



# **Response to Ofwat's PR19 Draft Determination**

## **Appendix**

**TW-DD-A15**

**Counters Creek**

**30 August 2019**



# Table of contents

<b>Section 1</b>	<b>Introduction</b>	<b>2</b>
<b>Section 2</b>	<b>Ofwat’s interventions on Counters Creek</b>	<b>3</b>
<b>Section 3</b>	<b>Relevant background</b>	<b>4</b>
<b>Section 4</b>	<b>Our response to Ofwat’s interventions</b>	<b>6</b>
<b>A</b>	<b>Initial considerations</b>	<b>6</b>
<b>B</b>	<b>We did not cancel our Counters Creek scheme</b>	<b>6</b>
<b>C</b>	<b>Ofwat’s calculation of the underperformance payment is not appropriate</b>	<b>10</b>

## List of tables:

Table 1: Our responses to Ofwat’s reasons as that Thames Water failed to deliver its Counters Creek scheme.....	9
---	---



## Section 1

# Introduction

- 1.1 This document sets out our response to Ofwat's interventions as regard our PR14 commitment to protect properties in the Counters Creek area against the risk of sewer flooding (SB3). This concerns the interventions TMS.PD.A2 and TMS.PD.A6a in Ofwat's PR19 Draft Determinations.
- 1.2 We consider that Ofwat erred in their imposition, and subsequent calculation, of the underperformance payment.
  - The imposition of this payment is based on Ofwat finding that we cancelled the Counters Creek scheme as we did not build the strategic sewer. We disagree. We made the right decision in revising our approach to this scheme (which involves not building this sewer), and we are on track to meet our PR14 commitment of ensuring that the (up to) 1,766 properties identified as at risk of sewer flooding are appropriately relieved.<sup>1</sup> This implies that we are delivering this scheme, indeed on completion of the work we are removing the hydraulic risk on our Sewer Flooding History Database to reflect relief offered to these properties. It is unreasonable for Ofwat to impose such a high underperformance payment solely on the ground of us delivering this scheme using a different combination of solutions than envisaged at PR14.
  - Ofwat did not appropriately account for relevant information on properties that need protection and the benefits associated with the relief that our revised approach delivers. This results in setting the underperformance payment at a too high level and with insufficient regard of what our revised approach delivers in terms of protection.
- 1.3 We request that Ofwat revisit their interventions and do so considering the bigger picture (in particular by having regard to consumer outcomes). We are confident that Ofwat will find that that we have delivered the Counters Creek scheme in a way that meets our PR14 commitment, and thus that no underperformance payment is needed.
- 1.4 We have structured this document as follows:
  - we summarise Ofwat's interventions;
  - we provide relevant background to our decisions and proposals in relation to the Counters Creek scheme and SB3, and to our recent engagement with Ofwat;
  - we explain why Ofwat erred in their interventions:
    - we have delivered the Counters Creek scheme and Ofwat are not correct in concluding that we cancelled it, and;
    - Ofwat's calculation of an underperformance payment is not appropriate.
- 1.5 Ahead of this submission, we sent Ofwat a letter describing our concern with Ofwat's interventions on Counters Creek and inviting Ofwat to discuss and hopefully resolve this area separate from and ahead of Ofwat publishing its PR19 Final Determination.

---

<sup>1</sup> We justify and explain this claim in more detail in Section 4.



## Section 2

# Ofwat's interventions on Counters Creek

- 2.1 Ofwat included an underperformance payment of -£130.1m (2012/13 prices) for our AMP6 performance on the Counters Creek part of SB3. This intervention (TMS.PD.A2) reduces our wastewater RCV at the end of AMP6 by £149.5m (2017/18 prices). Ofwat concluded that non-delivery of the 'strategic sewer' constitutes cancellation, and hence that an underperformance payment should be imposed.
- 2.2 In concluding that Thames Water failed to deliver its Counters Creek scheme for factors within its control, Ofwat identified the following reasons:
- its original assessment of benefits and its failure to appropriately check sewer flooding records;
  - its failure to deliver a hydraulic model that can be used to understand the risk of sewer flooding;
  - its failure to secure sites in advance and the delay of its stakeholder engagement, and;
  - its involvement in setting up Thames Tideway and its failure to make timely provision for joint working on the Cremorne Wharf site.
- 2.3 Ofwat calculated the underperformance payment by multiplying the proportion of promised benefits that Thames Water delivered in AMP6 with the maximum underperformance payment:  $(£14.2m - £2.8m)/£14.2m * £162m = £130.1m$ .
- 2.4 Relatedly, Ofwat intervened to change the 'Wastewater – Other adjustment to wholesale RCV' from -£86.4m to £0m. This intervention (TMS.PD.A6a) avoids double counting arising from the underperformance payment. It does so by withdrawing the £86.4m downward RCV adjustment that we had included in our plan to cover our commitment to fully return underspend on Counters Creek to our customers.<sup>2</sup>

---

<sup>2</sup> We proposed this commitment conditional on not being subject to an underperformance payment for our performance on the Counters Creek part of SB3.



