

September 2021

**Draft determination of Thames Water's  
in-period outcome delivery incentives  
for 2020-21**

## About this document

This document provides our draft decision on the extent to which the price controls set by our [PR19 final determination](#) need to be adjusted for Thames Water's performance for the 2020-21 Charging Year (and an adjustment in relation to its performance in the previous price control period), under [Part 3A of condition B](#) of the company's licence. The specific changes, and our reasons for these, are set out in this document and '[Sector overview: Draft determinations of in-period outcome delivery incentives for 2020-21](#)', which concerns the impact of our draft determinations across the companies.

We also publish models related to our draft determinations on our [website](#).

## Executive summary

This section sets out the results of our 2020-21 in-period outcome delivery incentives (ODI) assessment for Thames Water. ODIs are the financial or reputational consequences for companies of outperformance or underperformance against its performance commitments. Performance commitments are the pledges companies made to their customers and stakeholders at the 2019 price review (PR19) about service levels to make progress towards their outcomes.

'In-period' ODIs bring ODI payments closer in time to when customers experience a given level of performance. We do this through an annual reconciliation process between July and November following the relevant reporting year, in this case 2020-21. The results of our assessment for 2020-21 will affect Thames Water's bills in the 2022-23 charging year.

For 2020-21 Thames Water reported net underperformance payments of £31.870m against its performance commitments with in-period outcome delivery incentives, excluding C-MeX and D-MeX. We have assessed the company's performance against its performance commitments. In our draft determination, we are intervening on the following performance commitments:

- Per capita consumption (PCC) – in line with our July consultation proposals, we are changing the timing of payments for this performance commitment to end of period.
- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £16.659m and a D-MeX underperformance payment of £1.861m, based on assessment of 2020-21 company performance in our draft determinations.

We also are including an underperformance payment of £5.365m to correct for an overstatement of performance on the company's asset health performance commitment from the 2014 price review (PR14), as the company has identified that it used the incorrect length of mains when reporting against this PR14 performance commitment.

See sections 2.2, 2.3 and 3.1 for details of our interventions.

In our draft determination we propose that the amount of revenue the company can recover from its customers in 2022-23, as a result of its performance against its performance commitments with in-period ODIs in 2020-21, is reduced by £53.110m. This figure includes C-MeX and D-MeX payments as well as bespoke adjustments but is before adjustments for inflation, tax and other relevant factors.

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# 1. Introduction

## 1.1 Background

Thames Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Thames Water – Outcomes performance commitment appendix](#).<sup>1</sup> Most of the company's performance commitments have financial incentives which are paid 'in-period'. This brings ODI payments closer in time to when customers experience a given level of performance. The remaining incentives are end of period.

Thames Water reported its performance against these performance commitments in its annual performance report (APR) in July 2021. We have considered this information and, where necessary, further information from companies' answers to our queries. In our draft determination we set out relevant adjustments to the company's price controls, for one or more future years, in accordance with [Part 3A of condition B](#) of its licence (Performance Measure Adjustments, referred to in this document as 'in-period' determinations). Our determination, when finalised, will affect Thames Water's customers' bills from the 2022-23 charging year.

As set out in the PR19 final determinations, outperformance payments above 3% of a company's wastewater or water regulatory equity for that year are shared with customers. This means companies receive 50% of outperformance payments above this threshold. This aggregate sharing mechanism automatically applies to all ODI payments except to the customer measure of experience (C-MeX), developer measure of experience (D-MeX) and those allocated to retail price controls.

## 1.2 Purpose of this document

This document provides detailed information relating to the extent to which the price controls for the 2020-25 period need to be adjusted to reflect Thames Water's performance for the 2020-21 Charging Year and an adjustment in relation to its performance in the previous price control period. These changes are the result of the company's performance against its in-period ODIs as set out in the PR19 final determinations. This is our draft decision for consultation. We welcome your views by 21 October 2021 as set out in section 4. We will make our final determinations by 15 November 2021.

