

November 2021

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

Ofwat

About this document

This document provides our final decision on adjustments to Thames Water's price controls for the company's performance for the 2020-21 Charging Year¹ under Part 3A of condition B of the company's licence (Performance Measure Adjustments, referred to in this document as 'in-period' determinations). The specific changes, and our reasons for these, are set out in this document and ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#).

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

Executive summary

This section sets out the results of our 2020-21 in-period outcome delivery incentive (ODI) assessment for Thames Water. ODIs are the financial or reputational consequences for companies of outperformance or underperformance against their 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 customers' 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 assessed the company's performance against its performance commitments and, in October 2021, consulted on our [draft determinations](#) for companies' in-period ODIs for 2020-21.

Having considered the responses to our draft determination, in our final determination, we are intervening on the following performance commitments:

- Per capita consumption (PCC) – in line with our decision following our per capita consumption consultation, we are deferring our determination of payments for performance against this performance commitment for the 2020-21 Charging Year.

¹ We have also made an adjustment in relation to Thames Water's performance in the previous price control period.

- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £16.753m and a D-MeX underperformance payment of £1.861m, based on assessment of 2020-21 company performance in our draft determinations.

We also include 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.

Our final determination is 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 £53.205m. 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.

Further details regarding the responses we received, our final decisions and the adjustments that we have made are presented in sections 2 and 3, and ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#).

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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](#).² 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 considered this information and, where relevant, further information from companies' answers to our queries. In October 2021, we consulted on our draft determination for Thames Water's in-period ODIs for 2020-21. We have considered the responses we have received relating to our draft determination.

Our final determination sets out the adjustments to the company's price controls and will affect Thames Water's customers' bills from the 2022-23 Charging Year.

² 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 financial in-period ODIs is set out in table 3.1 below. The company's largest individual underperformance payment is £10.560m for its internal sewer flooding performance commitment. The company's largest individual outperformance payment is £2.671m for its leakage performance commitment.

2.2 Key interventions

2.2.1 PR14 asset health performance commitment

Our draft decision

In our draft determination we intervened to include an underperformance payment of £5.365m³ in relation to its PR1 performance commitment WB1 Asset Health Water Infrastructure. This intervention was required because Thames Water informed us that in calculating its performance for the 2015-20 period, it had overstated the length of decommissioned mains. This meant that the company's underperformance payment on this performance commitment in relation to the 2015-20 period was too low, so the company recovered more revenue from its customers than it should have done.

Thames Water confirmed the amount of underperformance payment due, and that its preference was for the underperformance payment to be reconciled at the 2024 price review (PR24). However, we considered that it was in the best interests of customers to include this underperformance as soon as possible, as part of the in-period ODI determination process rather than at the 2024 price review (PR24).

Stakeholders' responses

In its response regarding its PR14 asset health performance commitment Thames Water agrees that the underperformance payment of £5.365m is correct.

³ Converted to 2017-18 FYA CPIH prices from the 2012-13 FYA RPI price base used at PR14

Consideration of responses and final decision

Having considered the company's responses, our final decision on the company's performance payment for this performance commitment is as stated in our draft decision, above.

2.2.2 Environmental measures delivered

Our draft decision

In its APR, Thames Water stated that it delivered 182 schemes against its Environmental measures delivered performance commitment (PR19TMS_ES02). This exceeded the 2020-21 performance commitment level of 180. But, because this is an underperformance only performance commitment the company did not receive an outperformance ODI payment.

Stakeholders' responses

In its response to our draft determination, Thames Water stated that it had in fact delivered 187 schemes in relation to this performance commitment, so it had exceeded its performance commitment level by more than it had previously reported.

Consideration of responses and final decision

Although this has no impact on the in-period ODI payments we have reflected this improved performance in the company's ODI performance model we publish on our website alongside this document.

2.2.3 Inflation

Our draft decision

In our draft determination, we applied an inflation rate of 2.93% for all companies. We said we would revise this estimate in our final in-period determinations informed by latest forecasts and stakeholders' responses.

Stakeholders' responses

Thames Water suggests that we use a higher rate of inflation in our final determinations.