### Section 3

## Relevant background

3.1 This section presents the background relevant to our decision to revise our approach to alleviating sewer flooding risk in the Counters Creek area, our proposals to amend SB3 ('our ODI amendment proposal') to better account for our revised approach, and recent engagement with Ofwat on Counters Creek.<sup>3</sup> As such, it paves the way for our responses to Ofwat's interventions (see section 4).

3.2 Our ODI amendment proposal:

- explained how new information from additional severe weather events compared to modelled predictions and a review of the number of properties at risk of sewer flooding in the Counters Creek area affect our decision to revise our approach to Counters Creek;
- presented analysis in support of our conclusion that a revised approach (which involves a combination of Flooding Local Improvement Projects (FLIPs) and local schemes but not a strategic sewer) protects properties at risk of flooding in the Counters Creek area as effectively and more cost beneficially than the approach including the strategic sewer envisaged at PR14;
- described our engagement with customers, other stakeholders and the Independent Advisory Group (IAG) to inform them about our revised approach, and we presented an update of the progress made in delivering this revised approach;
- presented an updated cost-benefit analysis of our revised approach. We showed that fewer properties in the Counters Creek area are at risk of flooding and that total Annualised Benefits available in this area are between £4m and £5m. In the light of this evidence, the revised approach protecting individual properties at risk of sewer flooding is shown to be a better solution for customers. It protects those properties as well (if not better), sooner, at a much lower cost, and with materially less disruption than the approach envisaged at PR14.
- explained that the Counters Creek part of SB3 does not envisage a scenario where in the light of better evidence we identify a more appropriate combination of solutions compared to that funded at PR14, while still protecting properties at risk in the Counters Creek area. Furthermore, we noted that the Counters Creek part of SB3 included concessions to claim benefit for properties relieved since AMP5. Our revised approach is not allowed to count the benefits that originate from this protection;
- proposed amending SB3 by:
  - restating the tables and incentive rates in SB3 to reflect that the automatic financial incentive is separate to the Counters Creek scheme incentive;
  - inserting additional wording in SB3 to clarify that the Counters Creek part of SB3 can be met by an alternative approach than funded in PR14, and;
  - including a commitment to fully return any underspend from delivering the revised approach at a cost lower than funded at PR14.

---

<sup>3</sup> We submitted our ODI amendment proposal to Ofwat in November 2018.



- 3.3 We met Ofwat to discuss our proposals on 19 March 2019. Ofwat raised points during this meeting to which we responded by a letter sent to Keith Mason on 12 April 2019. This letter provided an update on engagement with the IAG and the Customer Challenge Group (CCG), was accompanied by WSP's independent assurance of our decision to revise our approach, reported costs incurred in delivering our Counters Creek scheme and performance on other schemes, and presented overviews of the properties that reported flooding in the July 2007 event and the AMP6 Sewer Flooding History Database.
- 3.4 Following this engagement, we were hopeful that Ofwat would agree that our decision to revise our approach to Counters Creek is in our customers' interest and would be open to resolve the Counters Creek part of SB3 along the lines of our ODI amendment proposal.



## Section 4

# Our response to Ofwat's interventions

## A Initial considerations

- 4.1 We agree that imposing an underperformance payment of the scale calculated by Ofwat requires withdrawing the downward RCV adjustment that we proposed. Of course, this intervention (TMS.PD.A6a) needs to be revisited when Ofwat impose no or a much lower underperformance payment. The remainder of this section sets out why we challenge the DD's intervention to impose the underperformance payment (and the calculations of this payment). This concerns intervention TMS.PD.A2.
- 4.2 We believe that the DD has not considered our decision-making on and delivery of our Counters Creek scheme in sufficient breadth. Ofwat should have considered the bigger picture, in particular by focusing on consumer outcomes. It is only right that companies respond to new information and an improved understanding by changing how they deliver their plans. This is what we did in Counters Creek. Penalising companies for being agile will disincentivise companies to do what is right and will result in the delivery of schemes that are no longer value for money for customers.
- 4.3 We recommend that Ofwat give further regard to the following:
- our decision to revise our approach to Counters Creek being the right one for our customers;
  - Thames Water being on track to meet its PR14 commitment to protect properties in Counters Creek area that were identified as at risk but by a different combination of solutions to that envisaged at PR14;
  - Thames Water protecting an additional ~100 properties in the Counters Creek area that were identified as at risk of sewer flooding since PR14, and;
  - proposed amendments to SB3 offering a practical route to assessing our AMP6 performance on both Counters Creek and non-Counters Creek schemes that accounts for all the changes that have occurred since PR14.
- 4.4 We explain in this section the misinterpretation reflected in Ofwat's DD interventions.
1. We did not cancel our Counters Creek scheme: we are on track to relieve the properties that we committed to protect at PR14, and;
  2. The underperformance payment has not been calculated appropriately.

