TMS-DD-043

Thames Water PR24 DD Response - Strategic Resource Options

Thames Water

Table of Contents

1 Executive summary 3

2 Cost allowances 7

2.1 South East Strategic Reservoir Option (SESRO) 8

2.1.1 Addressing Ofwat's 15% cost challenge 8

2.1.2 Development since October 2023 14

2.1.3 SESRO summary 21

2.2 Severn to Thames Transfer (STT) 22

2.3 Teddington DRA 24

2.4 Beckton Water Recycling 25

2.5 Lower Thames to West London Reservoirs 26

2.6 Financing contingent allowances 27

3 Customer protection mechanism 29

3.1 PR24 Business Plan 29

3.2 Existing mechanisms for managing uncertainty 30

3.3 Preferred option for managing SRO uncertainty 31

3.4 Possible scenarios for additional activity 32

3.5 Contingent spend 34

4 Incentives and penalties 36

4.1 Development phase cost sharing 36

4.2 Portfolio approach to funds 37

4.3 Delayed delivery cashflow mechanism (DDCM) 37

4.4 Risk and return 37

4.5 DPC Stage incentives 38

4.6 DPC success fee 39

5 Partner and future SROs and regulatory reform 42

5.1 Partner SROs 42

5.2 Future SROs 42

5.3 Regulatory reform 42

1 Executive summary

We welcome the opportunity to respond to Ofwat's PR24 Draft Determination and in particular the detail set out in the 'PR24 draft determinations: Major projects development and delivery' supporting document.

Our Strategic Resource Options (SRO) programme is continuing to develop, and we have been engaging extensively with Ofwat, via RAPID, on progression. It is a highly ambitious programme, that is aligned to our Water Resource Management Plan (WRMP) 2024 best value plan and will deliver significant resilience benefits to the wider South East region, securing water supply availability for generations to come.

The development phase is the period of considerable uncertainty for a project when investment has the greatest impact on mitigating risks to the delivery phase and providing value to customers. For the projects to be successful we need the development phase to be adequately funded, with flexibility to manage uncertainty and incentives which are aligned with the long-term objectives of the projects. Insufficient development funding jeopardies the successful delivery of major projects, risking project and expenditure overruns which cost customers more in the long term. The amendments we propose to the Draft Determination aim to achieve those conditions for success.

Additionally, it is critically important that the project is funded with cost allowances and incentives that support overall success, in order to enable the recruitment of high-quality resources and a best-in-class supply chain. If the perception is that a project is underfunded and/or incentives punitive, there is a material risk that people and companies will opt to work elsewhere.

We have reviewed our costs in the light of the PR24 Draft Determination and have reprofiled our AMP8 SRO cost allowance to £956m[1], an increase of £659m compared to Ofwat's Draft Determination. As directed by Ofwat in its Draft Determination, this increase in pre-delivery expenditure is focused on minimising implementation risk, a key determinate in delivering better overall value for customers (particularly in the case of SESRO). This expenditure increase is largely due to reprofiling and the bringing of spend forward in the programme, rather than as an overall increase in the cost envelope. We provide further evidence in support of this expenditure increase in this chapter.

We note that Ofwat has removed the proposed funding for our Beckton Water Recycling scheme. However, we remain of the view that it is in customers' interest to continue to develop this scheme in parallel to Teddington DRA, as set out in our WRMP monitoring plan.

[redacted]

[1] Post-FSE.

We recognise that Ofwat has taken steps to reduce risk to customers by differentiating cost allowances between baseline and contingent funds. However, we are concerned about the additional financing pressures that the proposed contingent allowances would result in. Our proposed solution to address this financeability challenge is a customer protection mechanism that would allow an in-period cost adjustment when triggers are met. It is essential that this mechanism or similar is put in place to ensure that Thames Water can subsequently finance the activities needed to progress these schemes. In RAPID wanting companies to do more earlier to de-risk delivery of the schemes it is essential that an associated approach is found to enable funding and financing which matches this accelerated profile. We welcome Ofwat's position that it is open to further engagement on shaping how this could work in practice.

Ofwat has defined baseline costs as all the activity that needed to be undertaken ahead of consenting decisions with contingent allowances relating to post-consent activities and, where appropriate, funding for in-house construction of the project due to the timing and quantum of these costs and activities being less certain.

We understand the need to split the costs into these categories but, for the purpose of this response, have changed the definition of baseline and contingent spend. We have decoupled the costs from the consenting decision point and simply split costs between those that are essential costs for the development of the SROs into baseline, and those with a higher degree of uncertainty into the contingency allowance. This allows us the flexibility to undertake certain activity in advance of the consenting decision if there is a solid case that it will reduce risk to the programme or reduce costs by bringing activity forward to earlier in the AMP.

We note the array of incentives and penalties that Ofwat has proposed, and welcome in particular the proposed 'success fee' to incentivise efficient and timely delivery. However, we are seeking clarity on how these would apply, both individually and in combination, especially for SIPR schemes that benefit customers of multiple Appointees. We are concerned that the proposed incentives, and in particular the proposed cost sharing regime, do not fully recognise the risk and uncertainty that exists at this stage of large infrastructure projects and risk creating a perverse incentive to minimise development costs at the expense of transferring risk to the delivery phase. In the case of SESRO, that is likely to translate to an increased cost to customers through the pricing of risk by the Infrastructure Provider (IP).

A summary of our response, and the key policy positions within, is given in Table 1. We are highly supportive of the positive contribution that RAPID has made in accelerating investment delivery and are encouraged by the collaborative approach adopted by all parties. We will continue to engage constructively with Ofwat and RAPID and would welcome the opportunity to discuss our proposals.

Table 1 – Summary of our response by Draft Determination theme.

Draft Determination theme	Summary of our response

Cost challenges	The 15% cost challenge to SESRO is unjustified and we are concerned with the consequences this reduction could have de-risking major schemes such as SESRO during the development phase, therefore increasing delivery phase risk. We constructively challenge Ofwat's assumptions in its benchmarking as we believe it does not recognise the risk and complexity of delivering the SROs and in particular SESRO. We propose to reinstate funding for Beckton to align to the strategy outlined in our WRMP.
Changes to project scopes	We have continued to engage with Ofwat and RAPID to develop our SRO portfolio and ensure value for customers and the environment. Hence, the scope of some of our schemes have changed. These include: • additional development of SESRO to de-risk delivery; • accelerating the development of the Severn to Thames Transfer (STT); • updating the conveyance design for Teddington DRA; • preferred solution selected for LTWLR.
Customer protection mechanism	We believe that a customer protection mechanism is required to allow for an in-period cost adjustment to reflect the high levels of uncertainty at the early stages of SESRO development. We have evaluated different cost adjustment mechanisms and have determined that the best solution for customers would be a conditional allowance with an appropriate gated process. This should remain separate to other Thames Water gated processes featured in Draft Determination.
Baseline and contingent funding split	Relying on an assumption that the lead promotor finances the contingent funding would introduce a material risk to the SRO projects, should for some reason it is not possible to raise that finance when required. For example, in the case of SESRO that could mean delays to land acquisition and hence the delivery schedule. We are proposing costs in contingent spend such as land will be accessed through the customer protection mechanism rather than delaying until AMP9.
DPC success fee	We welcome the steps Ofwat has taken to incentivise competitive delivery of major projects and have assumed that a success fee is applicable to SIPR. We seek further clarity on how the success fee will be calculated under SIPR, how it will be funded, its purpose (and the risks it covers and does not cover), and how it will be applied (including across multi-party solutions), so we can take an informed view on the balance of risk and reward under competitive delivery.
DPC stage incentives	We have also assumed that the stage penalties are applicable to SIPR. We seek confirmation that Appointees will not be incentivised twice over the same funding via the RAPID delivery incentive and the DPC stage incentives. We also seek further clarity on how these incentives will be calculated and applied in practice with respect to the specific

	requirements of SIPR projects – for which no guidance has been issued.
Cost sharing	We are highly concerned that the proposed cost sharing mechanism incentivises the minimising of development expenditure, acting as a constraint on the project, rather than incentivising front end investment to minimise the delivery phase risks to the IP, potentially driving up the cost of capital and eroding customer value. Instead, we propose an approach whereby cost reporting is transparent and expenditure is subject to appropriate oversight to ensure it is aligned with delivering customer value. We would welcome further discussions with RAPID on the potential role of enhanced independent governance to provide further assurance of our costs.
Portfolio approach to funds	We agree with Ofwat's proposal to continue portfolio funding. We are proposing to carry over previous underspend, due to programme changes, into stages in AMP8.
Delayed delivery cashflow mechanism	We have assumed that this does not apply to the SRO programme based on engagement with RAPID. If it does apply, we seek to clarify how this mechanism would materialise.

2 Cost allowances

Our October 2023 Business Plan submission set out our forecast for SRO expenditure with a supporting rationale as part of the 'TMS27 Enhancement Case: WRMP Supply Options appendix' and we provided a breakdown of expenditure in our SUP12 narrative in 'TMS65 PR24 Data Table Commentary - Supplementary Tables' (pages 9-29). We also provided details of our SIPR rationale in annex 'TMS38 – Direct Procurement for Customers (DPC)'.

In its Draft Determination, Ofwat stresses the importance of investing in development as stated in its document 'PR24 draft determinations: Major projects development and delivery'.

In this response, we provide additional substantiation for SESRO underpinning our October submission to show that our development forecasts were not unreasonably high. If anything, we now consider they were understated and therefore believe the 15% cost challenge for SESRO should be removed. We have also provided a breakdown of our costs separately in the Expenditure by AMP template provided by Ofwat in July 2024. We do not believe we can de-risk the delivery of SESRO without this funding being reinstated.

In addition, having reviewed our forecasts and assumptions we also set out our case for additional changes in relation to our approach and funding needs of the other SROs.

On page 15 of its 'Major projects development and delivery document', Ofwat distinguishes between pre- and post-consent development costs and DPC related costs. Furthermore, on page 23 Ofwat proposes a new categorisation and cost allocation linked to certainty with costs up to a consenting decision (including a proportion of DPC related costs) as baseline and forecast cost post a consenting decision as contingent. Summary details of its allocation of expenditure between baseline and contingent can be found in Table 8 of the document. We set out our views on this proposed approach in section 2.6.