Consideration of responses and final decision

We have updated our inflation assumption based on the latest available data, as set out in section 3.2 of '[Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21](#)'.

2.2.4 C-MeX and D-MeX

Our draft decision

Our draft determination included 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 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.

Stakeholders' responses

Thames Water proposes that the price base for ODI payments for C-MeX and D-MeX should be adjusted. The company says payments for C-MeX are calculated using the 2020-21 residential retail revenue allowance from the PR19 final determination in nominal prices, but the results are treated as being in 2017-18 prices without any price base conversion. It states that in the D-MeX model, ODI payments are calculated using 2020-21 actual developer services revenues in nominal prices, but the results are treated as being in 2017-18 prices without any price base conversion. Thames Water says it considers this to be a technical error that needs to be corrected. Thames Water acknowledges that it is stated in the PR19 reconciliation rulebook that no inflation adjustment is necessary.

Thames Water also states that the 2020-21 residential retail revenue allowance from the PR19 final determination is based on forecast numbers of customers, and that it expects the residential retail revenue allowance to be adjusted to use actual customer numbers.

Thames Water also highlights that the value for residential retail revenue allowance from the PR19 financial model is from the item labelled "Residential retail service revenue (sum of margin, CTS and revenue adjustment) – nominal" (£138.823m in 2022-23) and proposes it should instead use the item labelled "Residential retail service revenue (sum of margin, margin on DPC, CTS and revenue adjustment) – nominal" (£139.612m in 2022-23).

Consideration of responses and final decision

We acknowledge the response regarding the value of the residential retail service revenue and have adjusted the C-MeX model to correct this. This has resulted in a C-MeX underperformance payment of £16.753m. This modelling change only results in a change to C-MeX payments for Thames Water.

The values stated in our draft and final determinations are calculated in accordance with methodology set out in the December 2019 PR19 final determinations and as stated in the PR19 reconciliation rulebook therefore no price base conversion is required in calculating the appropriate level of ODI payments for C-MeX and D-MeX. The revenue allowance that is used for this reflects the forecast customer numbers in the December 2019 PR19 final determinations and any variance in customer numbers does not affect the retail revenue allowance for the purposes of determining payments for C-MeX in the 2020-25 period.

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

The company 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 final determination.

2.3.1 Renewable energy produced

Our draft decision

Thames Water has a bespoke performance commitment to generate 493 Gigawatt hours (GWh) of renewable energy in 2020-21 (PR19TMS_EWS03). It has reported generating 476 GWh of renewable energy which results in an underperformance payment of £1.370m. The company requested that we defer this payment due to Covid-19 impacts. It also requested that we reprofile the remaining years' performance commitment levels.

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 Covid-19 pandemic.

We recognised that Covid-19 has affected consumption patterns which could have impacted this performance commitment during 2020-21. However, Thames Water had 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 did 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 were encouraged that Thames Water is now working to increase its energy generation capacity at other sites. We noted that its suggested reprofiled performance commitment levels imply that it may be able to improve its performance over the period and this might result in net outperformance payments overall. We considered it was still incentivised to do this. We also noted 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 considered that neither intervening to defer the underperformance payment nor reprofiling the performance commitment levels was appropriate.

Stakeholders' responses

In its response to our draft determination, Thames Water expressed regret that we had not accepted its proposal to reprofile this performance commitment. It reiterated that it considered its proposal would have set a more stretching target at no cost to customers.

We did not receive any specific comments on this issue from other stakeholders.

Consideration of responses and final decision

We considered stakeholder responses, but were not persuaded that we should change our position. Consequently, our final decision on the company's performance payment for this performance commitment is as stated in our draft decision, above. While we understand the company's argument, its proposal would mean that the company is incentivised to seek to generate less renewable energy than the current performance commitment levels (PCLs) in the first few years of the 2020-25 period and more than the PCLs would be produced in the latter part of the 2020-25 period. This would delay when customers and the environment receive the full expected benefits, so we have not changed the position we set out in our draft determinations.

2.3.2 Per capita consumption (PCC)

Our draft decision

In line with our July consultation proposals, we proposed changing the timing of payments for this performance commitment to end of period. Thames Water also asked us 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.