## B We did not cancel our Counters Creek scheme

- 4.5 The DD implied that not building the 'strategic sewer' constitutes cancellation of our Counters Creek scheme. This approach to deciding on whether we delivered our scheme seems simplistic: project is deemed 'cancelled' when the sewer is not, and 'delivered' when it is built. Arguably, we did not build the sewer. We do not believe this is sufficient ground to conclude that we cancelled the scheme, with the underperformance payment then a direct consequence. We infer from this



that we would not be subject to an underperformance payment in case we are found to have delivered the scheme.

4.6 In support of their decision, Ofwat identified various reasons as to why we failed to deliver the scheme including the strategic sewer for reasons within our control. We do not believe, however, that the reasons identified by Ofwat relate to what really matters (as becomes apparent from our discussion below). We respond to them in Table 1 (see below).

4.7 Any assessment and decision on our AMP6 performance on the Counters Creek scheme should consider the following two questions.

1. Did we take the right decision in revising our approach to the Counters Creek scheme?
2. Are we protecting the properties that we committed to protect in our PR14 plan by the end of AMP6?

4.8 If we took the right decision and if we meet our PR14 commitment in terms of protecting properties in the Counters Creek area, then it is not reasonable to impose such a high underperformance payment on the sole ground of us delivering our scheme by a different combination of solutions from that envisaged at PR14.

#### **Did we take the right decision in revising our approach to the Counters Creek scheme?**

4.9 We believe that the DD did not consider our decision to revise our approach to Counters Creek. If we made the right decision in opting for a different approach, then not building the strategic sewer was the right thing to do for our customers.

4.10 Our November 2018 ODI amendment proposal extensively explains our decision to revise our approach to Counters Creek. We remain convinced that this is the right decision. An approach comprising of FLIPs and local sewer schemes protects properties at risk of sewer flooding as (if not more) effectively and more cost beneficially compared to the approach envisaged at PR14 (thus including building the sewer). Moreover, it substantially limits disturbance to residents in the Counters Creek area. By contrast, building the strategic sewer would have resulted in costs disproportionate to the benefits it would provide.

4.11 We refer to the WSP's statement for an independent assurance of our decision.<sup>4</sup>

4.12 Once Ofwat accept that we took the right decision, they will acknowledge that any assessment of our performance on the Counters Creek part of SB3 should be appropriately flexible. This should involve accepting that the Counters Creek part of SB3 can be met by an approach different to that envisaged at the time of PR14. We proposed amending SB3, as agreed at PR14, as it does not allow for a meaningful review of the performance of our revised approach.<sup>5</sup> Our proposals keep us tied to our PR14 commitment of protecting properties identified as at risk by the end of AMP6, but ensure that we are not punished for deciding and doing what is right for our customers.

#### **We will keep our PR14 commitment of protecting properties in the Counters Creek**

---

<sup>4</sup> This WSP assurance was included as Appendix B in the letter that Nick Fincham (Thames Water) sent to Keith Mason (Ofwat) on the subject of Counters Creek supplementary information





- 4.13 Taking the right decision in revising our approach to Counters Creek is not sufficient to conclude that we delivered our scheme. We forecast to meet our PR14 commitment of protecting properties in the Counters Creek area.
- 4.14 We have made good progress in delivering our revised approach. We refer to our November 2018 ODI amendment proposal, the letter sent to Keith Mason on 12 April 2019, and our Annual Report for updates on progress made. Critically, we are on track to protect all the properties at risk of hydraulic sewer flooding in the Counters Creek area by the end of AMP6. This includes providing appropriate relief to the 1,766 properties that were identified as at risk in the 2013 Change Protocol and our PR14 plan. This means that we expect to meet our PR14 commitment of protecting these properties.
- 4.15 Additionally, we are protecting ~100 properties at risk (because of reports of sewer flooding) that were identified only following our PR14 plan. We are providing relief to these properties even though they are not part of our commitment at PR14.
- 4.16 We have asked the IAG (Independent Advisory Group) to set out their views on how our revised approach, both in theory and in practice, meets our PR14 commitment of protecting the properties identified as at risk in the Counters Creek area. See Box 1 below.

