

November 2023

# Final determination of Thames Water's in-period outcome delivery incentives for 2022-23

Ofwat

## About this document

This document provides our final determination on the extent to which the price controls included in our PR19 final determinations, are to be adjusted to reflect Thames Water's performance for the 2022-23 charging year, 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 adjustments, and our reasons for these, are set out in this document and in our [Sector overview: Final determinations of in-period outcome delivery incentives for 2022-23](#).

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

## Background

At the 2019 price review (PR19), companies made pledges to their customers and stakeholders about the service levels they would meet to make progress towards stated outcomes (performance commitments). Companies' performance commitments form a key part of the service package that they are expected to deliver. 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>

Each performance commitment has an outcome delivery incentive (ODI) that provides either financial or reputational consequences for companies of outperforming or underperforming their performance commitments. Many of the financial ODIs are paid during the 2020-25 price control-period. The reason for this is to bring payments closer in time to when customers experience a given level of performance. The remaining incentives are paid at the end of the period.

ODIs act as an incentive for companies to deliver their committed levels of performance, returning funding to customers for foregone benefits if they deliver less than is expected. Companies that go beyond and deliver greater benefits than expected to customers and the environment can receive outperformance payments to incentivise them to keep up this outperformance.

Thames Water reported its performance against these performance commitments in its annual performance report (APR) in July 2023. We assessed the company's performance against its performance commitments and, in September 2023, consulted on our [draft](#)

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<sup>1</sup> We take account of performance commitments as set out in this appendix, adjusted, if relevant, in accordance with Annex 2 of the appendix. Annex 2 provides for changes and corrections to be made to 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](#).

[determinations](#) for companies' in-period ODIs for 2022-23. We have carefully considered the [responses](#) we received relating to our draft determinations.

Our final determination sets out relevant adjustments to the company's price controls, for one or more future years. The results of our assessment for 2022-23 will affect Thames Water's customers' bills in the 2024-25 Charging Year.

Further details regarding the responses we received, our final determinations and the adjustments that we have made are presented in sections 1 and 2, and in [Sector overview: Final determinations of in-period outcome delivery incentives for 2022-23](#).

In our [Sector overview Final determinations of in-period outcome delivery incentives for 2020-21](#) we deferred our determination of the value of companies' ODI payments for usage of water per person (known as Per Capita Consumption) for the 2020-21 to 2023-24 charging years to the end of the 2020-25 period. We set out this decision and the reasons for it in this [decision document](#), which we published after having considered stakeholder responses to our July 2021 consultation.

## Executive summary

Having assessed Thames Water's performance against its performance commitments in 2022-23, the ODI payments and performance are as reported by the company with the following exceptions:

- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £13.121m and a D-MeX underperformance payment of £5.320m based on our assessment of 2022-23 company performance; and

In its 2022-23 APR, the company requested that a 0% tax rate was applied to its ODI payments. In our draft determination, we retained a tax rate of 19% because the evidence submitted by the company did not convince us that a different tax rate should be applied at this time. In our final determination, we are intervening to apply a 0% tax rate, after accounting for the funding the company has received through its PR19 wholesale tax allowance. We consider this is appropriate based on all the evidence submitted, including the additional evidence submitted by the company on its tax losses and arguments regarding bill smoothing. This intervention will increase allowed revenue by £59.285m in 2024-25.

See section 1 for the results of our assessment.

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# 1. Results of our assessment

## 1.1 Interventions and policy decisions

The company has not requested any interventions to its reported performance and ODI payments. Based on our assessment of the company's performance, we do not consider any are required.

However, the company has requested that a 0% tax rate is applied to its ODI payments. We make comments on this and on the company's leakage performance below:

### 1.1.1 Leakage

#### Our draft determination

Thames Water had not achieved full compliance with the [PR19 common performance commitment definitions](#) and the [leakage reporting guidance](#). The company reported one main component as materially non-compliant (household night use). We said that we were applying the company's reported underperformance payment of £8.908m in our draft determination.

We stated that we expect all companies to be reporting full compliance with the leakage and per capita consumption (PCC) methodology. Should any leakage information be revised or restated in future, our subsequent determinations will take account of the company's relevant performance and the adjustments we have made to the relevant price control in relation to the leakage performance commitment.

#### Stakeholders' responses

We did not receive any specific comments on this issue.

#### Consideration of responses and final determination

Having received no stakeholder responses on this matter, our final determination on the company's performance payment for this performance commitment is as stated in our draft determination, above.

