

February 2023

Notice of intention to change:

**PR19 final determinations:
Thames Water – Outcomes
performance commitment
appendix**

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Background

At PR19 we conditionally allowed Thames Water a £300 million allowance to enhance the performance of its London water network. The allowance is conditional on Thames Water delivering an agreed scope of work through a gated process, and on a substantial contribution from shareholders to the cost of the improvement works.

We subsequently assessed the enhancement proposals through a number of gates. We wrote to Thames Water on 15 November 2022 to confirm that Thames Water could exit the gated process with respect to the London water network conditional allowance and deliver the agreed scope subject to making appropriate changes to the company's PR19 performance commitments to reflect the forecast benefits resulting from the conditional allowance.

Performance commitment adjustments

For PR19 we stated that for Thames Water, we may reset relevant performance commitments and/or outcome delivery incentives during the 2020–25 period in relation to its water network as part of the gated process. Annex 2 of Thames Water's outcomes performance commitment appendix,¹ provides that:

'Where potential benefits flow from the London water network improvement enhancement allowance and impact on performance commitments set in this final determination, potentially making the performance commitment levels or outcome delivery incentive outperformance payments easier to achieve, we will consider resetting those levels or incentives. This is to reflect the level of stretch and outperformance payment in line with our intention in our final determination. We will consider this and reset as necessary as part of the gated process.'

In line with this provision and as agreed with Thames Water, we propose to make the adjustments to the PR19 leakage and mains repairs performance commitments set out in

¹ See *Bespoke adjustments to performance commitments, Annex 2, PR19 final determinations: Thames Water – Outcomes performance commitment appendix.*

Annexes 1 and 2 to account for benefits forecast to materialise as a result of this allowance. We set out the new performance commitments in the following section.

New performance commitments

In line with our approval for Thames Water to exit the gated process, we also propose to implement three new performance commitments for the 2020–2025 price control period to further incentivise the efficient and timely delivery of the schemes associated with this allowance. These are:

- 1) a bespoke trunk mains renewal performance commitment; and
- 2) a reputational performance commitment for Thames Water to deliver a Future London Strategy; and
- 3) a reputational performance commitment related to Thames Water's Data Validation work streams.

1. Performance commitment adjustments

1.1 Leakage performance commitment adjustment

Leakage is reported as a three-year average in MI/d, corresponding to the percentage reduction reported. The interventions associated with this allowance are forecast to result in 1.69MI/d of leakage benefit in 2024-25 and then additional benefit in the 2025-2030 period.

Our draft decision

In order to maintain the stretch of the original PR19 leakage target, we will adjust the 2024-25 leakage target for the -1.69Md/d of benefit occurring, resulting in a three-year average performance target of 557.1 MI/d for 2023-24 and 536.2MI/d for 2024-25. This impacts the PR19 performance commitment by requiring a greater reduction in leakage increasing the performance target to 20.5% by the end of 2024-25 as shown in Annex 1.

Following Ofwat taking [enforcement action in 2017](#), Thames Water provided a series of undertakings under section 19 of the Water Industry Act 1991 in relation to its management of leakage reduction. These include commitments relating to the delivery of its leakage performance commitments. Thames Water has accepted that its section 19 undertakings related to leakage performance will now apply to the updated performance target rather than those defined in its PR19 business plan.

To note, the leakage interventions included in the conditional allowance are also anticipated to have benefits which are realised in the 2025-2030 price control period. We will reflect the quantum of the forecast benefit in 2025-2030 when setting the 2025-30 price control performance commitment levels for leakage.

1.2 Mains repairs performance commitment adjustment

The interventions associated with the London network allowance are forecast to reduce the number of mains repairs in the 2025-30 control period. The mains repairs performance commitment is reported as the number of mains repairs per thousand kilometres of the entire water main network (excluding communication and supply pipes) to one decimal place.

Our draft decision

In order to maintain the stretch of the original PR19 mains repairs target, the mains repairs per 1000km target will need to be adjusted by -4 in 2023-24 and -53 in 2024-25, resulting in a performance target of 254.7 mains repairs per 1000km for 2023-24 and 249.3 mains repairs per 1000km for 2024-25 (see Annex 2).