Revised PR24 funding requirement

Taking into account the additional substantiation presented in this document, updates of our forecasting assumptions, Ofwat's support to identify measures to increase confidence in delivery in a timely and efficient manner, and direction on the categorisation of forecast expenditure, our revised AMP8 funding requirements for the SROs are summarised in

Table 2.

Table 2 – Our proposed AMP8 investment for our SRO portfolio reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission		Draft Determination		August 24 Submission			
SRO scheme	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure	Total baseline expenditure	TMS only baseline expenditure	Total contingent expenditure (all TMS)	Combined total expenditure (all TMS)
SESRO	239	162	213	149	331	225	327	552
STT	13	10	13	10	25	20	28	48
Teddington	117	117	117	117	151	151	0	151
Beckton	58	58	0	0	32	32	0	32
LTWLR	36	36	21	21	58	58	114	172
Totals	**462**	**383**	**364**	**297**	**597**	**486**	**470**	**956***

* Costs exclude any allowances for external risks to be covered by the proposed customer protection mechanism (refer section 3.1).

We highlight that our revised approach brings forward early delivery phase spend to de-risk delivery and improve the attractiveness of the investment.

In the remainder of section 2 we provide substantiation of our revised position by SRO, including details of the TMS funding ask as set out in CW8 (i.e. after Partner allocations and Frontier Shift Efficiency (FSE) adjustments). The SROs discussed are:

- South East Strategic Reservoir Option (SESRO)
- Severn to Thames Transfer (STT)
- Teddington DRA
- Beckton Water Recycling
- Lower Thames to West London Reservoirs (LTWLR)

2.1 South East Strategic Reservoir Option (SESRO)

In this section we provide our response to address Ofwat's 15% cost challenge (of AMP8 forecast excluding land option cost) and changes to our forecasting assumptions to further de-risk delivery, resulting in the need for additional funding in AMP8.

2.1.1 Addressing Ofwat's 15% cost challenge

We summarised our approach to forecasting development costs in 'TMS27 Enhancement Case: WRMP Supply Options'. On page 24 we described our starting point being our RAPID Gate 2 reports:

> *"The Gate 2 Reports set out phasing strategies through development beyond Gate 4 to consents and contract award and into delivery, along with anticipated timeframes. This information together with Ofwat's guidance for DPC stage approvals was used to develop the AMP8 delivery plans and cost forecasts."*

Based on RAPID's 'Standard gate two final decision' document for SESRO dated June 2023 (which confirmed no change in the PR19 gate allowances) we assumed the Gate 4 allowance should be the starting point for developing our AMP8 forecast. On page 31 of 'TMS27 Enhancement Case: WRMP Supply Options' we summarised how we developed our AMP8 forecasts:

> *"In forecasting our development phase cost forecasts for PR24 we used our RAPID Gate 3 forecasts (included in the Gate 2 Reports) and the PR19 budget allowances for Gate 4, covering the period up to planning consents and the start of the ITT stage. We then added forecasts to cover the period through to the start of construction based on an assessment of resources and to deliver each SRO's work plan, assuming continued application of the above-mentioned efficiency principles.*
>
> *We have also undertaken a high-level benchmarking exercise comparing our forecast development spend for each SRO alongside other major infrastructure projects and satisfied ourselves that the SRO spend as a % of CAPEX compares favourably."*

Having developed our overall forecast, for the SUP12 commentary we followed Ofwat's guidance which requested for SUP12.8 a high-level breakdown of the development costs into various categories including design, consents, land, enabling works and separately, for SUP12.14 a breakdown of the 'DPC' forecast. As our underlying forecasting tool (see below) was not constructed using these categories but the RAPID WBS, we examined our forecast and made a judgment based on experience as to what proportion of each type of functional resource would be focussed on which topics through development. This led to the % splits for design and consents given in the SUP12 commentary.

We now set out in more detail both our approach to forecasting and the benchmarking we have undertaken.

Forecasting

To inform our development phase forecasts we created a 'top-down forecasting' (TDF) spreadsheet tool. This generates a cost profile by quarter for each RAPID WBS category (excluding Land and Enabling Works). The cost profiles are derived from multiplying the profiled

resources by quarterly rates for staff and professional services and the use of lump sums for other categories, such as surveys. It also includes provisions for contingency and overheads. The resource profiles are generated by creating a view of the maximum team size for each function (e.g. client/PM, design, environment, consents, commercial etc.), then scaling the teams relative to the demands of each SRO programme (e.g. engagement flexing around consultation events, environmental resources ramping up to Development Consent Order (DCO) application and then reducing, commercial resources ramping up beyond Ofwat Stage 3). Rates for staff were based on an average of typical input costs and rates for professional services consultants were based on rates on other projects sense checked against our competitively procured framework rates.
The TDF was first created in 2022 (in 17/18 prices) and calibrated against the PR19 allowances for the five SROs at that time: SESRO, STT, London Re-Use (including for Teddington and Beckton), Thames to Affinity transfer (T2AT) and Thames to Southern transfer (T2ST). This then gave a base for testing changes in the organisation, resource sourcing, procurement strategy, timings, rates and mix of SROs.

The PR24 version was set to broadly align with the RAPID Gate 4 allowance and to then pivot forward to create a post Gate 4 forecast (Gate 4+) through to the start of the delivery phase. The TDF tool led to a different % allocation of RAPID's Gate 4 allowance of £48.2m (17/18 prices) shared with RAPID in December 2022, as illustrated in
Table 3.

Table 3 – Comparison of Gate 4 cost forecasts: Gate 2 (December 2022) approach versus PR24 top-down forecasts (October 2023).

	Gate 2 Report	TDF for PR24
RAPID WBS	Dec 22	Oct 23
Programme & Project Management	15%	30%
Feasibility Assessment and Concept Design	24%	19%
Option benefits development and appraisal	1%	1%
Environmental Assessment	10%	11%
Data Collection, Sampling, and Pilot Trials	7%	6%
Planning Strategy	12%	5%
Stakeholder Engagement	9%	1%
Procurement Strategy	12%	16%
Legal	10%	9%
Other - Third Party Costs	0%	2%
	100%	**100%**

There are three notable differences in

Table 3 for PR24 based on the TDF approach:

- **Project management** – on account of the scale of SESRO, we forecast higher costs for the organisation and resourcing of the client team (including PMO), the multiplicity of

stakeholders and interfaces to manage and the set-up of a shadow IP, and the need to respond to RAPID, Ofwat, and DCO processes.

- Design - we forecast a lower design input on the basis that significant design development is being undertaken in Gate 3 (specifically in relation to the reservoir engineering design), and the focus in Gate 4 will be capturing, assessing, and mitigating environmental and stakeholder impacts following statutory consultation.
- Procurement strategy - we forecast higher costs for procurement reflecting our split (IP/Main Works Contractor) procurement strategy and the costs of establishing the shadow IP.

In our PR24 submission, for post Gate 4 spend we assumed that following DCO submission the level of input from our technical partners would reduce through the DCO examination stage. We assumed the client team would lead procurement of the Main Works Contractor and IP as well as recruit for, and set up, the shadow IP, supported by financial and legal advisors.

Benchmarking

As advocated by the Infrastructure Project Authority[2], in early 2023 we benchmarked our emerging forecast development costs (excluding land and early works) of SESRO, STT, Teddington and Beckton SROs against the development costs of four other major infrastructure programmes, comparable in size and complexity. This is summarised in Figure 1.

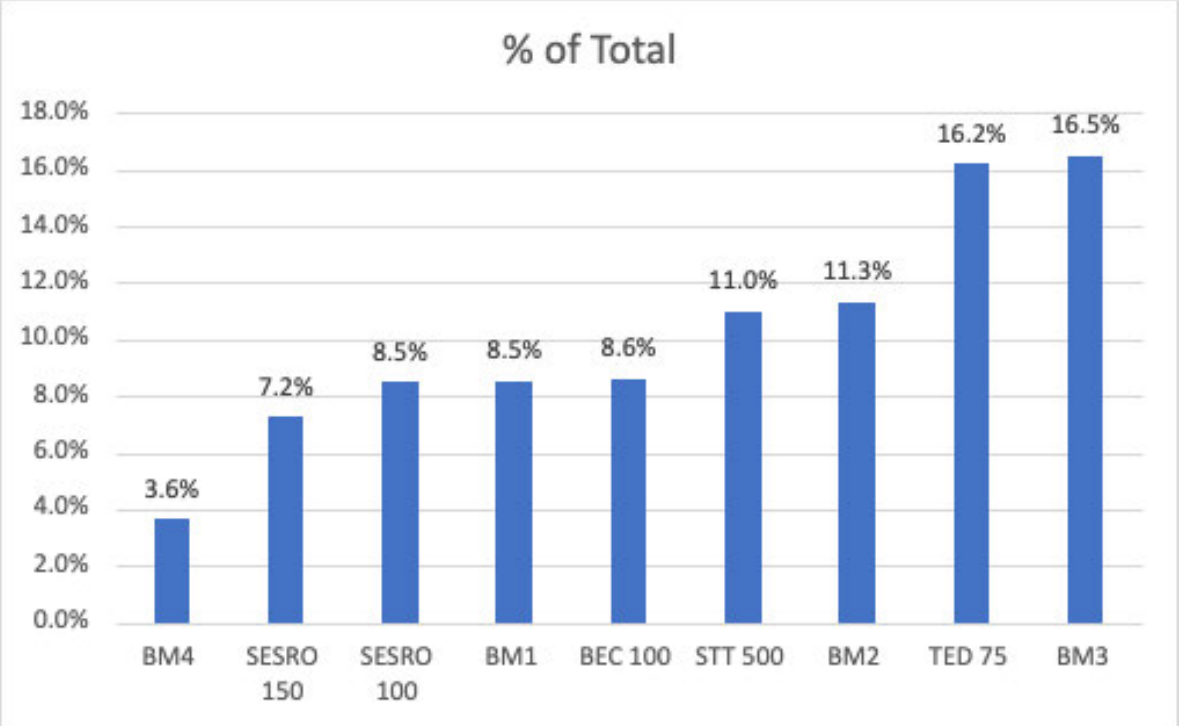

Figure 1 - Benchmarking development costs of SROs vs external projects.