We apply the following adjustments in the in-period adjustments model:

### 1.1.2 Tax

#### Our draft determination

In its 2022-23 APR, Thames Water submitted information to support its view that it does not expect to pay corporation tax within the 2020-25 period. As a result, the company included a 0% tax rate in its in-period adjustments model for the remaining years of the 2020-25 period. This is the first year that the company has requested a 0% tax rate on its ODI payments.

In our 2022-23 in-period ODI draft determination, we retained a tax rate of 19% because the evidence submitted by the company did not convince us that a different tax rate should be applied at that time. We said that the company confirmed that it is surrendering tax losses to group companies and receiving tax credits. The total value of tax losses surrendered will be finalised by March 2024.

In our draft determination we said that as these tax losses have a value if other group companies are able to use them, we considered it was possible that the company could benefit within the 2020-25 period from the additional tax losses. We said we would be in a better position to consider whether such an adjustment to tax is appropriate as part of our decisions for the 2024 price review (PR24) determinations, when we would have information on the value of tax losses surrendered by the company over 2020-25 and the company's proposed opening tax loss balance at PR24.

## Stakeholders' responses

In its [consultation response](#), Thames Water stated that it disagreed with our draft determination in relation to tax as it will have a material adverse impact on the customers it serves. The company submitted material additional evidence to support its position. It states that its "efficient management of its tax affairs over several AMPs delivers benefits to customers as the routine restriction of capital allowances claims by the company in order to utilise tax losses from other group companies has minimised tax allowances, thereby reducing customer bills."

Thames Water states that it is in customers' interests that the marginal tax rate on ODI payments is reduced in 2020-25 and not left to be adjusted as part of PR24, to avoid the company having to reduce expenditure that would otherwise be spent on delivering improved customer outcomes and to ensure smoother customer bill profiles between the 2020-25 and 2025-30 periods.

The company states that it anticipates being in a zero tax liability position throughout the 2020-25 period; therefore, a 0% marginal rate should apply to the ODI payments for 2022-23 and also retrospectively be applied to the 2020-21 and 2021-22 in-period determinations.

The company states that if the receipt of value from the surrender of 2022-23 tax losses by Thames Water to group companies means that a tax gross-up should be applied to ODIs for 2022-23, then any such gross-up should be limited to the tax allowance actually received for 2020-25 period because Ofwat guidance states that (i) ODI payments return funding to customers, and (ii) the full tax value of any losses surrendered is deducted from the tax allowance; and the underlying costs which caused the exceptional 2022-23 tax losses were

not used to determine allowed revenues, and therefore any receipts from the surrender of such tax losses should be excluded from any ODI tax gross-up calculation to avoid customers unduly gaining.

The company suggests that if instead of surrendering tax losses to group companies the 2022-23 tax losses are carried forward by Thames Water, no benefits to customers are forecast to be derived within either the 2020-25 or 2025-30 periods.

Thames Water concludes that based on currently available forecasts, it has a high degree of certainty that there is nothing that it is aware of that would cause it to believe that the above conclusions would change during the remainder of the 2020-25 period.

### **Consideration of responses and final determination**

Since the publication of our draft determination, the company has submitted additional information as part of its consultation response and in its PR24 business plan. This provides further information on the use (both surrenders and receipts) of group relief over the 2020-25 period and further detail on the opening balances reflected in its PR24 business plan and the impact on customers in the 2025-30 period. This shows that it is very unlikely that the company would be able to benefit from the additional tax losses generated by the underperformance payments within the 2020-25 period. In the event that the company does benefit, we will take this into account when making our PR24 determinations. Also as part of accepting Thames Water's request to limit the tax adjustment to the value of the company's PR19 wholesale tax allowance, we would not expect to make an additional allowance for tax through the operation of the PR19 tax reconciliation at PR24. In addition, we note there are bill smoothing benefits associated with accepting this adjustment now, rather than to implement it through PR24.

Having considered Thames Water's response on this matter, we are intervening to adjust the assumed tax rate included in the in-period modelling to 0%. Consistent with the approach we applied for Southern Water and Dwr Cymru in the 2021-22 in period determinations, we take account of the impact on prior years as well as adjusting for 2022-23. The adjustment is £12.480m for 2020-21 and £17.011m for 2021-22, reflecting the size of the net out and underperformance payments in those years. The adjustment for 2022-23 is £33.573m. We also note that Thames Water received an allowance for tax at PR19 of £3.779m. Consequently, we apply a one-off deduction equivalent to this allowance. Given that the company is stating it is not paying tax and we are intervening now to adjust tax rates to reflect this issue, we consider it is in customers' interests to adjust for the tax allowance.