Stakeholders' responses

In its response on per capita consumption, Thames Water agreed with our revised timing of this performance commitment to end-of-period.

We did not receive any specific comments on this issue from other stakeholders.

Consideration of responses and final decision

Our consultation on moving the timing of the per capita consumption performance commitment to the end of the 2020-25 period has [concluded](#). After carefully considering the responses to that consultation, we have confirmed that ODI payments for per capita consumption performance commitments will be determined at the end of the period for all years within the 2020-25 price control period. Consequently, we have not included any adjustment in relation to this performance commitment in our final determination.

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

3.1 Our final determination

In this section we outline the financial impacts of our final 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 final 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 final decisions on deferrals and abatements and how we propose that these payments should be applied in 2022-23.

Table 3.5 sets out the changes that we are determining to the company's relevant price controls because of those decisions.

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 final 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 final 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)	Our final decisions after interventions (£m)
Water resources	-0.018	-0.018	-0.018
Water network plus	-11.745	-9.100	-9.100
Wastewater network plus	-18.355	-18.355	-18.355
Bioresources	-1.233	-1.233	-1.233
Residential retail	-0.519	-0.519	-0.519
Thames Tideway Tunnel	0.000	0.000	0.000
Total payments	-31.870	-29.226	-29.226

See section 2 for details of our interventions on the company's performance commitments.

Table 3.2: C-MeX and D-MeX payments

Our final 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	-16.753	n/a
Water network plus	n/a	-1.227
Wastewater network plus	n/a	-0.634
Total payments	-16.753	-1.861

See section 2 for further details on C-MeX and D-MeX.

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 final 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	-0.018
Water network plus	-9.100	-1.227	0.000	-5.365	-15.692
Wastewater network plus	-18.355	-0.634	0.000	0.000	-18.989
Bioresources	-1.233	0.000	0.000	0.000	-1.233
Residential retail	-0.519	-16.753	0.000	0.000	-17.273
Thames Tideway Tunnel	0.000	0.000	0.000	0.000	0.000
Total	-29.226	-18.614	0.000	-5.365	-53.205

See section 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 final 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 final deferrals (£m)	Ofwat final abatements (£m)	Total ODI payments to be applied in 2022-23 (£m)
Water resources	-0.018	0.000	0.000	-0.018
Water network plus	-15.692	0.000	0.000	-15.692
Wastewater network plus	-18.989	0.000	0.000	-18.989
Bioresources	-1.233	0.000	0.000	-1.233
Residential retail	-17.273	0.000	0.000	-17.273
Thames Tideway Tunnel	0.000	0.000	0.000	0.000
Total	-53.205	0.000	0.000	-53.205

See section 2 for our decisions relating to deferrals and abatements for this company.

Table 3.5: Changes to price controls (final determinations)

This table sets out the changes to the level of the company's price controls that we are determining for the Charging Years beginning on 1 April 2022 and 1 April 2023. The details for other charging years are included for completeness and ease of reference. The in-period adjustments model published on our website shows how these changes reflect the impact of our final decisions. See '[Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21](#)' for how we have applied adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
Water resources (K factors)	Last determination	3.90	-1.00	0.67	3.51
	Final determination	3.90	-1.02	0.70	3.51
Water network plus (K factors)	Last determination	7.44	0.04	1.30	0.22
	Final determination	7.44	-2.34	3.70	0.22
Wastewater network plus (K factors)	Last determination	-0.81	-1.59	-0.40	-0.16
	Final determination	-0.81	-4.61	2.66	-0.16
Bioresources (unadjusted revenue, UR_t – £m, 2017-18 Nov CPIH prices)	Last determination	160.767	161.621	162.479	163.333
	Final determination	160.767	160.099	162.479	163.333
Residential retail (total revenue, TR_t – £m, nominal prices)	Last determination	143.177	146.137	148.468	150.721
	Final determination	143.177	122.550	148.468	150.721
Thames Tideway Tunnel (K factors)	Last determination	4.64	2.78	-11.51	-10.68
	Final determination	4.64	2.78	-11.51	-10.68

We have based Thames Water's final determination on the data and commentary provided to us by Thames Water (and, where relevant, other water companies). 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.

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