Whilst we acknowledge it is preferable in benchmarking to draw on a wide range of data sets, this exercise provided a degree of comfort in the reasonableness of our forecasts. Our forecast

[2] IPA Best Practice in Benchmarking

costs for SESRO 150 (our preferred scheme as described in 'TMS27 Enhancement Case: WRMP Supply Options') at 7.2% of CAPEX was at the lower end. We also reflected on the broad-brush approach used in the WRMP options assessment which used 2% for planning (assumed to be RAPID Gates 1-2) and 5-8% for development (RAPID Gates 3,4, 4+/5). Our % development costs for the other SROs were higher with Teddington the highest at 16.2%. The average for all schemes was 10.2%, dropping to 9.2% for schemes over £500m.

The spread of % costs for the five SROs reflects the non-linear relationship between development cost and CAPEX. All SROs require similar level of resources to comply with the OFWAT/RAPID processes and outputs, the DCO consenting process and outputs and manage similar activities, sequences, interdependencies, timings, complexities, and risks. Based on the final forecasts used for the PR24 submission there was a small upward movement in the SESRO benchmark to 7.8%.

In response to Ofwat's Draft Determination we have also compared our forecasts with information published by Anglian Water (AHN) in respect to its reservoir schemes in its RAPID Gate 2 reports and its PR24 documents. Our interpretation of the AHN forecasts relative to our SESRO forecasts is shown in Table 4. We note we may have used different overlays for contingency and overheads.

Table 4 - Comparative analysis of Thames Water and Anglian Water bids (£m).

Component		SESRO	Lincs Res	Fens Res	Source
CAPEX		2,662	2,628	2,210	TW SUP12; ANH Gate 2 report
Project development	AMP7 (G1-3) *% CAPEX*	60.3 *2.3%*	41.3 *1.6%*	42.0 *1.9%*	TW SUP12; ANH Gate 2 report
	Gate 4 *% CAPEX*	48.0 *1.8%*	33.2 *1.3%*	21.3 *1.0%*	TW F/C from TMS65; ANH from ANH27
	Gate 5 (or 4+) *% CAPEX*	70.2 *2.6%*	28.3 *1.1%*	28.3 *1.3%*	
	Ops integration	0	5.4	5.4	
	All project development (excl. SIPR) *% CAPEX*	**178.5** *6.7%*	**108.2** *4.1%*	**97.0** *4.4%*	-
Commercial procurement (SIPR)	PM *% CAPEX*	5.9 *0.2%*	38.6 *1.5%*	38.6 *1.7%*	TW F/C from TMS65; ANH from ANH27
	Shadow IP set up *% CAPEX*	23.6 *0.9%*	36.5 *1.4%*	36.5 *1.7%*	
	All commercial costs *% CAPEX*	**29.5** *1.1%*	**75.1** *2.9%*	**75.1** *3.4%*	-
All development phase *% CAPEX*		**208.0** *7.8%*	**183.3** *7.0%*	**172.1** *7.8%*	-
All AMP8 development phase *% CAPEX*		**147.7** *5.5%*	**142.0** *5.4%*	**130.1** *5.9%*	-

Delivery phase (in AMP8)	Land Options (delivery brought forward)	69.9	15.2	10.5	TW data from SUP12.14; ANH data from ANH27
	Client IP management	21.9	1.43	1.43	
	All AMP8 delivery phase	**91.8**	**16.6**	**11.9**	
Total AMP8 expenditure request *% CAPEX*		**239.5** *9.0%*	**157.2** *6.0%*	**140.6** *6.4%*	-

Benchmarking of SESRO against the ANH reservoirs (which follow the same consenting strategy (DCO) and same procurement strategy (SIPR), over similar timescales (start of construction 2030 albeit have a different mix of scope elements), highlights our % development phase forecast of 7.8% is the same as ANH's Fens reservoir forecasts but slightly higher than ANH's forecast for its South Lincolnshire reservoir. Similarly, our 'all AMP8 development forecasts' compare favourably, with SESRO at 5.5% falling between ANH's range of 5.4% to 5.9%.

However, there are notable differences. Extracting the allowances for commercial procurement suggests our forecast is on the low side at 1.1% compared to ANH's range of 2.9% to 3.4%. Conversely, our development cost excluding commercial is higher at 6.7% compared to ANH's range of 4.1% to 4.4%.

By observation this suggests that ANH may have under-estimated the cost of project development leading to DCO award whilst we may have under-estimated the SIPR procurement costs. It is also possible that we have made different assumptions about the allocation and transition of project management resources between development and shadow IP. Our allocation is £5.9m, much lower than ANH's £38.6m, but we have a much higher Gate 4+ forecast of £70.2m compared with ANH's forecast of £28.3m.

Independent benchmarking

In addition to our own benchmarking, we also commissioned Oxford Global Projects (OGP) to undertake benchmarking of development costs. They examined data from over 200 global projects from different sectors, sizes, and funding mechanisms including both public and private sector schemes. A summary of their findings is given in Figure 2.

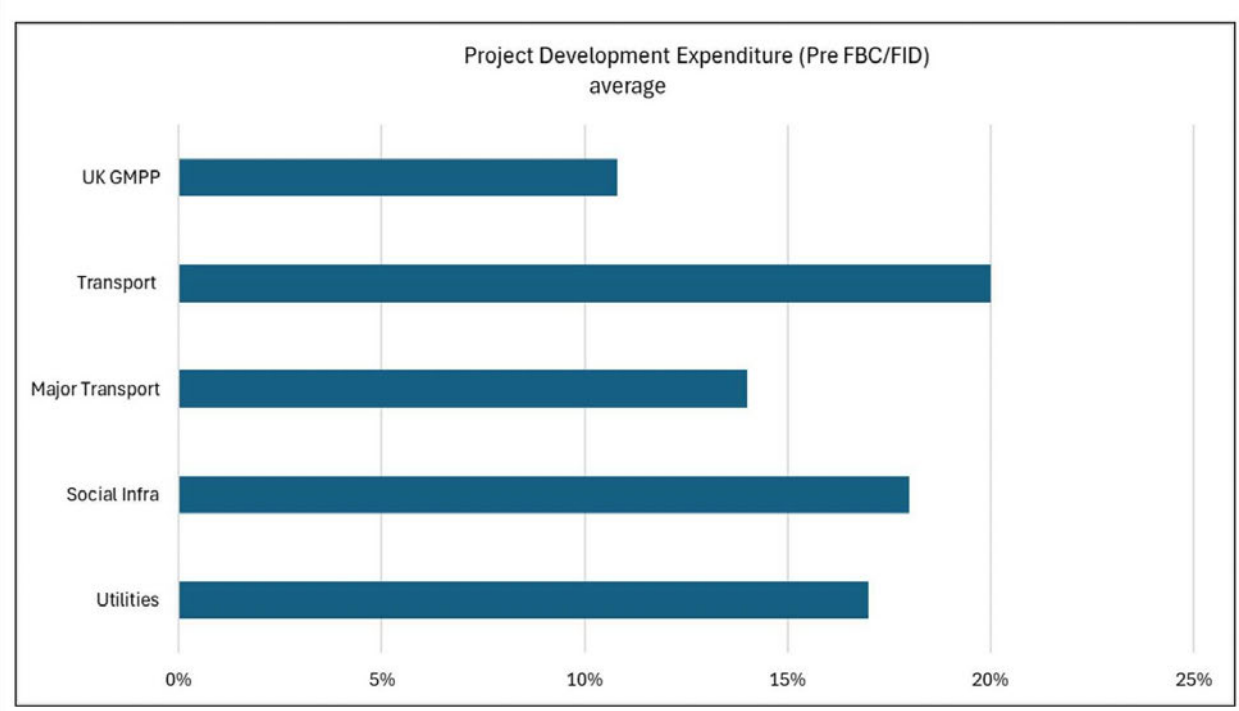

Figure 2 – Results of benchmarking of major projects undertaken by OGP.

The report reveals that the development costs of nine comparable UK publicly promoted projects ranges between 7.95% and 13.15%, higher than our SESRO forecast of 7.8%. Further, OGP selected six schemes falling in a CAPEX range of £750m to £2bn and for these projects the average is 10.8%, again significantly higher than our SESRO forecast.

Summary

Our SESRO development cost forecast is anchored in the Gate 4 allowance set by RAPID which we used to set up our TDF tool to forecast the Gate 4+ costs, which in turn were estimated on the basis that we could ramp down design resources post DCO examination but build up the shadow IP leading to appointment of the IP and MWC in 2029, post DCO award. The overall forecast results in a lower % of CAPEX when benchmarked against other Thames Water led SROs and projects. The forecast also benchmarks favourably against ANH's reservoir forecasts and is significantly lower than infrastructure norms as evidenced through the OGP benchmarking exercise.

We therefore consider that SESRO is not an outlier and in light of the additional substantiation given above, request Ofwat withdraws its 15% cost challenge.

2.1.2 Development since October 2023

Since our October submission, we have continued to develop SESRO and refined our strategies to both align with our WRMP24 adaptative planning approach and to de-risk delivery. We have:

- continued with RAPID Gate 3 activities and matured the designs;
- undertaken informal engagement on the SESRO;
- re-procured programme management and technical professional services;
- developed the SESRO commercial strategy;

- looked for opportunities to de-risk the SROs, specifically SESRO; and
- refined our forecasts.

We have shared the changes in our approach with RAPID and Ofwat at regular meetings and check points with favourable steers and now consider that additional funding should be allowed.

The changes required the TDF tool to be updated so that we could better represent changes in the assumptions across the RAPID workstream categories, better model the effects of staff vs consultant mix in the client team and, for SESRO, to better model the establishment of the shadow IP and changes to the MWC procurement strategy. The re-procurement of professional services has required preparation of detailed scope of requirements and given insights into current market rates for different disciplines and grades which we have used to create more accurate weighted fee rates for use in the TDF.

The headline changes in assumptions cover:

1. Project development;
2. MWC procurement strategy;
3. Earlier establishment of the shadow IP organisation;
4. Early start of enabling works; and
5. The ability to acquire all land pre-IP appointment.

The rationale for each of the changes is set out below.

Project development

In our October 2023 submission, our project management and technical forecasts assumed an externally resourced team and following DCO submission and public examination, the client team would focus on the IP and MWC procurement and support establishment of the shadow IP. We assumed the technical resources would reduce post DCO submission on the basis that the MWC would not be appointed until 2029 following IP appointment and that no early works could be progressed without land acquisition, also assumed post DCO award and IP appointment.