The mains repairs interventions included in the conditional allowance are also anticipated to have benefits which are realised in the 2025–2030 price control period. We will reflect the quantum of the forecast benefit when setting the 2025–30 price control performance commitment levels for mains repairs.

2. New Performance Commitments

2.1 Bespoke trunk mains performance commitment

The purpose of this performance commitment is to incentivise the delivery of planned trunk main renewals in specific locations covered by the London water network allowance. The delivery profile is informed strictly by the forecast of trunk main interventions covered in the conditional allowance, meaning delivery of other trunk mains outside the scope of this allowance won't contribute towards meeting this performance commitment. The majority of the planned trunk main renewals are planned to be completed by 2024–25, however, 2km will fall into AMP8. The 2km will be reflected in a Price Control Deliverable when setting the 2025–2030 price control.

Our draft decision

This performance commitment is subject to Outcome Delivery Incentive (ODI) underperformance payments to incentivise timely delivery of the intervention. Annex 3 provides the formal definition and parameters of the performance commitment.

2.2 Future London Strategy

We are proposing to implement a reputational incentive for its Future London Strategy workstream, which Thames Water is delivering to define how it will operate in the future and will set out the strategic direction for its London network.

Our draft decision

Thames Water has provided a granular description of the activities and outputs associated with its Future London Strategy, against which it will report progress. We expect Thames Water to report progress through quarterly through performance reports to Ofwat and on an annual basis as part of Thames Water's annual performance report. Annex 4 provides the formal definition and parameters of the performance commitment.

2.3 Data Validation

We are proposing to implement a reputational incentive for Thames Water's Data Validation workstream, which is focussed on improving its understanding of mains performance and leading to better management of the company's London Network.

Our draft decision

For the Data Validation workstream, the reputational incentive will incentivise the provision of high evidential standards to support proposed investments in the 2020-25 price control period. The incentive ensures delivery of data validation activities in terms of progress against an output are reported. Progress will be reported through a quarterly report to Ofwat and annually as part of Thames Water's annual performance report. Annex 4 provides the formal definition and parameters of the performance commitment

Next steps

If you would like to raise views in relation to this notice, please send these to kate.haycock@ofwat.gov.uk by 14 March 2023.

Subject to considering views raised, we expect to make the proposed changes to Thames Water's Outcomes performance commitment appendix. To note, the final changes will be effective as of 15 November 2022.

Annex 1 – Leakage performance commitment

The detail for this performance commitment is set out on page 3. This annex shows the current performance commitment as published at PR19 (in the first table) and the proposed change to the performance commitment as a result of the London network allowance (in the second table).

In section 1.1.3 (page 12) of the ['Thames Water PR19 Final Determination – Outcomes performance commitment appendix'](#) table for:

		Company forecast	Committed performance level				
	Unit	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level – percentage reduction	%	NA	4.1	10.2	14.1	17.4	20.4
Enhanced underperformance collar – percentage reduction	%		NA	NA	NA	NA	NA
Standard underperformance collar – percentage reduction	%		-10.0	-10.0	-10.0	-10.0	-10.0
Underperformance deadband – percentage reduction	%		NA	NA	NA	NA	NA
Outperformance deadband – percentage reduction	%		NA	NA	NA	NA	NA
Standard outperformance cap – percentage reduction	%		7.4	14.9	18.8	22.1	25.1
Enhanced outperformance cap – percentage reduction	%		NA	NA	NA	NA	NA

Read:

		Company forecast	Committed performance level				
	Unit	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level – percentage reduction	%	NA	4.1	10.2	14.1	17.4	20.5
Enhanced underperformance collar – percentage reduction	%		NA	NA	NA	NA	NA
Standard underperformance collar – percentage reduction	%		-10.0	-10.0	-10.0	-10.0	-10.0
Underperformance deadband – percentage reduction	%		NA	NA	NA	NA	NA
Outperformance deadband – percentage reduction	%		NA	NA	NA	NA	NA
Standard outperformance cap – percentage reduction	%		7.4	14.9	18.8	22.1	25.1
Enhanced outperformance cap – percentage reduction	%		NA	NA	NA	NA	NA

Annex 2 – Mains repairs performance commitment adjustment

The detail for this performance commitment is set out on page 3. This annex shows the current performance commitment as published at PR19 (in the first table) and the proposed change to the performance commitment as a result of the London network allowance (in the second table).