Overall, this means that, as per Table 1.2, revenue will be £59.285m higher in 2024-25 compared to our draft determination. However, due to the way the modelling is applied in the final determination, we include a bespoke adjustment of £25.712m (the aggregate of the 2020-21 and 2021-22 adjustments plus the adjustment for the PR19 tax allowance, the £33.573m adjustment is automatically accounted for in the calculated revenue adjustment).

We will also apply the adjusted tax rate of 0% to its future ODI payments in 2023-24 and 2024-25.

**Table 1.1: Breakdown of tax adjustments**

	Adjustment (£m)
Adjustment for tax on 2020-21 ODI payments	12.480
Adjustment for tax on 2021-22 ODI payments	17.011
Adjustment for tax allowance at PR19	-3.779
Bespoke adjustment included in model (see table 2.3)	25.712
Impact incorporated into FD modelling for 2022-23	33.573
<b>Net position 2020-23 including impact incorporated into 2022-23</b>	<b>59.285</b>

We have the following comments relating to the unplanned outage performance commitment:

### 1.1.3 Unplanned outage

#### Our draft determination

We did not intervene or comment on this matter in our draft determination; nor did we receive any stakeholder comments on it.

#### Our final determination

In our [Sector overview: Final determinations of in-period outcome delivery incentives for 2022-23](#), we highlight matters identified by our review of company submissions for the unplanned outage performance commitment. In light of these matters, companies should review their approach to peak week production capacity (PWPC) against the common methodology in the PR19 reporting guidance to ensure that they are acting in compliance. Should Thames Water's unplanned outage performance information be revised or restated in future, we expect the company to clearly identify any reasons for the restatement and quantify the impact of any changes to data and/or assumptions on reported unplanned outage. We will take account of adjustments we have made to the relevant price control relating to the company's unplanned outage performance in making future determinations.

## 1.2 C-Mex and D-Mex

#### Our draft determination

On 26 September 2023, we published the relative performance of all companies. Our final determination includes a C-MeX underperformance payment of £13.121m and a D-MeX underperformance payment of £5.320m based on our assessment of 2022-23 company performance.



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

We did not receive any specific comments on this issue.

## Consideration of responses and final determination

Having received no stakeholder responses on this matter, our final determination on the company's performance payments for these performance commitments is as stated in our draft determination, above.

## 1.3 Payment deferrals and abatements

As set out in the [PR19 Reconciliation Rulebook: Guidance Document](#), companies can ask us to defer outperformance or underperformance payments, or abate outperformance payments. 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.

Thames Water did not request any payment deferrals or 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 deferrals or abatements in our final determination.

# 2. Impact of 2022-23 in-period ODI assessment on price controls

## 2.1 Our final determination

In this section we outline the financial impacts of our final determinations.

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

Table 2.1 below sets out the change between our draft and final determinations.

**Table 2.1: Change between draft and final determination on total ODI payments to be applied to customer bills in 2024-25**

Price control	Draft determination on total ODI payments to be	Change between draft and final determination on total ODI	Final determination on total ODI payments to be

	applied to customer bills in 2024-25 (£m)	payments to be applied to customer bills in 2024-25 (£m)	applied to customer bills in 2024-25 (£m)
Water resources	-0.471	0.037	-0.434
Water network plus	-64.417	3.834	-60.583
Wastewater network plus (WaSCs only)	-24.616	16.738	-7.878
Bioresources (WaSCs only)	1.886	-0.209	1.677
Residential retail	-13.100	9.292	-3.808
Thames Tideway	0.000	-2.739	-2.739
<b>Total</b>	<b>-100.719</b>	<b>26.953</b>	<b>-73.766</b>

Note: This table does not include the impact of adjusting the modelled tax rate to 0% for Thames Water in the in-period adjustment model as it is pre-tax. The impact of the adjusted tax rate on 2022-23 revenue is shown in line 5 of table 1.2. This is captured directly in the K factors we determine once the ODI payments and bespoke adjustments are taken into account (see table 2.4 below). On a like for like basis, Thames Water's allowed modelled revenue in 2024-25 will be £81.819m (nominal prices) higher than in the draft determination. Further details of the impact are set out in the in-period adjustments model published on our website.