Our organisational strategy is to client-manage the SROs as a portfolio with common governance, processes, systems and procedures, and client team personnel overseeing development. This reduces overall resources and enables us to respond quickly to emerging issues and changing priorities across the SROs and is inherently more efficient than setting up bespoke standalone arrangements for each SRO. The client programme management team is around 100 personnel with circa 60-70% working on SESRO.

Whilst we are proposing to continue with this model, we have reviewed our resourcing assumptions and made the following adjustments:

- We have restructured the TDF to be able to better represent the current staff:consultant mix and changes over time, and staff:consultant input costs (as well as better representing the shadow IP client team);

- We have increased the size of the client team in the TDF to reflect the current organisation;
- We have retained the size of the client team, PMO and technical partner support post DCO submission rather than reduce it. This is to:
    - reflect lessons from the Thames Tideway Tunnel (TTT) DCO experience which experienced a higher than anticipated level of technical responses during the examination stage;
    - support the establishment and transition to the shadow IP, again drawing on insights from the TTT experience; and
    - support the additional work arising from the move to an ECI strategy for the MWC.
- We have increased the resources for establishing the shadow IP drawing on further insights from the TTT experience; and
- We have increased allowances for third party costs pivoting off current levels of expenditure and to fund anticipated costs of statutory bodies such as PINS and Utilities.

Following a competitive procurement process, we have appointed Arup-Binnie as our technical partner for SESRO (to provide engineering, environment, planning, land, and stakeholder engagement services) and Turner & Townsend as our programme partner (to provide programme management services across the SRO portfolio). Along with existing legal and financial advisor appointments this gives as us access to all the professional resources to deliver the SESRO programme at pace, covering DCO, MWC and IP procurement and shadow IP establishment needs.

As part of our competitive procurement process, we requested bidders submit resource forecasts to deliver the detailed tender scope to DCO submission and RAPID Gate 4. Arup-Binnie's view (based on the delivery of other DCOs) is considerably more than we allowed for in our October submission. We believe the increase reflects our detailed specification (including by way of example of over 70 substantive documents for the DCO application) and Gate 4 extending from circa 12 months at PR19 to 18 months. This follows RAPID's resetting of the Gate 4 submission to one month after DCO submission. As we work with Arup-Binnie and Turner & Townsend to unpack our detailed requirements, we will establish a robust schedule and resource plan backed up with ways of working that will deliver the DCO programme efficiently. The net result of the above changes is an increase in resources for AMP8 and Table 5 shows our proposed AMP8 client programme management costs (including staff). There is no contingent expenditure proposed for this component.

Table 5 - Our proposed AMP8 project development costs for SESRO, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission		August 24 Submission		Movement	
SESRO Component	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure

Project development (excluding commercial/ SIPR)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Main Works Contractor (MWC) procurement

Our October 2023 submission assumed split procurement with the MWC procured via a two-stage (PQQ/ITT) NEC4 ECC Option C (target price) procurement process in parallel with the CAP/IP procurement via the SIPR route. MWC award was assumed to be co-incident with IP award in late 2028 with all MWC costs funded by the IP.

For the MWC procurement we now proposing adopting an Early Contractor Involvement (ECI) approach, which we have shared with Ofwat and will be formalising as part of our Ofwat Stage 2 report to be submitted this autumn. We consider that ECI will de-risk delivery, increase confidence in cost and time forecasts, reduce carbon impacts and support IP investment attractiveness leading to a better, lower cost, IP procurement outcome and better value for customers. The approach aligns with Ofwat's challenge to *'identify mitigating actions and enabling works that would increase confidence that the project will deliver in an efficient and timely manner'.*

Subject to Ofwat's agreement to our Stage 2 proposals, we plan to commence procurement in mid-2025 and award the MWC contract by late 2026, shortly after submission of the DCO application. Once appointed the MWC would:

- strengthen Thames Water's DCO defence during PINS examination;
- have time and access to information and the Thames Water team and advisors to develop a robust target price (and construction schedule) based on the DCO reference design and the MWC's insights and constructability innovations (including use of digital, technological advances to reduce cost, time, and carbon impacts);
- subject to agreement of the target price in autumn 2027 (post DCO examination), accelerate preparations for commencement of critical path early works in 2028 post DCO award (such as archaeological investigations, ecological mitigations, and utility diversions) subject to land acquisition/access and secondary consents/permits; and
- add credence to the IP proposition by supporting the shadow IP and due diligence processes.

The MWC would be appointed through a two-stage process. In the first stage the MWC would work with us and our technical partner to develop the target price on an open book basis. Then, subject to agreement of the target price, the MWC would be paid on a cost reimbursable basis to undertake critical activities through to IP award. At this point the MWC would be novated to the IP. Thus, to give effect to this revised strategy we need funding for:

- meeting the costs of the MWC from appointment to IP award; and

- covering the Thames Water Client costs for managing the MWC contract and agreeing the target price.

We forecast the anticipated cost for adopting ECI and managing the MWC is [redacted] derived by estimating the size of the team, disciplines, grades, rates, and inputs over time. Changes from our October 2023 submission are set out in Table 6. Of the new forecast, just over [redacted] would be for paying the MWC to prepare the target price which ordinarily under a standard two-stage procurement process would be borne by the MWC tenderers. The remainder of the forecast represents accelerated delivery spend. There is no contingent expenditure proposed for this component.

Table 6 - Our proposed AMP8 ECI costs for SESRO, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission		August 24 Submission		Movement	
SESRO Component	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure
ECI costs	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

We are also proposing that the MWC be incentivised both in terms of qualitative and quantitative measures as described below.

Qualitative measures would focus on:

- an MWC target price submitted in accordance with our mandated procedure and agreed programme. The target price represents a critical input into the success of the IP procurement and therefore has great significance in overall project success; and
- the MWC's continued collaborative working with us through the DCO examination phase and later, alongside the shadow IP and supporting the vendor due diligence teams leading towards successful award of the IP contract.

Quantitative measures would focus on:

- value created by the ECI activity itself. The incentive mechanism will be configured on a sliding scale (with a cap) that will reward the MWC for finding ways to reduce the target price from:
    - the preliminary target price calculated using price building blocks submitted by the successful MWC within its tender; and
    - the final target price that is agreed and used as the delivery phase baseline.

At this stage we envisage the incentive being paid either out of SESRO underspend or by the IP post award.

Increased allowance for shadow IP establishment

Our October 2023 submission assumed that we would establish a shadow IP entity post DCO submission in 2026 to work alongside and draw on the resources and expertise in the SRO

[3] Post-FSE.

client team and its professional advisors to progressively transition to become the shadow IP at the heart of the IP procurement process in 2028/29. The bid assumed that a new senior team and shadow Board would be appointed along with standalone business management systems. Our estimate of the commercial procurement and shadow IP establishment costs were provided in TMS65/SUP12.14 (see also Table 4). In addition to the new IP team and systems the estimate also included for client oversight, procurement, financial advisory and legal inputs.

As noted earlier, the submission also assumed split procurement with the MWC procured in parallel with the IP and appointments in 2029, and that no enabling works would be undertaken pre-IP/MWC awards. Following DCO examination in 2027, in the absence of having to develop the design and manage the MWC and enabling works, the SRO client team and professional advisors could transition to be the shadow IP under the direction of the new senior team focussed on procurement and IP establishment rather than managing early works.

We have reviewed our assumptions and consulted with the team that led the establishment of the TTT shadow IP and inputted to the IP procurement process. We now consider that there is a need to build up a fully-fledged shadow IP entity earlier (covering people, processes, and systems) during 2027. This is to allow for additional costs vendor due diligence reviews and reports to be available to support the IP procurement process in 2028, and to ensure that the 'voice' of prospective investors can influence key decisions.

The adoption of ECI and early appointment of the MWC means there will be an additional focus for the shadow IP team through 2027 and 2028 while the Thames Water client team proceeds with the IP procurement and the Ofwat Stage 4 process. We envisage that the shadow IP team, supported by the MWC, would play a key role in demonstrating to potential investors the capability, competence, and readiness of the shadow IP entity to transition smoothly into the delivery phase.

For our revised position we have included for the shadow IP team ramping up in 2027 into 2028 (see Table 7). There is no contingent expenditure proposed for this component.

Table 7 - Our proposed AMP8 shadow IP establishment costs for SESRO, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission		August 24 Submission		Movement	
SESRO Component	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure
Commercial procurement (SIPR) incl. shadow IP establishment	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Early works

As noted earlier, our October 2023 submission assumed no enabling works before IP award and minimal allowance to cover third party/utility interface costs. This was based on the rationale that the enabling works could not commence until 2029 on the basis that they are spread across most areas of the SESRO site (~7 km^2) and therefore dependent on completion of land acquisition (of over 300 land interest) post DCO award in 2028. Such acquisition could take over 12 months.

As part of Gate 3 we have commissioned Costain to review the SESRO construction programme. Its 'earliest start' deterministic programme forecasts commissioning the SESRO reservoir by 2038. This is two years ahead of the 'Water Available for Use' (WAFU) date to meet the statutory 1 in 500-year drought resilience requirement. This would represent a potential two-year contingency allowance, not inconsistent with HMT Green Book guidance for schedule optimism bias for a project at feasibility stage. By pursuing an early start programme we would generate time risk allowance to increase confidence in achieving the WAFU objective and would increase confidence in the deliverability of the project on schedule.

To achieve the early start programme we would need to:

- contract with key statutory undertakers to secure their commitment to the procurement of long lead items, outages, and the planning and design of critical path diversions;
- contract with Network Rail for the on-network rail-head to develop the rail connection design and procurement and secure their commitment to railway possessions; and
- post DCO award from 2028 (and subject to land access/acquisition and secondary consents/permits) instruct the MWC to organise and manage archaeological surveys and ecological and environmental mitigations.

We forecast the cost for the pre-delivery enabling works spend is up to [redacted], but consider this to be accelerated delivery spend, not development spend. We have categorised this as contingent due to the uncertainty over land acquisition, the extent and programme of the statutory undertaker works, and the lead-in times for the Network Rail related scope. Greater certainty will be obtained through the completion of Gate 3 and the undertaking of Gate 4 activities.

Land acquisition

As noted earlier, our October 2023 submission was based on an 'Options to Buy' land acquisition strategy consistent with RAPID's clarification note to the ACWG published 23 May 2023. We are now proposing to acquire the necessary permanent and temporary land as well as rights in land, subject to agreeing a funding mechanism to enable this acquisition. Accordingly, in the following we set out our rationale and current land forecast, and we have categorised the additional funding request as being part of the contingent allowance.