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<sup>1</sup> We take account of performance commitments as set out in the PR19 definitions adjusted, if relevant, by the annex 2 process. Annex 2 of the company's performance commitment appendix provides for changes and corrections to be made to its performance commitment definitions during the 2020-25 period in certain circumstances. An overview of changes and corrections made to companies' performance commitment appendices can be found at [PR19 Outcomes performance commitments: changes and corrections](#).

## 2. Results of our assessment

### 2.1 Reported performance

Thames Water's reported performance for 2020-21 against its performance commitments with in-period ODIs is set out in table 3.1 below. The company's largest individual underperformance payment was £10.560m for its internal sewer flooding performance commitment. The company's largest individual outperformance payment was £2.671m for its leakage performance commitment.

### 2.2 Key interventions

#### PR14 asset health performance commitment

In our draft determination we are intervening to include an underperformance payment of £5.365m<sup>2</sup> in relation to the company's mains rehabilitation element of its asset health performance commitment from PR14. This intervention is required because Thames Water informed us that in calculating its performance for this performance commitment during the 2015-20 period, it had overstated the length of decommissioned mains. This means that the company's underperformance payment on this performance commitment in the 2015-20 period was too low, so the company recovered more revenue than it should have from customers. We are intervening to correct this by applying an underperformance payment of £5.365m in our draft determination.

In Thames Water's letter to Aileen Armstrong dated 17 June 2021, the company confirmed the amount of underperformance payment due, and that its preference was for the underperformance payment to be reconciled at the PR24 price review. However, we consider that it is in the best interests of customers that we include this underperformance as soon as possible, as part of the in-period ODI determination process rather than at the PR24 price review.

### 2.3 Payment deferrals and abatements

As set out in our [PR19 Reconciliation Rulebook: Guidance Document](#), companies can ask us to defer outperformance or underperformance payments, or abate outperformance payments on individual performance commitments. A deferral results in us delaying when the adjustment will be made to companies' revenue. An abatement results in no adjustment to

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<sup>2</sup> Converted to 2017-18 FYA CPIH prices from the 2012-13 FYA RPI price base used at PR14

the company's revenues in relation to the relevant performance commitment in the subsequent charging year.

## Renewable energy produced

Thames Water has a bespoke performance commitment to generate 493 Gigawatt hours (GWh) of renewable energy in 2020-21. It has reported generating 476 GWh of renewable energy which results in an underperformance payment of £1.370m. The company requested that we defer the ODI payment due to Covid-19 impacts. It also requested that we reprofile the remaining years' performance commitment levels (PCLs).

Thames Water said that this underperformance was due to lower flows of wastewater to its Beckton wastewater treatment works, which has capacity to generate renewable energy. It linked the lower flow to changes of consumption patterns during the pandemic.

We recognise that Covid-19 has affected consumption patterns which could have impacted this performance commitment during 2020-21. However, Thames Water has not provided sufficient evidence to demonstrate that deferring the underperformance payment or reprofiling its performance commitment levels for this performance commitment would be appropriate. The in-period process is designed to deliver payments closer in time to when customers experience a given level of performance and the circumstances in this case do not persuade us that there is reason to diverge from that principle. Delivery against this performance commitment is not limited to generation at Beckton, and we are encouraged that Thames Water is now working to increase its energy generation capacity at other sites. We note that its suggested reprofiled PCLs imply that it may be able to improve its performance over the period and this might result in net outperformance payments overall. It is still incentivised to do this. We also note that the longer-term impact and trend in wastewater flows is uncertain but as the economy continues to reopen and recover the flows could re-establish quickly, which may support delivering against this commitment.

Based on the evidence provided, the wider considerations set out in our [sector overview](#) about the potential impacts of Covid-19, and specific consideration of the operation of this performance commitment, we consider that neither intervening to defer the underperformance payment nor reprofiling the performance commitment levels is appropriate.