**Box 1: IAG statement on how we deliver our PR14 Counters Creek commitment**

The IAG have been informed by Thames Water that in considering the current proposal to address the flood risk in Counters Creek by a solution essentially involving FLIPS and local sewer upgrading schemes, Ofwat considers the scheme to be cancelled. We have been asked for our opinion on this specific point. The IAG does not agree with this point of view – to be clear, we do not consider the scheme to be cancelled. In arriving at our view, we have taken into account the following:

- The proposal originally presented to Ofwat in the Change Protocol, which formed the basis of the final determination of the AMP6 business plan (FDBP), included a mix of different measures including a tunnel (commonly referred to as the Strategic Tunnel), local sewer upgrading proposals and FLIPs. The present proposal, in essence, retains two of these elements.
- In the FDBP the defined customer benefit was to provide protection to 1,766 properties where flooding had been recorded. We understand that the current proposal will deliver a substantial part of this customer benefit.
- There have been significant changes to the local environment and to the understanding of current system performance that justify the reasons for a major review and development of alternative strategies for managing flood risk in the area.

The IAG would be happy to expand or clarify any of the points in this statement and if necessary, enter into a dialogue with Ofwat in support of our view.

- 4.17 The combination of having taken the right decision and meeting our PR14 commitment means that we deliver on our Counters Creek scheme. After all, our customers care about what we do, less about how we do it. We do not consider it reasonable to conclude that we cancelled our scheme solely on us delivering using a different combination of solutions compared to that envisaged at PR14. We request that Ofwat revisit their conclusion that we cancelled the scheme (and their subsequent decision to impose an underperformance payment).



### Ofwat's reasons for concluding that we did not deliver are not relevant

- 4.18 Table 1 presents our responses to the reasons that Ofwat had regard to in concluding that we had failed to deliver the Counters Creek scheme for reasons within our control. We argue that Ofwat's reasons tend to misrepresent what we did and give disproportionate weight to areas Ofwat believe that we failed on. As explained above, these reasons are not directly relevant to an assessment of our AMP6 performance on Counters Creek.

**Table 1: Our responses to Ofwat's reasons as that Thames Water failed to deliver its Counters Creek scheme**

Ofwat reason	Our response
<b>There is insufficient evidence that Thames Water understands the risk of flooding in the Counters Creek area</b>	<p>At PR14 we cited some 2,042 properties as having reported sewer flooding in the catchment. We committed to remedy 1,766 of these properties by the end of AMP6, and we are on track to meeting this commitment.<sup>6</sup> Furthermore our investigations have only yielded a further c100 properties as requiring protection additional to properties identified at PR14. This concerns less than 10% compared to what we identified at PR14.</p> <p>We made reference to the potential number of 'modelled' properties that may be at risk but as agreed with Ofwat at PR14 and reiterated in the letter received from Keith Mason (Ofwat) in 2013 we have focused on alleviating the risk of properties with a report of sewer flooding in recent years. This picture does not support Ofwat's suggestion as that we do not sufficiently understand the risk of flooding in the Counters Creek area.</p>
<b>Thames Water fell short in its original assessment of benefits and failed to appropriately check sewer flooding records</b>	<p>Ofwat do not fully comprehend the SB3 mechanism agreed at PR14. The strategic sewer had it proceeded would have allowed us to claim benefits for properties relieved by the 634 FLIPs installed in AMP5. Yet the mechanism does not allow us to count properties protected by these FLIPs towards the performance of our revised approach.</p> <p>We have been transparent about this in our November 2018 ODI amendment proposal by not including the Annualised Benefits for properties relieved in AMP5. The shortfall is more to do with this fact than the quality of the records, many of which reside on the 'severe' weather register as opposed to the DG5 register.</p>
<b>Thames Water failed in delivering a hydraulic model that can be used to understand the risk of sewer flooding</b>	<p>The hydraulic model is fit for purpose and has been independently verified. The majority of properties identified at PR14 are the ones subject to relief through a solution developed using the verified model and delivered by our revised approach. We were not funded to relieve properties that had not reported sewer flooding. The letter sent by Keith Mason (Ofwat) to Thames Water in 2012 clearly confirms this. Hence it would not have been appropriate for us to spend significant sums in investigating properties that may only be at risk in the future.</p>
<b>Thames Water failed to secure sites in advance and its stakeholder engagement was delayed</b>	<p>The Counters Creek scheme is the largest flooding scheme in the UK, larger than many companies flooding programmes! It was necessary to be certain of the facts before we proceeded. Hence it was not so much a delay as Thames Water taking the time to assure that the need for investment and the appropriate way of delivering the required protection was delivered.</p>
<b>Despite its involvement in Thames Tideway, Thames Water failed to make timely provision for joint working on the Cremorne Wharf site</b>	<p>See above.</p>