Since the May 2023 submission, we have appointed a land acquisition and project management surveyor to the client team who has reviewed the land acquisition strategy, risks, and opportunities. Upon completion of this review we now consider that budgeting for full land acquisition and control of the land acquisition programme would deliver a number of significant benefits to the project over and above the strategy proposed in May 2023.

This revised strategy will still enable the project to acquire land by 'Options to Buy' but will now ensure we have a range of other acquisition options available to the project. These additional options could de-risk the DCO programme, de-risk the construction programme and potentially reduce the overall cost of land acquisition.

The previously proposed strategy only allows for land acquisition through 'Options to Buy' which overall is a more expensive approach to land acquisition. Furthermore, having only one land acquisition option (and associated budget) is restrictive and does not allow the project to take advantage of early land acquisition opportunities, strategic acquisitions or acquisitions required to mitigate project risk. Furthermore, land acquisition is a critical path activity to enable commencement of early works and the deliverability of the earliest start Costain programme described above.

Previously, we discounted the possibility of early acquisition on the basis that we did not consider Thames Water could finance the full acquisition. However, assuming Ofwat's support and an acceptable funding mechanism, then we consider there are opportunities to reduce both programme and cost risk, as well as at least having the option to support those parties affected by acquiring their interests in a manner which mitigates the effects on them as best the project can.

If fully funded, land acquisition would no longer be dependent upon IP procurement, allowing a clear mitigation to any procurement risk such as delay or challenge. Land acquisition can then be managed to a greater degree by the client team with support from the technical partner. As of 2024, we forecast the cost of full land acquisition to be [redacted] This is considered to be accelerated delivery and not development spend. In this response, we propose that the £69m[5] included in the October 2023 submission be included as baseline expenditure and the balance of the full land acquisition of [redacted][6] be treated as contingent expenditure.

Table 8 - Our proposed AMP8 land acquisition costs for SESRO, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission		August 24 Submission		Movement	
SESRO Component	Total expenditure	TW only expenditure	Total expenditure	TW only expenditure	Total expenditure	TW only expenditure
Land acquisition	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

2.1.3 SESRO summary

Drawing the above responses together our revised funding request is summarised below.

[4] Post-FSE.
[5] Post-FSE.
[6] Post-FSE.

Table 9 – Proposed AMP8 allowance for SESRO, split between baseline and contingent (£m incl. D&PG and post-FSE).

	Baseline expenditure		Contingent expenditure	
SESRO Component	Total	TMS only	Total	TMS only
October 23 Submission	[redacted]	[redacted]	-	-
Addition for enhanced project development	[redacted]	[redacted]	-	-
Addition for ECI strategy	[redacted]	[redacted]	-	-
Adjustment for enhanced shadow IP readiness	[redacted]	[redacted]	-	-
Addition for Early Works	-	-	[redacted]	[redacted]
Adjustment for further Land Acquisition	-	-	[redacted]	[redacted]
Total	[redacted]	[redacted]	[redacted]	[redacted]

Our submitted Expenditure by AMP data table provides further detail and commentary on our SESRO funding request.

We consider that there would be value in developing the role of an independent advisor to provide assurance to Ofwat, RAPID, Partner Companies and the Thames Water Board that development phase costs are being incurred efficiently and in the best interests of our customers. This could be similar to the Independent Technical Advisor (ITA) role used successfully on the TTT project but extended into the development phase of projects. It would be in addition to the independent expert panel currently established for procurement assurance and there may be merit in the role extending across all SIPR projects. We would like to develop this proposal further working with Ofwat.

2.2 Severn to Thames Transfer (STT)

STT is not a preferred option in our revised draft WRMP24 but is included in various adaptive pathways as set out in our WRMP monitoring plan. The delivery of STT will be required in the case of SESRO being found to be unpromotable, or to counter any under-performance in demand reduction strategies.

Accordingly, our October 2023 submission included for limited Gate 3 'tick-over' funding (Figure 3) to fund risk mitigation work to enable us to ramp up activity, if required to do so. In the event of a switch from SESRO to STT, we assumed that the unused SESRO funding would be sufficient to fund the development of STT to achieve RAPID Gate 3 status by the end of AMP8.

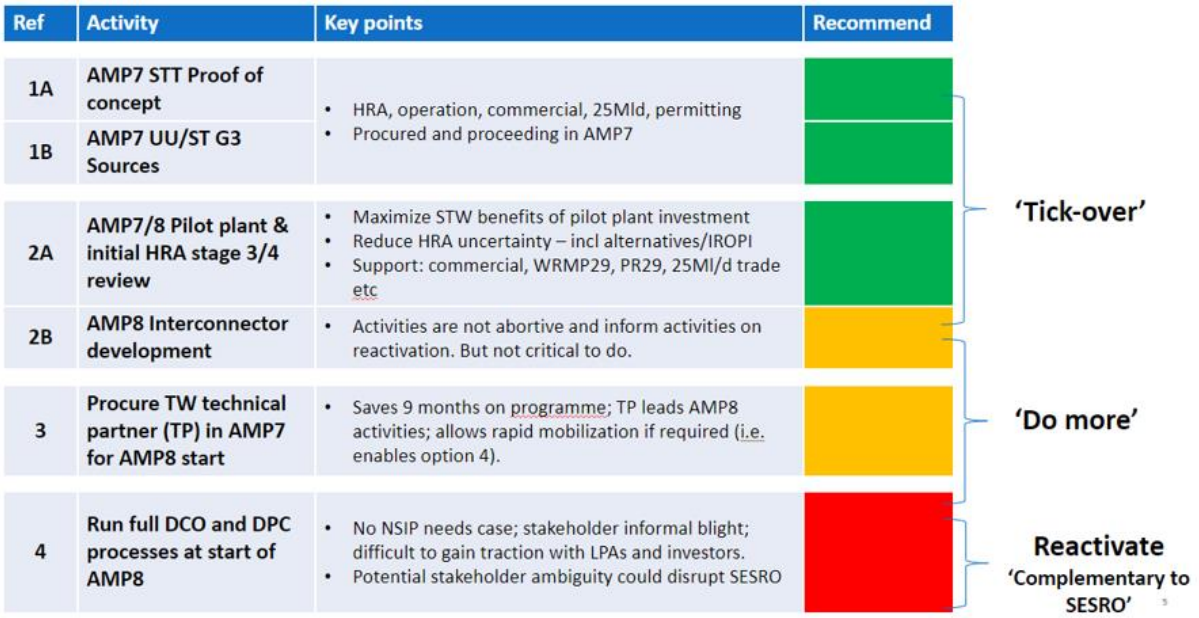

Figure 3 – Three strategic options for funding STT in AMP8.

Since October, RAPID (through monthly checkpoints) has provided the steer to 'do more'. RAPID has highlighted the need for accelerated development of STT into AMP8 to ensure strategic WRMP resilience, and manage risks and uncertainties within the future WRMP programme. In response to this, the three STT partner companies (TMS, SVE, NWT) are jointly proposing an increase in the AMP8 development funding with the objectives of (i) resolving uncertainty of option viability issues, focused on HRA, permitting, commercial and system design, and (ii) maintaining project readiness and minimising schedule risk by providing agility to ramp-up the option in AMP8 if required (e.g. if triggered mid-AMP8 to reactivate the option at draft WRMP29 stage).

We have identified the following provisional enhanced scope of STT work to achieve the objectives:

- Further HRA assessment including a limited programme of environmental monitoring and assessment and targeted expert and legal advice.
- Interconnector design development with a focus on cost definition of key components such as high-pressure fittings and staged pumping.
- System hydrodynamic modelling to determine the frequency of STT use to prevent coincidental drought in the South-East and North-West. This will include the modelling of source availability.
- Development and agreement of the system operational philosophy including operations, maintenance, and system failure scenarios.
- Developing a joint agreement in principle of commercial terms and terms for bulk supply agreements ratified by regulatory bodies.
- Some low-level engagement with targeted stakeholders and input into engagement on interfacing projects (i.e. SESRO and the North-West transfer SRO).

The actual scope would be developed and agreed with RAPID. To deliver the enhanced scope of work we would need to increase resources for client and project management and to re-procure a technical partner.

The activities would progress Gate 3 design development but would not include:

- reactivation of the option to meet all RAPID Gate 3 submission milestones;
- DCO and DPC activities to meet a pre-2040 WAFU target;
- inquiry or judicial review inputs; or
- development of new source support options (e.g. Welsh Water).

Funding would be split using the agreed 80:10:10 Gate 3 allocation between Thames Water, Severn Trent Water and United Utilities respectively.

We forecast the anticipated cost for developing STT in AMP8 would be £25m[7]. We propose a further £28m[8] of contingent expenditure which allows for the recommencing of STT's Gate 3 if decided STT needs to be delivered sooner (e.g. as determined through future WRMP). Re-commencing Gate 3 mid-AMP8 could deliver the scheme by FY39/40.

Table 10 - Our proposed AMP8 costs for STT (excluding contingent), reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 submission		August 24 submission		Movement	
Scheme	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure	Total expenditure	TMS only expenditure
STT Development	13	10	25	20	+12	+10

Our submitted Expenditure by AMP data table provides further detail and commentary on our STT funding request.

2.3 Teddington DRA

Teddington DRA is proposed in our revised draft WRMP24 as the preferred scheme to deliver our commitment to achieve 1 in 200-year drought resilience for the London region by 2033. Since our October submission, we have considered three changes in schedule, resource, and scope:

- Rescheduling Gate 3 submission.
- Re-procurement of our technical partner.
- Change in the conveyance design.

[7] Post-FSE.
[8] Post-FSE.

We are proposing to reschedule the submission of Teddington DRA Gate 3 to December 2024. This, in turn, reprofiles some Gate 4 spend into AMP8. The rescheduling of Gate 3 is not expected to affect the target dates for DCO application in 2026, start of construction in 2029, and WAFU in 2033.

We have competitively procured a multi-disciplinary framework for the provision of multi-disciplinary services and plan to appoint a new technical partner by September 2024. Following mobilisation, the new technical partner will be responsible for further developing Teddington's design to enable DCO application and providing support throughout the DCO examination. In addition, the new technical partner will provide the tender design documentation and support the tender process for the MWC. As with SESRO, the tender responses indicate a higher level of resourcing than allowed for in our PR24 submission. Following contract award we will work with the new technical partner to unpack our detailed requirements and to establish a robust schedule and resource plan that will deliver the DCO programme efficiently. At this stage we have not increased our technical partner cost forecasts to endeavour to remain with the constraint of the PR19 Gate 4 allowance.