## Per capita consumption

Thames Water requested to defer underperformance payments for its per capita consumption performance commitment for 2020-21. In our [July 2021 consultation](#) on changing the timing of our determination of the value of ODI payments for per capita consumption performance commitments, we proposed that this should be end of period for all companies. Prior to our July 2021 consultation, we had asked relevant companies to include ODI payments arising from their per capita consumption performance commitments

in the deferrals function of the in-period adjustments model. We now consider it would be more appropriate to reflect this proposed treatment through the ODI performance model, ensuring consistency with our policy proposals and ensuring that all ODI payments accrued during the 2020-25 period can be applied at PR24, when we will make our final decisions.

Thames Water did not request any payment abatements. Based on our assessment of the company's performance, we do not consider any are required. As such, we do not apply any payment abatements in our draft decisions.

### 3. Impact of 2020-21 in-period ODI assessment on price controls

#### 3.1 Our draft determination

In this section we outline the financial impacts of our draft decisions. First, we set out our view compared to the company's requested ODI payments in table 3.1.

Table 3.2 sets out the C-MeX and D-MeX payments included in our draft determination.

Table 3.3 summarises the overall ODI payments, after other payments and relevant adjustments, that the company is due based on its performance in 2020-21.

Table 3.4 sets out our draft decisions on deferrals and abatements and how we propose that these payments should be applied in 2022-23.

Table 3.5 sets out the impact of our draft decisions on the company's relevant price controls.

Unless otherwise stated all values are £m in 2017-18 FYA CPIH prices.

#### **Table 3.1: In-period ODI payments for 2020-21 by price control (excluding C-MeX and D-MeX)**

This table sets out the in-period ODI payments requested by Thames Water for 2020-21, by price control, and our draft determination on these payments after any interventions.

Further detail on how these overall numbers have been derived is set out in the ODI performance model, which we have published on our website as part of the draft determinations. Where we have applied interventions, this is set out in "Ofwat\_PC\_Interventions" in the ODI performance model for this company.

Price control	Company's reported payments (£m)	Our draft decisions after interventions (£m)	Difference (£m)
Water resources	-0.018	-0.018	0.000
Water network plus	-11.745	-9.100	2.645
Wastewater network plus	-18.355	-18.355	0.000
Bioresources	-1.233	-1.233	0.000
Residential retail	-0.519	-0.519	0.000
Thames Tideway Tunnel	0.000	0.000	0.000
<b>Total payments</b>	<b>-31.870</b>	<b>-29.226</b>	<b>2.645</b>

See section 2.2 for details of our interventions on the company's performance commitments.

### Table 3.2: C-MeX and D-MeX payments

Our draft determinations include the following C-MeX and D-MeX payments for this company:

Price control	C-MeX payments (£m)	D-MeX payments (£m)
Residential retail	-16.659	n/a
Water network plus	n/a	-1.227
Wastewater network plus	n/a	-0.634
<b>Total payments</b>	<b>-16.659</b>	<b>-1.861</b>

We have taken the data from the company's APR submissions and compared this against the recorded data from our survey agent, Accent.

Further details on C-MeX and D-MeX can be found on the [Customer and Developer Services experience](#) pages of the Ofwat website and in the published C-MeX and D-MeX models.

### Table 3.3: ODI payments including C-MeX, D-MeX, bespoke adjustments and deferrals from 2019-20 (before 2020-21 deferrals and abatements)

This table sets out the composition of total ODI payments, including C-MeX and D-MeX, brought forward deferrals and bespoke adjustments where relevant, but before our draft decisions on 2020-21 deferrals and abatements.

Price control	Ofwat view of in-period ODI payments (£m)	C-MeX and D-MeX payments (£m)	ODI payments deferred from 2019-20 (£m)	Bespoke adjustments (£m)	Total ODI payments (£m, before 2020-21 abatements and deferrals)
Water resources	-0.018	0.000	0.000	0.000	<b>-0.018</b>
Water network plus	-9.100	-1.227	0.000	-5.365	<b>-15.692</b>
Wastewater network plus	-18.355	-0.634	0.000	0.000	<b>-18.989</b>
Bioresources	-1.233	0.000	0.000	0.000	<b>-1.233</b>
Residential retail	-0.519	-16.659	0.000	0.000	<b>-17.178</b>
Thames Tideway Tunnel	0.000	0.000	0.000	0.000	<b>0.000</b>
<b>Total</b>	<b>-29.226</b>	<b>-18.520</b>	<b>0.000</b>	<b>-5.365</b>	<b>-53.110</b>

See section 2.2 for details of the bespoke adjustments we have applied for this company.