<sup>6</sup> Excerpt from 2013 Change Protocol (page 16): "A total of 2,042 properties in the Counters Creek catchment have reported flooding to us. Flooding at 276 properties (2,042 – 1,766) will not be resolved by the scheme. These properties are likely to have flooded due to more extreme rainfall events than the 1 in 30 design event."



## C Ofwat's calculation of the underperformance payment is not appropriate

- 4.19 Having found that Thames Water cancelled the Counters Creek scheme, Ofwat imposed an underperformance payment.<sup>7</sup>
- 4.20 The DD calculated this payment by multiplying the proportion of not achieved Annualised Benefits with the maximum underperformance payment:  $(£14.2m - £2.8m)/£14.2m * £162m = £130.1m$ . These calculations used the maximum underperformance payment reported in our PR14 plan, being the £162m. We understand that the calculations determined the proportion of not achieved Annualised Benefits as the ratio of not achieved Annualised Benefits (i.e. AMP6 target of £14.2m minus the £2.8m delivered by solutions implemented in AMP6) to the Annualised Benefits as per our AMP6 target.<sup>8</sup>
- 4.21 Our concern with the calculations of underperformance payment as per the DD has similar roots as our challenge to Ofwat's imposition of the underperformance payment (discussed above). SB3 was agreed at PR14. It envisaged that the Counters Creek scheme (and our PR14 commitment to protect identified properties by the end of AMP6) would be delivered by a particular combination of solutions that includes the strategic sewer. It is not flexible to the scheme being delivered using a different combination of solutions than that funded at PR14.
- 4.22 An assessment of our performance on Counters Creek that has insufficient regard to the bigger picture results in Ofwat setting a payment that is disproportionate to any harm that our customers suffer. If we keep our PR14 protection commitment (and we explain above that we will), then the high underperformance payment calculated by Ofwat has to be the consequence of the figures used in their calculation not capturing what we committed to and are delivering in terms of protection of properties.
- 4.23 The £14.2m includes for the Annualised Benefits properties that no longer need to be protected as new information shows that these properties did not experience hydraulic sewer flooding, possibly as a result of the temporary FLIPs we installed in AMP5. Implementing solutions to protect these properties is neither necessary nor cost beneficial. It's not what our customers want us to do. Moreover, we had explicitly agreed with Ofwat in the Change Protocol that we would only provide relief to properties that experienced sewer flooding. Yet the protection of these properties is included in the £14.2m.
- 4.24 A factor that impairs an objective review of the performance of our revised approach is that SB3 allowed us to count the Annualised Benefits of properties protected by the strategic sewer but which had previously been relieved by the 638 temporary FLIPs installed in AMP5.<sup>9</sup> We are not allowed to count these Annualised Benefits of £5.5m towards the performance of our revised approach even though these properties are effectively protected. This implies that these benefits are not included in the £2.8m thus giving rise to a much higher payment than would otherwise have been the case. This unintended differential can be addressed by adding the Annualised Benefits delivered by temporary FLIPs installed in AMP5 (i.e. the £5.5m) to our AMP6

<sup>7</sup> In deciding on this payment, Ofwat acknowledged that cancellation can occur where some benefits have been achieved.

<sup>8</sup> This £2.8m is calculated as the sum of the £0.5m, £0.4m and £1.9m reported in Table 14 of our November 2018 ODI Amendment Proposal.

<sup>9</sup> We report this number of 638 properties protected by temporary FLIPs installed in AMP5 in Table 14 of our November 2018 ODI amendment proposal. Annualised Benefits associated with the protection of these properties amount to £5.5m.



performance. This would significantly reduce the payment that Ofwat would calculate when using their approach: from £130m to £68m.<sup>10</sup>

- 4.25 We recommend that Ofwat revisit their calculation if they after considering the evidence above and our request to focus more on consumer outcomes continue to conclude that Thames Water cancelled the scheme for reasons within our control.

---

<sup>10</sup> We calculated this as  $(£14.2m - £2.8m - £5.5m) / £14.2m * £162m = £68m$ .