The design of the conveyance system has changed from pipe-jacking with several intermediate access shafts to a bored tunnelled solution with one intermediate shaft. The updated design solution reduces consenting risk, but results in an increase in cost uplifting our AMP8 delivery forecast.

Teddington DRA is being delivered in-house as the scheme does not pass Ofwat's DPC discreteness criteria. Therefore, the delivery of Teddington would need to be funded in full through allowances set in the price review process. The publication of Draft Determinations saw Teddington's delivery costs assigned as contingent, as these costs are incurred post consent award. Due to the risk financing the contingent fund presents Thames Water, and the confidence that we have in the timing and quantum of Teddington's delivery costs due to its progression through the RAPID gated process, we have reassigned these costs as baseline. Further information on the financial risk posed by contingent allowances to Thames Water is given in section 2.6. Our revised funding requirement is summarised in Table 11. There is no Contingent expenditure proposed for this scheme.

Table 11 - Our proposed AMP8 costs for Teddington DRA, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission	August 24 Submission	Movement
Scheme	Total expenditure (100% TMS)	Total expenditure (100% TMS)	Total expenditure (100% TMS)
Teddington DRA	117	152	+35

Our submitted Expenditure by AMP data table provides further detail and commentary on our Teddington DRA funding request.

2.4 Beckton Water Recycling

In the Draft Determination, Ofwat has not provided an allowance to continue the development of our Beckton Water Recycling scheme as an alternative option to Teddington DRA. This was due to Ofwat expecting a decision on our preferred London Water Recycling option in March 2025, and therefore the case to fund parallel development of Beckton and Teddington DRA is not compelling. Below summarises our rationale for the continued development of Beckton and we have included a proposed development fund allowance of £32m[9] in our response.

To be funded for the development of Beckton alongside Teddington, up to the point of Teddington consent is awarded, is critical to maintain compliance with our WRMP24 monitoring plan. Our current schedule for Teddington forecasts consent award in late-2027. Up until the point of consent award, there is an inherent risk that Teddington is found to be unpromotable. To ensure that we are able to meet the WRMP's target of providing a 1 in 200-year level of resilience for our customers in the early 2030s, it is essential that the development of both London Water Recycling options are continued to allow for a timely adoption of Beckton, if required.

In April 2024, we submitted a Statement of Response to Defra following their request for further information on our rdWRMP24. In Annex C of this response, we provided an update to our monitoring plan, giving greater clarification on the metrics and triggers that will be used to evaluate progress against our preferred plan and guide decisions where specific adaptations may be required. These triggers represent the remaining risk in Teddington development which, if materialised, will result in the scheme becoming unpromotable. These triggers are summarised below.

Table 12 – WRMP monitoring plan metrics and thresholds which define the potential adaption of the Beckton scheme.

When?	Metric(s)	Threshold	Decision
Until c.2026	Teddington DRA Environmental Assessment	Option found to be not environmentally promotable due to environmental impacts which cannot be mitigated	Adopt alternative plan
2025-27 (i.e., before next WRMP)	Teddington consent	Consent not granted, or infeasibility identified, or not deemed environmentally promotable	Adopt alternative plan

[9] Post-FSE.

In our October 2023 submission, we requested an allowance of £58m to fully fund Beckton's AMP8 development costs and DPC contract management. This allowance was an 'extra over' budget line to progress Beckton in AMP8 if Teddington became untenable. The 'extra over' budget was in addition to the Teddington budget and based on a decision point to switch to Beckton in Y1 of AMP8. The requested allowance of £32m in our resubmission is to fully fund development of Beckton up to the point of Teddington consent award forecast in 2027 to align with the WRMP monitoring plan. In developing Beckton in parallel with Teddington we would progress targeted mitigations to refine the solution options whilst avoid activities that could impact on our DCO application for Teddington. There is no contingent expenditure proposed for this scheme and any underspend on Beckton will be managed across the SRO portfolio in line with RAPID's guidance.

Table 13 - Our proposed AMP8 costs for Beckton, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission	August 24 Submission	Movement
Scheme	Total expenditure (100% TMS)	Total expenditure (100% TMS)	Total expenditure (100% TMS)
Beckton Water Recycling	58	32	-26

Our submitted Expenditure by AMP data table provides further detail and commentary on our Beckton funding request.

2.5 Lower Thames to West London Reservoirs

In our October 2023 submission we proposed the Lower Thames to West London Reservoirs (LTWLR) transfer as a new SRO to address abstraction constraints identified during the 2022 drought. Our funding request in our October submission was based on very early outline feasibility studies. We have continued to develop the solution and considered two potential tunnel solutions:

- Teddington to the Queen Mary Reservoir transfer.
- Surbiton to the Queen Mary Reservoir transfer.

We have now established Surbiton to the Queen Mary Reservoir transfer as our preferred scheme. Through further development of this solution, we have identified the requirement to install three new abstraction pumps at Datchet, Littleton and Staines pump stations to enhance abstraction pumping capacity at low flows. The combined estimated CAPEX of this additional scope is £608m.

Our October AMP8 development forecast for LTWLR followed Ofwat's PR19 allowance of 6% of capital expenditure profiled to the RAPID Gates (up to DCO pre-application), with an additional 2.5% for post Gate 4 development. We do not agree that Ofwat's re-benchmarked allowance of 5.5% is adequate to sufficiently de-risk the delivery phase of major projects. Therefore, we have increased the baseline allowance for LTWLR by £11m[10].

[10] Post-FSE.

Our October submission assumed LTWLR would be delivered via DPC. This is may no longer be the case as we are continuing to assess whether the preferred solution satisfies Ofwat's DPC discreteness test. Therefore, in our response we have also included an allowance of £114m[11] to commence delivery towards the end of AMP8. As this scheme is still in the early stages of development, and we are uncertain as to the timing and quantum of the delivery costs, we have assigned the £114m as contingent.

Table 14 - Our proposed AMP8 costs for LTWLR, reflecting the changes from our October 2023 submission (£m incl. D&PG and post-FSE).

	October 23 Submission	August 24 Submission	Movement
Scheme	Total expenditure (100% TMS)	Total expenditure (100% TMS)	Total expenditure (100% TMS)
LTWLR	36	47	+11

Our submitted Expenditure by AMP data table provides further detail on commentary on our LTWLR funding request.

2.6 Financing contingent allowances

We recognise Ofwat's concern of customers funding and bearing the risk of large infrastructure investments that may not progress beyond a Development Consent Order (DCO) milestone. We therefore understand the rationale behind Ofwat's proposal to split cost allowances between baseline and contingent allocations.

However, the proposed approach to funding the contingent allowance, as set out in the Draft Determination, raises significant concern for Thames Water and we do not support the proposals.

As described in the chapter above, the contingent allowances required for the SRO programme could be up to £470m[12]. For Thames Water to finance this magnitude of allowance represents a significant cash flow concern which needs to be addressed for us to be able to efficiently deliver the SRO programme.

Additionally, the SRO contingent allowance does not exist in isolation and the financeability challenge this presents should be viewed in conjunction with the other unfunded allowances in Thames Water's overall revised Business Plan.

We have set out our proposed solution to the specific SRO challenge in section 3. For further detail on Thames Water's wider financeability challenge see our document 'TMS-DD-036 Strategic Narrative'.

[11] Post-FSE.
[12] Post-FSE.

3 Customer protection mechanism

3.1 PR24 Business Plan

In our Business Plan we highlighted, including through Reference Class Forecasting (RCF), the high levels of uncertainty on cost and schedule and that it would be uneconomic for customers to fully fund total uncertainty at this stage of development of the SRO programme. We proposed that a tiered approach to the funding of uncertainty could be established, which places the emphasis on the project team to manage risk within PR24 allowances, but which then provides controlled access to additional funding should the projects experience risk more than those allowances or if further SRO options are required. More detail of the uncertainty in the early stages of project development can be found in Appendix A: Strategic Resource Option uncertainty and Customer Protection Mechanism of the "TMS27 Enhancement Case: WRMP Supply Options".

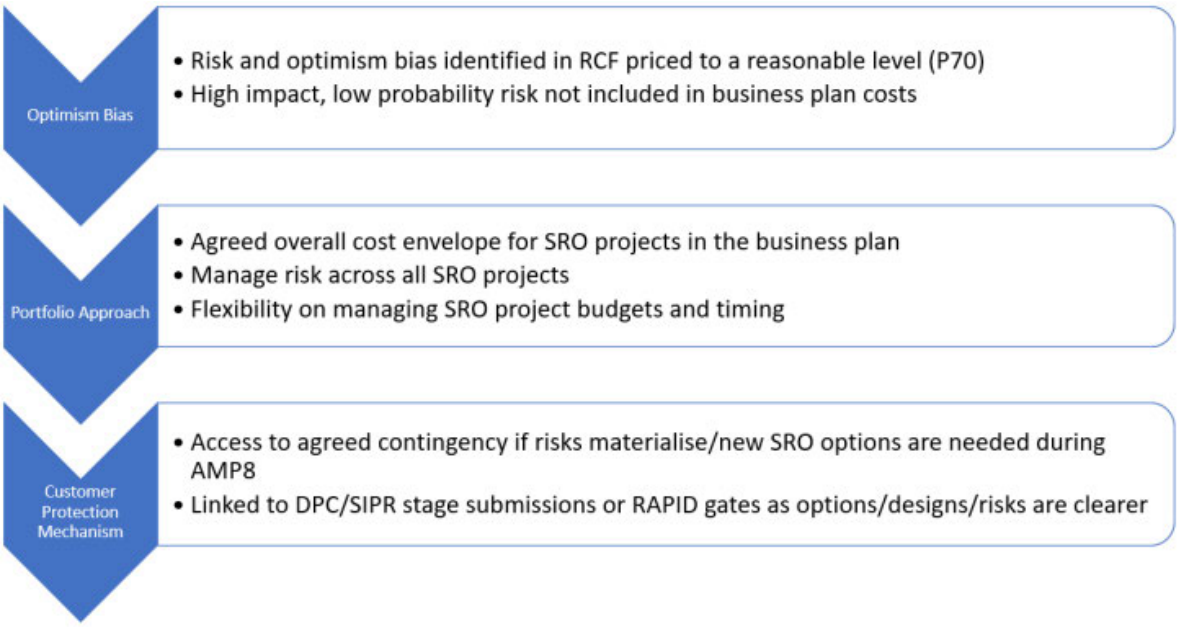

Figure 4 – Our previously proposed approach to managing uncertainty in the SRO programme.