**Table 3.4: 2020-21 ODI payments after deferrals and abatements**

This table sets out our draft decisions on the ODI payments to be applied, after deferrals and abatements, as set out in the in-period adjustments model published on our website for this company.

Price control	Total ODI payments (£m, before 2020-21 deferrals and abatements)	Ofwat proposed deferrals (£m)	Ofwat proposed abatements (£m)	Total ODI payments to be applied in 2022-23 (£m)
Water resources	-0.018	0.000	0.000	<b>-0.018</b>
Water network plus	-15.692	0.000	0.000	<b>-15.692</b>
Wastewater network plus	-18.989	0.000	0.000	<b>-18.989</b>
Bioresources	-1.233	0.000	0.000	<b>-1.233</b>
Residential retail	-17.178	0.000	0.000	<b>-17.178</b>
Thames Tideway Tunnel	0.000	0.000	0.000	<b>0.000</b>
<b>Total</b>	<b>-53.110</b>	<b>0.000</b>	<b>0.000</b>	<b>-53.110</b>

See section 2.3 for our decisions relating to deferrals and abatements for this company.

**Table 3.5: Changes to price controls (draft determinations)**

This table sets out the impact of our draft decision on the company's price controls, as set out in the in-period adjustments model published on our website. See [Sector overview: Draft determinations of in-period outcome delivery incentives for 2020-21](#) for how we propose to apply adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
<b>Water resources (K factors)</b>	Previous determination	3.90	-1.00	0.67	3.51
	Revised	3.90	-1.02	0.70	3.51
<b>Water network plus (K factors)</b>	Previous determination	7.44	0.04	1.30	0.22
	Revised	7.44	-2.33	3.70	0.22
<b>Wastewater network plus (K factors)</b>	Previous determination	-0.81	-1.59	-0.40	-0.16
	Revised	-0.81	-4.61	2.66	-0.16
<b>Bioresources (unadjusted revenue, <math>UR_t</math> – £m, 2017-18 Nov CPIH prices)</b>	Previous determination	160.767	161.621	162.479	163.333
	Revised	160.767	160.099	162.479	163.333
<b>Residential retail (total revenue, <math>TR_t</math> – £m, nominal prices)</b>	Previous determination	143.177	146.137	148.468	150.721
	Revised	143.177	122.742	148.468	150.721
<b>Thames Tideway Tunnel (K factors)</b>	Previous determination	4.64	2.78	-11.51	-10.68
	Revised	4.64	2.78	-11.51	-10.68

We have based Thames Water's draft determination on the data and commentary provided to us by Thames Water. Should any of this information be revised or restated in future years, we will take account of adjustments we have made to the relevant price control in relation to the performance commitment(s) in question in making future in-period determinations.

## 4. Next steps

We welcome any written comments or representations on our draft determinations by **21 October 2021**. Representations can be made by all stakeholders. Representations can be sent to our inbox [OfwatPandO@ofwat.gov.uk](mailto:OfwatPandO@ofwat.gov.uk).

To ensure transparency, we expect companies to publish their representations in full. We also intend to publish all the written representations we receive on our website once we set out our final decisions.

In view of this, if respondents consider that some of the information in their representations should not be disclosed (for example, because they consider it is commercially sensitive information) they should identify that information and explain why. We would expect strong, robust reasons that are specific to the information concerned. We will take such explanations into account, but we cannot give an assurance that information included in representations will not be disclosed.

Information provided in response to this document, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the General Data Protection Regulation 2016, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our [privacy policy](#).

Where companies are making representations, they should consider what further evidence may be necessary to submit with their representations.

We will publish our final decisions by 15 November 2021, after considering representations from all stakeholders.

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