In section 1.1.5 (page 18) of the ['Thames Water PR19 Final Determination – Outcomes performance commitment appendix'](#) table for:

		Company forecast	Committed performance level				
	Unit	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level	number	NA	265.9	262.2	258.5	254.8	251.1
Enhanced underperformance collar	number		NA	NA	NA	NA	NA
Standard underperformance collar	number		372.3	372.3	372.3	372.3	372.3
Underperformance deadband	number		NA	NA	NA	NA	NA
Outperformance deadband	number		NA	NA	NA	NA	NA
Standard outperformance cap	number		212.9	209.2	205.5	201.8	198.1
Enhanced outperformance cap	number		NA	NA	NA	NA	NA

Read:

		Company forecast	Committed performance level				
	Unit	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level	number	NA	265.9	262.2	258.5	254.7	249.3
Enhanced underperformance collar	number		NA	NA	NA	NA	NA

		Company forecast	Committed performance level				
	Unit	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Standard underperformance collar	number		372.3	372.3	372.3	372.3	372.3
Underperformance deadband	number		NA	NA	NA	NA	NA
Outperformance deadband	number		NA	NA	NA	NA	NA
Standard outperformance cap	number		212.9	209.2	205.5	201.8	198.1
Enhanced outperformance cap	number		NA	NA	NA	NA	NA

Annex 3 – Bespoke trunk mains performance commitment

Performance commitment definition and parameters – Trunk Mains renewal

Conditional allowance commitment	This commitment includes the length of mains renewed as part of the London water network conditional allowance programme. Mains renewal includes mains whose prime purpose is renewal of an existing main, even where existing main remains in service (i.e. is not abandoned immediately on commissioning of new main). It also includes mains sleeving/pipe cracking/slip lining, where used for this category of work and records any original main as abandoned. An adjustment to size classification should be made where renewal activity results in upsizing or downsizing of mains.
Detailed definition of performance measure	The total length of trunk mains network renewed in km attributable to the investments agreed with Ofwat and delivered as part of the LWI Conditional Allowance programme.
Additional detail measurement units	Total trunk mains renewal is defined as the output (in km) delivered from the Trunk mains replacement intervention comprised of 8 schemes and operational interventions. Outcome delivery incentives will be applied in 2020-25 and based on the incentive rates formula in the table below. The trunk mains renewal level is expressed as number of kilometres to one decimal place.
Specific exclusions	N/A
Reporting and assurance	Thames Water will report on progress in delivering these conditional allowance interventions on a quarterly basis to Ofwat and annually as part of their annual performance report.
Measurement unit and decimal places	Km of trunk mains renewed, reported to one decimal place
Measurement timing	Reporting year
Incentive form	Revenue
Incentive type	Underperformance only
Timing of underperformance payments	In-period
Price control allocation	100% water network plus
Frequency of reporting	Annual
Any other relevant information	N/A

Links to relevant external documents	N/A
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Performance commitment levels – Trunk Mains renewal

Trunk Mains interventions	Unit	Committed performance level	
		2023-24	2024-25
Trunk mains renewed	Km	4.1	10.3
Total cumulative km of trunk mains renewed	Km	4.1	14.4

Incentive rates – Trunk Mains renewal

Incentive type	Incentive rate (£m/km/year)
Mains renewal: Underperformance payment - standard	$\text{ODI rate} = \text{scheme totex}^* (\text{WACC} + \text{RCV run-off rate}) / \text{units}$ where: Schemes totex is the agreed baseline investment totex in 2017/18 prices = £0.3940m incentive rate per km