The first mechanism we asked for was to a portfolio approach to the management of risk and we are pleased to see this in the Draft Determination. In practice though, due to cuts in allowances for SESRO and the continued development of Beckton, the level of funding in the Draft Determination gives us little flexibility to manage risk or changes in costs and schedule across the portfolio of SRO projects in an effective way. To allow us to efficiently manage the SRO project risk we would require these costs reinstating and have provided further evidence for the need for these costs in section 2. This will allow us to manage risk across the SRO projects and will give us the flexibility to best deliver our portfolio of projects.

We also highlighted the need for a customer protection mechanism (CPM) which would require evidence that risk of a magnitude greater than that funded has materialised before access to additional funding is provided, thus protecting customers from automatically funding risk or options that were uncertain to proceed.

The CPM would provide a clearly defined means of regulating increases in SRO funding in the event that cost overruns cannot be managed within the budgeted risk allowances. In practice, a change process would be established that relies on the project team providing compelling evidence to RAPID of the impact of risks. Risk that might give cause to apply to the CPM could include:

- Late approval of the WRMP impacting submission of a DCO application.
- Referral of the WRMP to Public Inquiry causing delay to the DCO application.
- Changes in legislation or policy causing additional work or delay.
- Market failure – lack of appetite or inability to establish VfM.
- Differential inflation, more than assumptions in PR24.
- Additional scope – new SROs, development of alternative SROs and/or material scope change driven by external factors.
- Force Majeure.

3.2 Existing mechanisms for managing uncertainty

We note that in the "Major projects development and delivery" annex Ofwat state that it has considered several approaches. We agree that including the whole allowance for uncertain projects and expenditure in the price controls would not benefit our customers and would adversely impact customer bills for activities that are uncertain to be undertaken in the APM.

We note that Ofwat has considered a risk pot approach that could be drawn down with Ofwat's consent and can see the value in such an approach for certain circumstances, especially where the risks are out of our control to mitigate. This could include a pot for changes in policy or regulations causing changes in scope or delays, higher inflation than we have assumed in our cost estimates or force majeure. A risk pot would not be suitable to cover all the uncertainty in the SROs though, due to the high levels of expenditure that could be required in certain circumstances. This could include high value scenarios such as the LTWLR scheme being delivered in house and construction beginning in AMP8. We believe an SRO risk pot would need to be prohibitively large to cover the whole range of uncertainty still inherent in our SRO projects but could form part of a suite of measures to protect customers against higher bill impacts. After further engagement with Ofwat and RAPID following the Business Plan submission in October 2023, we have also explored existing mechanisms for managing uncertainty but do not see a suitable solution that would enable us to deliver high value infrastructure projects within the five-year price control period.

Table 15 - Existing uncertainty mechanism assessment

Mechanism	Assessment	Reasons
IDoK	Unsuitable	There could be several points throughout the AMP where further funding is required and undertaking an IDoK each time would be time consuming and impractical. The mechanism also does not provide the certainty that we require in developing projects that we would be able to access funds.

Transitional Funding	Unsuitable	Although we foresee this mechanism being suitable for some costs, we do not believe it gives us enough certainty on accessing further funds during the AMP. As accessing transitional funding is currently restricted to the last two years of the AMP, this would also restrict access to further funds earlier in the AMP.
RAPID Gates	Unsuitable	Although we support the continued use of RAPID gates for existing SROs during their development phase, we do not believe they would be suitable in their current format. The current gates are restricted to only funding development costs with no scope for funding or approving any in-AMP construction costs.
Notified Items	Unsuitable	While we see the value in this approach, we do not believe it would be suitable to manage the whole range of uncertainty on SROs. For example, a new SRO which is in a very early stage of development with several possible options and little certainty on cost and programme.
End of AMP reconciliation	Unsuitable	We view an end of AMP reconciliation of any contingent spend as retrogressive, and counter to RAPID's direction of travel for front-loading spend to de-risk delivery. The time lag between our needing to incur expenditure and cost recovery adds to Thames Water's financial challenge when considered in the round with the other contingent allowances applied to the business. Ofwat must undertake a financeability cross-check on its application of contingent allowances on the basis of each actual company (not on the basis of a notional efficient company as it does now).

3.3 Preferred option for managing SRO uncertainty

To fully manage the uncertainty within the SRO programme and individual SRO projects we propose a suite of mechanisms. The first of which is a gated CPM which would release funds at pre-determined trigger points, the scope and timing of which will be agreed with RAPID once our programme becomes more certain. While we have early estimates of forecast costs for projects, we believe there is not enough certainty on options to accurately forecast them at this point so would also request that levels of funding are set at these trigger points, rather than agreeing a set budget now. This funding will be released at the trigger points once robust evidence is supplied to RAPID to support figures. This will ensure that we have the budget we require to develop the SROs, but also reduce the risk to customers of funding excessive cost or delays to projects. The CPM would cover areas of uncertainty including:

- costs associated with delivering the Lower Thames to West London Reservoir Transfer;
- if alternative, more costly SROs were required to our preferred options as a result of triggers in the WRMP; and

- if additional SROs were required to those selected in our preferred options as a result of assumptions within the WRMP changing.

Although the CPM can be used for managing some of the risk and uncertainty in the SRO programme a risk pot could be used for exogenous risk including:

- late approval of the WRMP impacting submission of a DCO application;
- referral of the WRMP to Public Inquiry causing delay to the DCO application;
- changes in legislation or policy causing additional work or delay;
- market failure – lack of appetite or inability to establish VfM;
- differential inflation, more than assumptions in PR24; and
- Force Majeure.

This risk pot would be managed by RAPID and could be accessed only if any of these risks materialise. This approach would again protect customers from funding risk that is unlikely to materialise but, if it does, has a high impact either on cost or time and could hold up delivery of the SROs.

Although we recognise RAPID has agreed to a portfolio approach, to fully utilise the portfolio approach to risk that we requested in our Business Plan submission, we would also require the additional budget requested in section 2 to further develop additional or alternative SRO projects. The current allowance in the Draft Determination only funds the lowest cost options in the WRMP and additional development of other SRO options within AMP8 would incur further cost. Without the additional funding requested there would not be enough funding in the portfolio to deliver any alternative options meaning delivery could be delayed until AMP9.

3.4 Possible scenarios for additional activity

Since October 2023, when the Business Plan was submitted, further work has been conducted on the SROs. This included our response to the February 2024 Defra request for more information to support our Water Resources Management Plan 2024. As part of this we further developed the WRMP monitoring plan which identifies potential issues and what and when alternative action could be taken if these issues arise.

The WRMP monitoring plan identifies key points in time which could cause a change to the delivery plans of our SRO projects. Although consenting of the SRO projects tends to fall towards the end of AMP8, there are several triggers earlier in the AMP. Until these points are passed, we will not have certainty on which options will be needed. These trigger points occur across AMP8 making it difficult for us to fund and finance any additional activities, Figure 5 gives some examples of these trigger points.

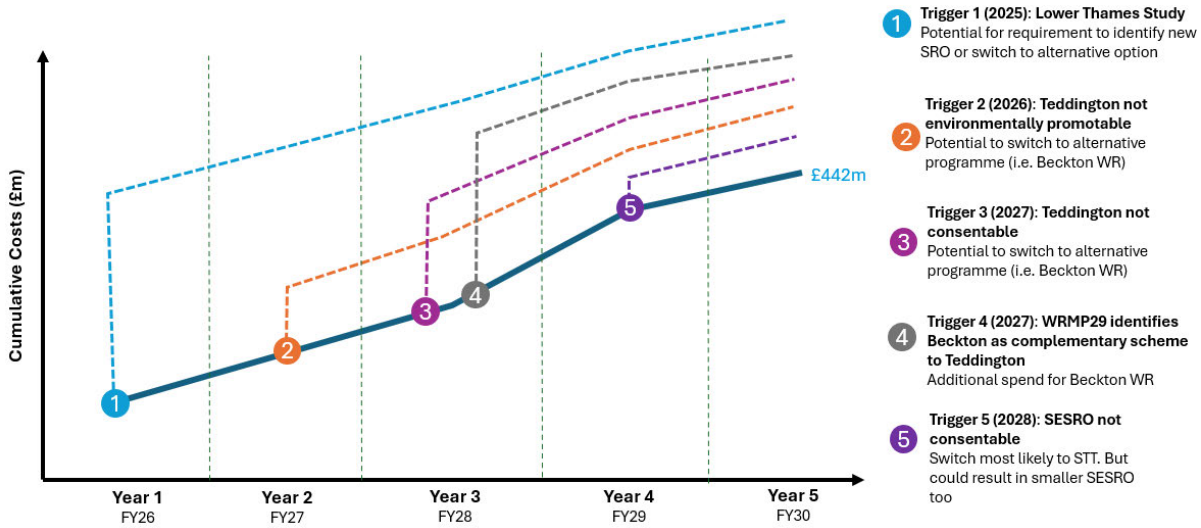

Figure 5 - Alternative scenarios and trigger points in the WRMP Monitoring Plan.

Trigger 1 – Lower Thames Study

As part of the WRMP we will undertake a Lower Thames Study to better understand the role that river levels play in abstraction management on the Lower Thames. We will report the findings of the Lower Thames study as part of the annual review in 2025 and this will identify if a new scheme is needed and is feasible.

Trigger 2 – Teddington is not environmentally promotable

In the WRMP we have confirmed that the Teddington DRA scheme remains the best option to provide 1 in 200-year resilience. If, however, we identify that constraints on our Lower Thames abstractions exist or will be created by the River Thames Scheme, and that an engineering solution is infeasible or we do not gain a discharge licence consent from the EA, we will need to revisit the decision made regarding option selection for the early part of the WRMP24 planning period. The outcome of the monitoring to inform the adaptive plan for the Lower Thames will identify whether a new option is needed to mitigate issues around our Lower Thames abstractions, and whether such an option would be feasible.