## Table 2.2: Final determination on adjustment to 2024-25 price controls as a result of performance against ODIs

This table sets out our final determination on the ODI payments to be applied to price controls in the 2024-25 charging year after accounting for:

- the in-period ODI payments for each company based on their performance in 2022-23;
- our final determination on these payments after any interventions;
- brought forward deferrals;
- our final determinations on 2022-23 deferrals and abatements;
- bespoke adjustments, including prior year restatements, where relevant; and
- our final determination on C-MeX and D-MeX payments.

For further details, see section 1.

This final determination on the ODI payments to be applied for Thames Water is also set out in the in-period adjustments model published on our website.

Final determination of Thames Water's in-period outcome delivery incentives for 2022-23

Price control	Company's reported ODI payments (£m)	Ofwat FD ODI payments (£m)	ODI payments deferred from 2021-22 (£m)	Ofwat FD deferrals (£m)	Ofwat FD abatements (£m)	Bespoke FD adjustments (£m)	C-MeX FD payments (£m)	D-MeX FD payments (£m)	Final determination on total ODI payments to be applied to customer bills in 2024-25 (£m)
Water resources	-0.471	-0.471	0.000	0.000	0.000	0.037	0.000	0.000	-0.434
Water network plus	-60.714	-60.714	0.000	0.000	0.000	3.834	0.000	-3.703	-60.583
Wastewater network plus (WaSCs only)	-22.999	-22.999	0.000	0.000	0.000	16.738	0.000	-1.617	-7.878
Bioresources (WaSCs only)	1.886	1.886	0.000	0.000	0.000	-0.209	0.000	0.000	1.677
Residential retail	0.020	0.020	0.000	0.000	0.000	9.292	-13.121	0.000	-3.808
Thames Tideway	0.000	0.000	0.000	0.000	0.000	-2.739	0.000	0.000	-2.739
<b>Total</b>	<b>-82.278</b>	<b>-82.278</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>26.953</b>	<b>-13.121</b>	<b>-5.320</b>	<b>-73.766</b>

**Table 2.3: Breakdown of bespoke adjustments**

This table provides a breakdown of the bespoke adjustments included in our final determinations.

Price control	Prior year restatements (£m)	Time value of money adjustment on prior year total (£m)	Green economic recovery (£m)	Total bespoke adjustments to be applied to customer bills in 2024-25 (£m)
Water resources	0.036	0.001	0.000	0.037
Water network plus	3.617	0.216	0.000	3.834
Wastewater network plus (WaSCs only)	16.112	0.626	0.000	16.738
Bioresources (WaSCs only)	-0.220	0.011	0.000	-0.209
Residential retail	8.905	0.387	0.000	9.292
Thames Tideway	-2.739	0.000	0.000	-2.739
<b>Total</b>	<b>25.712</b>	<b>1.241</b>	<b>0.000</b>	<b>26.953</b>

**Table 2.4: Changes to price controls (final determinations)**

This table sets out the impact of our final determination on the company's price controls, as set out in the in-period adjustments model published on our website. See [Sector overview: Final determinations of in-period outcome delivery incentives for 2022-23](#) for how we apply adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
Water resources (K factors)	Previous determination	3.90	-1.02	0.55	3.66
	Revised	3.90	-1.02	0.55	3.15
Water network plus (K factors)	Previous determination	7.44	-2.34	3.74	0.19
	Revised	7.44	-2.34	3.74	-7.26
Wastewater network plus (K factors)	Previous determination	-0.81	-4.61	-4.42	6.60
	Revised	-0.81	-4.61	-4.42	5.48
Bioresources (unadjusted revenue, Urt - £m, 2017-18 FYA CPIH prices)	Previous determination	160.767	160.099	163.349	163.333
	Revised	160.767	160.099	163.349	165.010
Residential retail (total revenue, TRt - £m, nominal prices)	Previous determination	143.177	122.550	124.750	150.721
	Revised	143.177	122.550	124.750	145.842
Thames Tideway Tunnel (TMS only)	Previous determination	4.64	2.78	-11.51	-10.68
	Revised	4.64	2.78	-11.51	-16.90

We have based Thames Water's final determination on the data and commentary provided to us by Thames Water. Should any of this information be revised or restated, we may take account of this, and previous price control adjustments relating to company performance, when making future determinations.

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