Alliance Board on temporary works opportunities i.e. implement opportunities to leave in situ

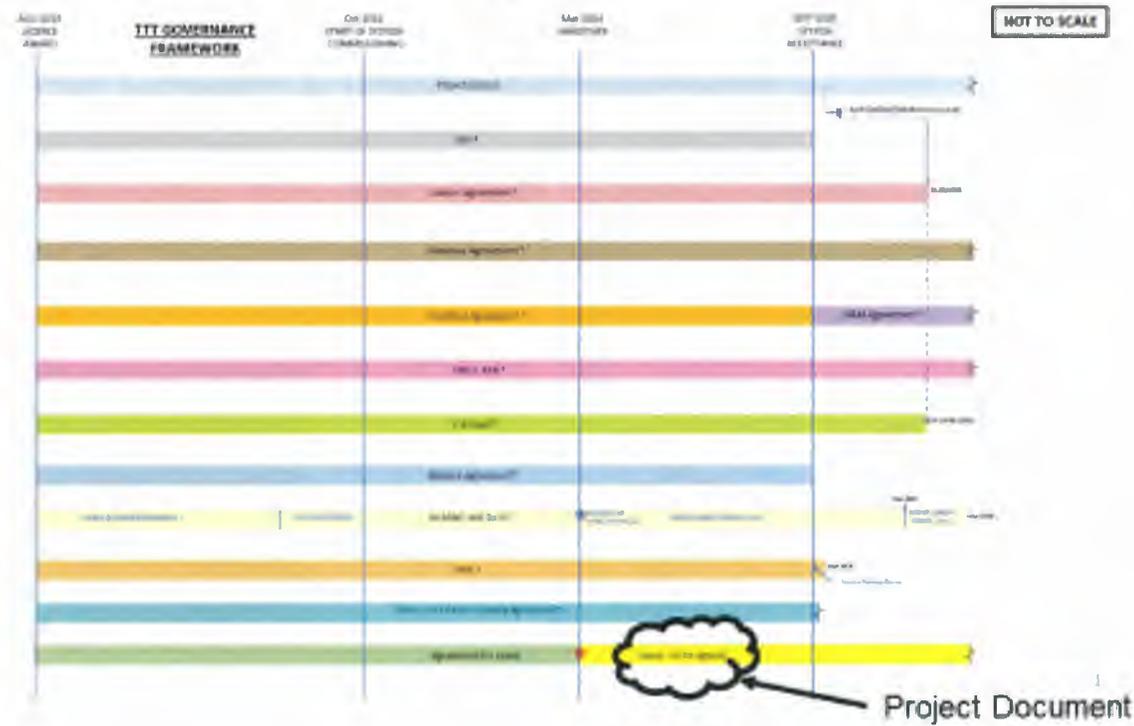
Joint Approach to Handover and System Acceptance

Reporting:

Monthly to Interface Committee and Quarterly to Liaison Committee

TTT Governance Framework:

