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Dear Ofwat colleagues

Re: Consultation on “PR24 and beyond: Creating tomorrow, together”

Thank you for giving us the opportunity to respond to the above consultation, which sets out Ofwat’s framework for the 2024 periodic review (PR24) and beyond. While PR24 will set revenues for 2025-2030 for appointed water firms (not for Tideway), we are very interested in Ofwat’s emerging thinking on the key challenges and questions for PR24, and potential ways forward. Our goals in engaging with the PR24 process are to ensure that Thames Water’s settlement supports the timely and efficient delivery of the later stages of the Thames Tideway Tunnel project, and to share lessons learned from Tideway’s experience where this may be relevant to Ofwat’s choice of regulatory regime applying to major projects.

Overall, we welcome the increased focus on the long term signalled in this consultation document, together with Ofwat’s support for a broad approach to value that recognises the importance of companies delivering environmental and social value. As set out in our response to Ofwat’s December 2020 discussion paper on public value, Tideway has sought since the early stages of the project to deliver value in its broadest sense and to put measures in place to ensure that we leave a positive legacy. We encourage Ofwat to consider how PR24 could facilitate the adoption of similar approaches by competitively appointed providers and ensure that the value created is maintained under the stewardship of incumbents once the construction phase is complete.

In this response we focus on three themes:

- The need for major project delivery models to give confidence to investors. In many areas long term certainty over the model is key to achieving this, while in others – particularly where new models are deployed for the first time – it is important that regulatory arrangements are sufficiently flexible to respond to unforeseen issues with the model and/or extreme macroeconomic conditions. A willingness by Ofwat to keep existing models under review to ensure they continue to represent an appropriate balance between risk and return, while applying lessons learned from past procurements to new ones, will reduce investors’ perception of risk across the sector. Particularly in competitive bidding situations, this will help to deliver a required level of return that is satisfactory to customers, companies and regulators.
- Where projects span multiple price control periods, it is impossible to predict all events (macro-economic or project specific) that may occur during the lifetime of the project. Building appropriate re-opener mechanisms into delivery models is therefore important in

achieving equitable outcomes for customers and other stakeholders while managing investors' perception of risk; and

- The need to best manage interfaces on major projects – particularly between Infrastructure Providers/ Competitively Appointed Providers (CAP) and the incumbent. A critical success factor for project delivery is that both parties are aligned behind the project and the incumbent has sufficient funding and the right incentives to fulfil its deliverables to time and quality.

Further detail on the above is set out in our responses to specific questions in the appendix to this letter.

We are very happy to discuss these comments with you, if that would be helpful. Please contact me on [REDACTED].

Yours sincerely,

[REDACTED]

Matt Parr
Director of Strategy & Regulation

Appendix

Chapter 8 (Design and implementation of price controls)

Q8.3: Do you agree with, or have any comments on, our proposals spanning multiple parts of the value chain, i.e. for major projects and future reconciliations?

Ofwat recognises the importance of the direct procurement for customers (DPC) approach in delivering projects that run across price controls and the need at PR24 to further incentivise incumbents to use the approach. “Delivering schemes in this way will lower costs, drive innovation, and enable companies to fund other additional schemes which deliver benefits to customers” (p24). We also note that Ofwat is reviewing whether the SIPR model used on the Thames Tideway Tunnel project could be put to broader use.

Tideway recognises the roles that these frameworks can play to facilitate the successful delivery of major projects. To ensure success we believe the framework for all major projects needs to offer:

- Regulatory certainty for major projects during construction periods that run across price controls;
- Incentives for timely and efficient delivery by all parties;
- Regulatory flexibility to protect both customers and companies from unforeseen changes in the macro-economic environment, that may impact project resilience; and
- Stable regulatory framework for the operational period that protects the operator and customers.

In general, we consider that the Tideway model has delivered the first two of these success factors, and that Ofwat’s economic guidance published in 2015 provided an important signal to investors on the regulatory framework for the operational period. Events since licence award have however highlighted the need for appropriate regulatory flexibility in response to unforeseen changes. It is important that such issues are considered upfront and reopeners included in the model where appropriate. Failure to do so risks deterring bidders, with consequences for the cost of capital, number of participants in the sector, range of new business models and level of innovation.

Chapter 9: Outcomes

Q9.1: What kinds of performance commitments should we include in the price review? What outcomes require financial incentives for all companies for the foreseeable future?

We recognise and understand Ofwat’s desire to focus on common performance commitments (PCs) and outcome delivery incentives (ODIs) that apply across all companies and the intention to reduce the number of bespoke PCs / ODIs.

On major projects however, there may be a particular case for retaining some bespoke commitments for appointed water companies to ensure alignment of their incentives with those of the overall project. As set out in our responses to Ofwat consultations during PR19, given the importance of the interface between the incumbent and the CAP/Infrastructure Provider, if incentives are not aligned the financial impacts on customers may be substantial and there may be significant delays in achieving project outcomes.

We ask Ofwat to retain flexibility within PR24 for a small number of bespoke commitments where there is a clear case that this will incentivise timely and efficient delivery of specific projects to the benefit of customers and the environment. For example, an incentive for timely completion of

system acceptance could help to align Thames Water's interests with those of the overall Thames Tideway Tunnel project after 2025.

Timely and efficient delivery of major projects also relies on incumbents being fully funded for their activities relating to these projects. In Tideway's case, it is important that Thames Water is funded, for example, to enable maintenance access by Tideway contractors and to maintain the architecture and landscape elements of the project.

Chapter 11: Risk and Return

Q11.1: Are there areas of our risk allocation framework where mechanisms could be added, simplified or removed in a way which would benefit customers?

For major projects, we recognise the importance during the construction phase of a stable, predictable, regulatory regime that crosses price control periods and delivers a risk allocation and return framework that benefits customers and investors. Such a regime, if accompanied by project re-openers where there are unforeseen macro-economic or project specific events, will deliver investor confidence to best facilitate project delivery.

At the project bid stage, it will also drive competitive submissions based on an optimal approach to risk and return, which benefits customers.