Annex 4 – Reputational performance commitments

Performance commitment definition and parameters – Future London Strategy

Conditional allowance commitment	Reporting of progress against the delivery of a baseline of work (in outputs) committed to as part of Thames Water's Gate 4 London Water Network Improvement submission that comprise Thames Water's London Future Strategy workstream.
Detailed definition of performance measure	<p>The number of outputs delivered against a baseline, including:</p> <ul style="list-style-type: none"> • London Strategy & strategic roadmap (1 report) • London Strategic System long term adaptive plan (1 report) • Lower Hall B Proof of concept: <ul style="list-style-type: none"> • System level adaptive plan (1 report) • System model linked to telemetry on IWLIVE • Deployment of approximately 200-300 additional pressure monitoring points • No Dig Repair Innovation project (1 business case for submission to Ofwat Innovation fund) • Coppermills system start after Lower Hall B approach confirmed in year 4 <p>System level adaptive plan (1 report) System model linked to telemetry on IWLIVE Deployment of c600 monitors</p>
Specific exclusions	NA
Reporting and assurance	Thames Water will report on its progress in delivering these conditional allowance interventions on a quarterly basis to Ofwat and annually as part of our annual performance report. Thames Water will also report progress to their Board and shareholders on a quarterly basis, with an update on conditional allowance and shareholder contribution being included as a standing item on the Thames Water Utilities Limited Board agenda.
Measurement unit and decimal places	Outputs in number (nr) dependent on the nature of the activity being delivered
Measurement timing	Reporting year
Incentive form	Reputational
Incentive type	NA
Timing of underperformance payments	NA
Price control allocation	NA

Frequency of reporting	Quarterly to Ofwat and Thames Water Board, annually as part of Thames Water's Annual Performance Report process.
Any other relevant information	NA
Links to relevant external documents	NA

Performance commitment levels – Future London Strategy

London Future Strategy Workstream 2020-25	Unit	Committed performance level		
		2022-23	2023-24	2024-25
London Strategy & strategic roadmap (1 report)	Nr			1
London Strategic System long term adaptive plan (1 report)	Nr			1
Lower Hall B Proof of concept:				
- system level adaptive plan (1 report)	Nr			1
- system model linked to telemetry on IWLIVE	Delivered/not delivered			Delivered
- deployment of approximately 200-300 additional pressure monitoring points	Nr			200
- No Dig Repair Innovation project (1 business case for submission to Ofwat Innovation fund)	Nr			1
Coppermills system start after Lower Hall B approach confirmed in year 4	Delivered/Not delivered			Delivered
System level adaptive plan (1 report)	Nr			1
System model linked to telemetry on IWLIVE	Delivered/Not delivered			Delivered
Deployment of c600 monitors	Nr			600

Incentive rates – Future London Strategy

Incentive type	Incentive rate (£m/km/year)
Reputational	N/A; reputational

Data validation

Performance commitment definition and parameters – Data Validation

Conditional allowance commitment	Reporting of progress against the delivery of a baseline of work (in outputs) committed to as part of our Gate 4 London Water Network Improvement submission that comprise Thames Water's Data Validation workstream.
Detailed definition of performance measure	The number of outputs delivered against a baseline, including: <ul style="list-style-type: none"> • 1000 samples • 1 report (issued internally, available on request)
Specific exclusions	N/A
Reporting and assurance	Thames Water will report on progress delivering these conditional allowance interventions on a quarterly basis to Ofwat and annually as part of Thames Water's annual performance report. Thames Water will also report progress to their Board and shareholders on a quarterly basis, with an update on conditional allowance and shareholder contribution being included as a standing item on the TWUL Board agenda.
Measurement unit and decimal places	Outputs in number (nr) dependent on the nature of the activity being delivered.
Measurement timing	Reporting year
Incentive form	Reputational
Incentive type	N/A
Timing of underperformance payments	N/A
Price control allocation	N/A
Frequency of reporting	Quarterly to Ofwat and Thames Water Board, annually as part of Thames Water's Annual Performance Report process.
Any other relevant information	N/A
Links to relevant external documents	N/A

Performance commitment levels – Data Validation

Data Validation 2020–25	Unit	Committed performance level	
		2023–24	2024–25
Samples	Nr	259	741

Report (issued internally, available on request)	Nr		1
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Incentive rates – Data Validation

Incentive type	Incentive rate (£m/km/year)
Reputational	N/A; reputational

**Ofwat (The Water Services Regulation Authority)
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