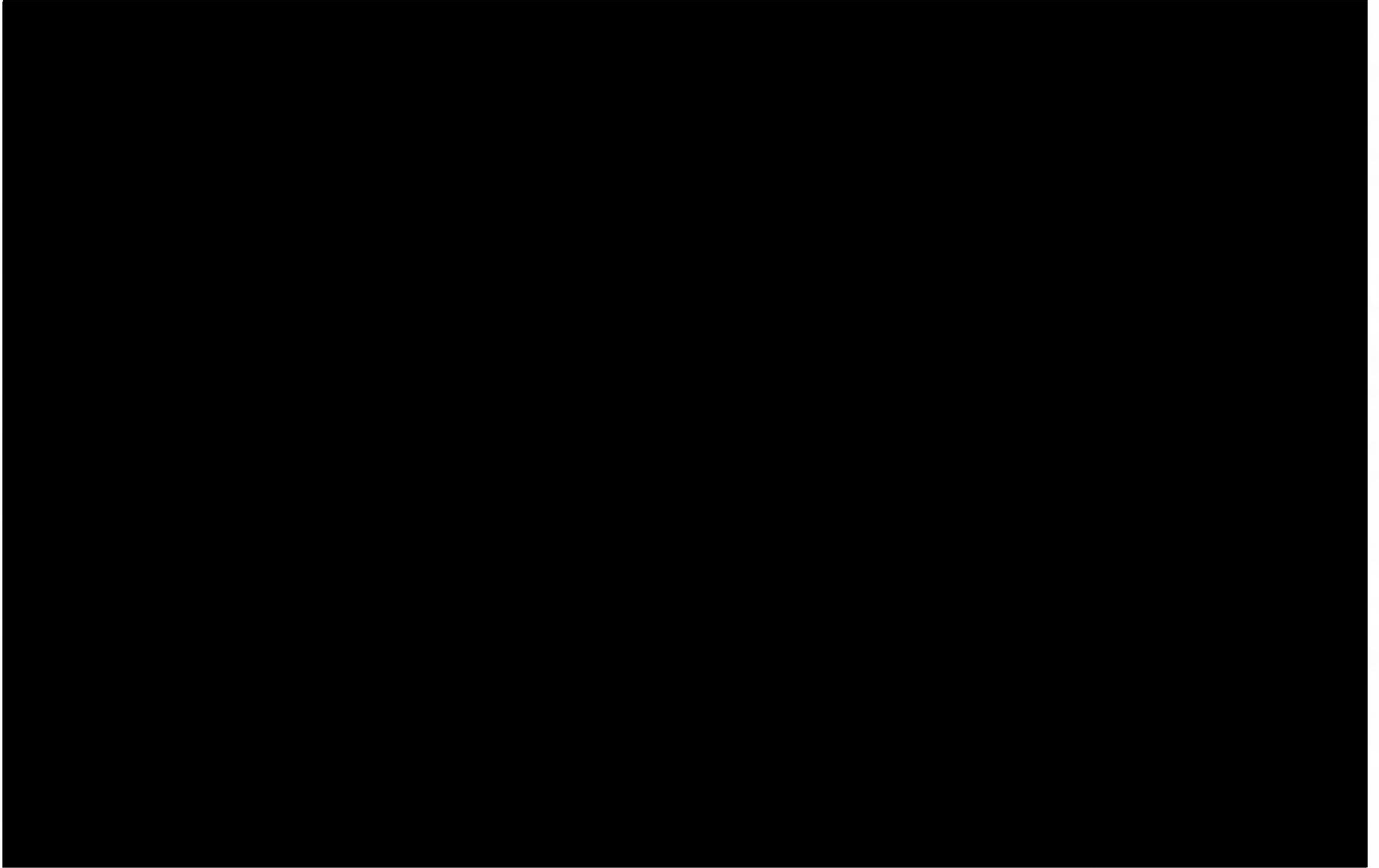
Joint Approach to Handover and System Acceptance is not a legal document

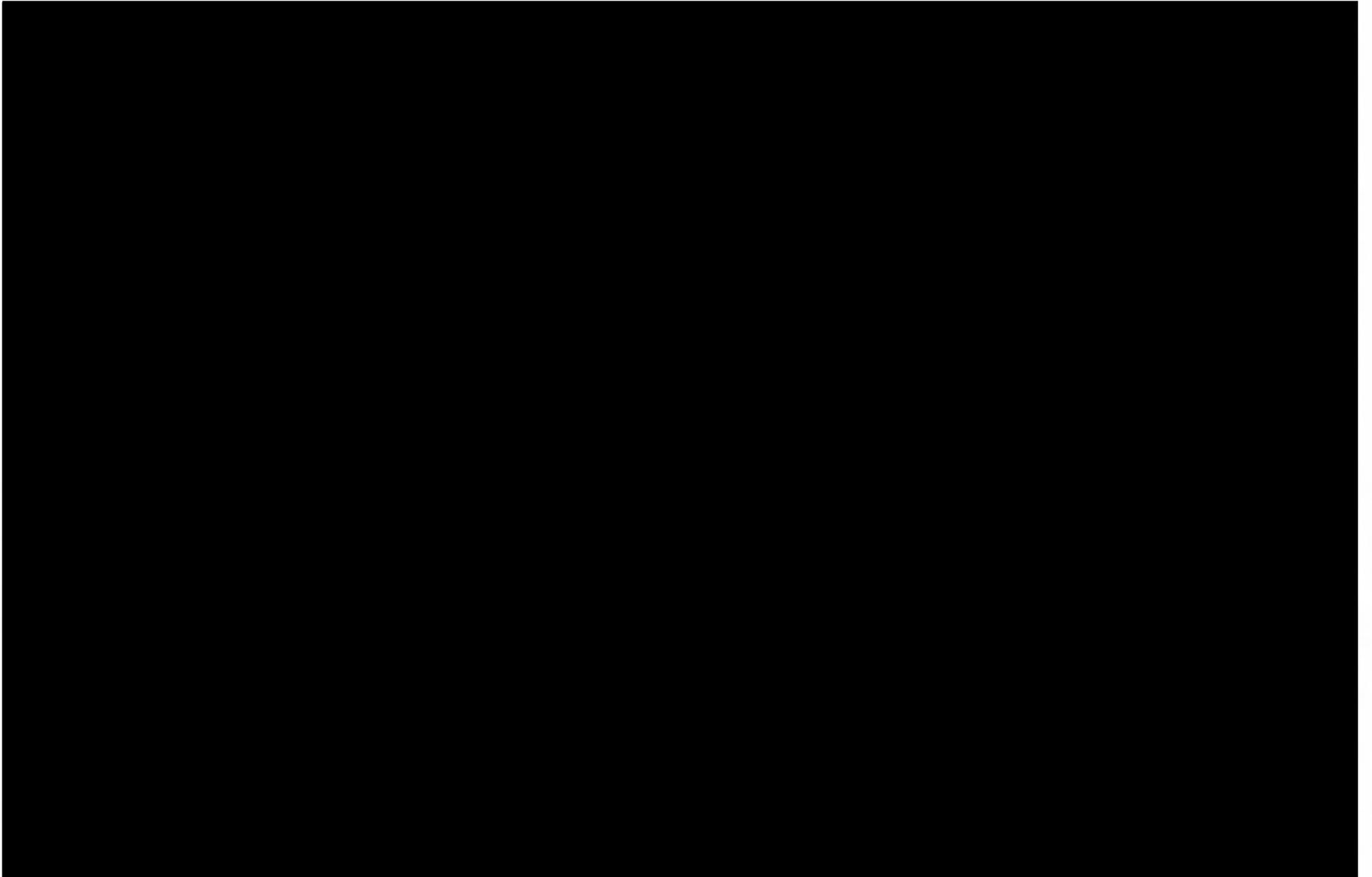


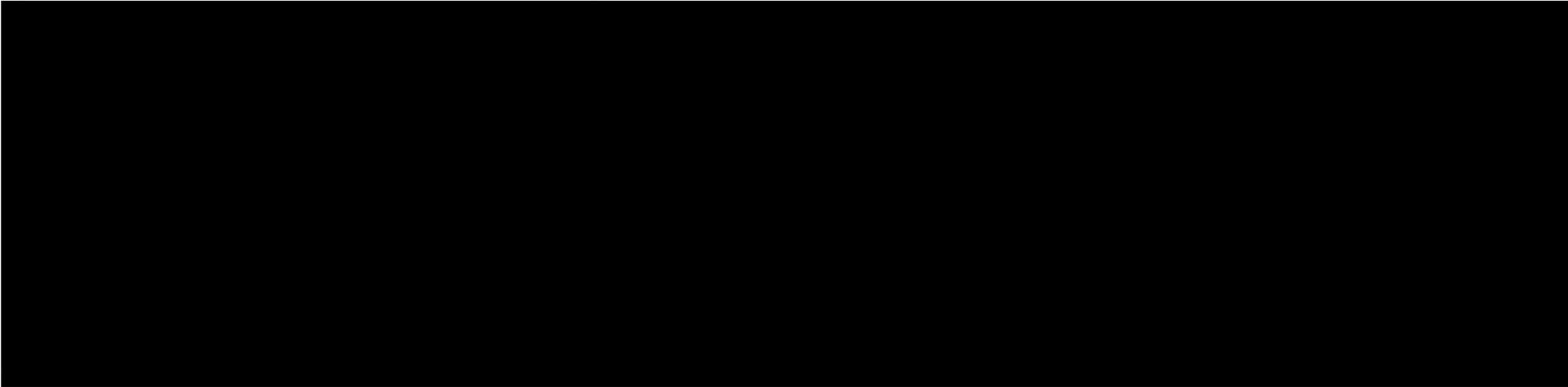
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OFFICIAL SENSITIVE

[REDACTED]

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