Trigger 3 – Teddington not consentable

The schedule for the Teddington DRA scheme involves submission of a DCO application by mid-2026, with grant of consent in late-2027. Although we believe at this stage that Teddington DRA is consentable, up until the point of grant of consent, there is an inherent risk that the Teddington DRA scheme is found to be unpromotable. To ensure that we are able to meet the WRMP's target of providing a 1 in 200-year level of resilience, additional funding for Beckton or an alternative scheme would be required to allow continued development and adoption of the alternative pathway in the WRMP monitoring plan.

Trigger 4 – WRMP29 identifies Beckton as a complimentary scheme to Teddington DRA

We will be developing WRMP29 in AMP8 with much of the modelling undertaken in 2027 and our first draft submitted to the Secretary of State in March 2028. There are several assumptions on leakage reduction, reducing per capita consumption and reducing non-household demand in AMP8 to meet our forecast shortfall in water resources in the WRMP24. We will monitor against

these targets and if they are not met this could mean a further SRO is needed, for example Beckton. We included some costs to further develop Beckton in AMP8 and ensure that it remains a viable option to progress if needed. There is insufficient funding to fully progress Beckton as an SRO in addition to Teddington DRA and we would require a significant uplift in funds to deliver both SROs.

Trigger 5 – SESRO not consentable

We have also needed to include in the WRMP the risk of SESRO being denied its Development Consent Order. Although we believe at this stage that SESRO is consentable, we need to mitigate the risk that it will not be due to its importance to providing resilience to climate change, population growth and protecting the environment. Should the 150 Mm3 SESRO be found to be infeasible or be denied consent we should seek consent for and develop an alternative SESRO size (the largest feasible size), and if SESRO is denied consent overall we will switch to our alternative plan and proceed with development and consenting of an alternative option, most likely the Severn Thames Transfer SRO.

3.5 Contingent spend

We note that in the Draft Determination the SRO funding allowance has been divided between baseline and contingent allowance which is split by pre and post consenting activity. We agree that the timing and quantum of costs such as finalising land acquisition, enabling and interface works and completing the SIPR procurement process is uncertain. However, we believe that a conditional allowance would be a more suitable solution to managing the contingent allowance.

As discussed in section 2, costs that sit in this contingent spend have risen from the business plan submission with increased costs included for further land acquisition and early enabling works on SESRO delivered by Thames Water, rather than the Infrastructure Provider.

This contingency allowance could be material if all the uncertainty is realised, especially on land costs with significant land needing to be acquired for SESRO. This could provide a financing challenge in Ofwat's proposed contingent allowance with significant in-AMP costs and spend only hitting customer bills in AMP9.

It would be poor value for customers to fund the full risk exposure at the early stages of projects development when uncertainty remains high. We are therefore proposing that this uncertainty be managed with an in-AMP adjustment mechanism similar to the CPM suggested in the Business Plan. This would protect customers from funding uncertain activity until costs were more certain and the need for these activities was established while also aiding Thames Water with financing issues. It also reduces the impact of delivering the SROs on customers' bills with significant construction costs forecast in AMP9. Without the certainty of this in-amp mechanism we would have to develop options to manage the financing risk which could include delaying activities, setting up land options for the IP to complete or delaying procurement of the IP. All of these could increase the levels of risk in the SRO projects overall and cause delays to the project.

While we have included an estimated figure for the contingent costs of up to £470m; this is a maximum figure and the actual figure in AMP8 could be lower, depending on what activity is delivered and when. All additional contingent activity will be looked at through a lens of what is best for our customers and will need to be justified on a value for money basis.

We recognise Ofwat's concern that the inherent uncertainty within SRO programmes has the potential to also impact customers adversely in terms of when activity happens. We acknowledge that there is a risk of customers funding proposed increased baseline costs which do not the occur within AMP8 because of changes in strategy, options, or delays to projects. While we would be incentivised to efficiently manage costs via the proposed incentives (discussed further in section 4) we would welcome the opportunity to further engage with RAPID and Ofwat before the Final Determination on how to further protect our customers from funding uncertain costs while also ensuring that we are fully funded to reduce risk during the development phase of projects. Mechanisms linked to the CPM could be explored with reconciliation of forecast costs undertaken at key points connected to project milestones when there is certainty on costs and scope.

4 Incentives and penalties

For RAPID projects to be delivered through a competitive tender process (the likely delivery route for large, discrete projects, whether DPC or SIPR), value for money will be maximised where projects are delivered and de-risked to a good standard by the Appointee prior to the tender process.

In line with the RAPID ethos, Appointees' developing major projects should be able to incur efficient expenditure in the development phase to achieve the best possible outcome. The amount required will be determined by the characteristics and context of each scheme, including the approach to procurement. Specifically, for SESRO to be delivered under SIPR, we consider it important that Thames Water is funded appropriately to:

- Develop a high-quality planning application and secure consents.
- Engage with the contractor market to obtain maximum value in the development phase, such as through Early Contractor Involvement.
- Develop high-quality commercial arrangements which are acceptable to investors.
- Establish high-quality delivery organisations, such as a shadow IP. This is particularly important under the proposed 'split procurement' model.

These elements will be set out in detail in the SESRO Stage 2 submission.

4.1 Development phase cost sharing

We are concerned that the proposed cost sharing incentive is not directed towards the long-term value for customers or ensuring development phase expenditure is economic and efficient.

The upside/downside cost mechanism creates an incentive for development costs to be minimised rather than minimising the risk to the delivery phase - a greater driver of customer value. That may result in circumstances when a risk is not mitigated to the full extent possible, yet the incentive rewards the underspend. We do not believe that was Ofwat's intention and ask it is reconsidered.

In addition, we would like any incentive to our suppliers to be aligned with our objectives with the long-term interests of the customers. The proposed cost sharing mechanism does not easily permit that, because of the capacity of the supply chain to bear material downside risk, meaning the overall effectiveness and value is limited. We would like to continue discussions to develop a more appropriate incentive mechanism with Ofwat.

In developing an alternative with Ofwat, we would like to focus on the overall success of the development phase, creating measures of success related to securing the DCO, procuring the MWC and IP, and confidence in the overall project cost and risk envelope. We believe linking these metrics to the success fee and deleting the cost sharing arrangements, could better incentivise the delivery of value to customers.

With regards to ensuring development phases costs are economic and efficient, absent a cost sharing incentive, we believe that is better achieved through transparent reporting, effective assurance, and governance. Which for the major projects could include the appointment of an

independent cost advisor to provide assurance to Ofwat, Partner Companies and the TW Board that costs have been incurred approximately.

We consider the size and complexity of schemes being delivered through SIPR warrant a tailored incentive mechanism. Separating the incentive regimes for SIPR and DPC projects would allow the accurate reflection and remuneration of the risk associated with each delivery route.

We have set out a proposal above for a customer protection mechanism (CPM) in section 3 which we believe will better administer spend through a gated process, ensuring that Thames Water is sufficiently funded to incur appropriate costs during the development phase.

4.2 Portfolio approach to funds

We agree with Ofwat's proposal to continue portfolio funding, as this allows Appointees to efficiently manage their spend across major projects they are developing.
To this end, we propose to carry over previous underspend, resulting from programme changes, into AMP8.

4.3 Delayed delivery cashflow mechanism (DDCM)

Through our engagement with RAPID we understand that the DDCM is not expected to apply to the SRO programme.

We consider the SROs are multi-AMP programmes with spend profiles that do not follow the typical AMP cycle Ofwat is looking to address with this mechanism. However, if this assumption is not correct, we seek clarity from Ofwat on how this mechanism would apply to the SRO programme.

We acknowledge Ofwat's desire to ensure that SRO spend is efficient and incurred on a timely basis, however we note that if this mechanism is combined with other incentives and the division between baseline and contingent funding places a great deal of uncertainty onto Appointees which may not drive Ofwat's desired outcomes.

Our proposed CPM is explained above in section 3 which we feel better serves the needs of SRO project development.

4.4 Risk and return

We welcome Ofwat revisiting the risk and return arrangements which apply to Appointees delivering major infrastructure projects under competitive delivery models as an opportunity to ensure that Appointees are appropriately incentivised to drive the right outcomes for customers.

In particular, we welcome Ofwat's proposal to create a 'success fee' incentive for Appointees, recognising that the traditional approach to remuneration of risk (i.e. RCV growth) is not available to Appointees under competitive delivery models. We consider that this has the potential to strongly incentivise quality and timely delivery of complex consenting and procurement activities by the Appointee, and to remunerate some of the risks that Appointees

incur in developing and procuring major projects through competitive delivery – including both DPC Stage incentives and, for SROs, RAPID penalties.

However, we seek further clarity on how the incentives and success fee will be calculated and applied in practice. We also consider that the success fee should not be used to offset operating phase risks that are unique to SROs and water trading (e.g. liquidated damages on failure to supply). Instead, other mechanisms should be used to remunerate such risks (e.g. economic profit earned on water trades).

4.5 DPC Stage incentives

We recognise and support Ofwat's desire to incentivise the timely delivery of high-quality DPC stage submissions. We assume a similar incentive is intended to also apply to SIPR projects.

However, we do not consider that the guidance as currently drafted makes clear how these incentives will be calculated and applied in practice. We would welcome clarification from Ofwat of the following assumptions:

1. RAPID and DPC incentives will be applied only once, and to separate components of funding.

We are concerned at the potential for "double jeopardy" between:

- the RAPID delivery incentive - which can apply an up to 30% reduction on recovery of efficiently incurred development spend; and
- the DPC stage incentive - which can apply an up to 40% of DPC-related development spend, itself a subset of the project's efficiently incurred spend.

For the DPC incentive to be applied, we consider that there should be a clear division between funding allocations subject to the DPC stage incentive and subject to the RAPID delivery incentive, for example by excluding DPC-related expenditure from the RAPID incentives.

We would welcome clarification from Ofwat and RAPID as to how the overall incentive regime will be administered and how penalties will be applied.

2. The maximum penalty applicable under the DPC stage incentive is 40% of total DPC-related development costs on a cumulative basis.

We note Ofwat's confirmation that incentives will be applied at the end of the period, and therefore interpret Ofwat's guidance (Major projects development and delivery appendix, table 9: illustration of proposed incentives) in the Draft Determination to mean that the maximum overall penalty across Stages will be 40% of the total development allowance for DPC related costs.

In other words, if an incentive penalty has been applied at an earlier stage, we do not consider it appropriate that a further penalty is then applied to that Stage as a result of the assessment made against a later Stage submission (which would mean a greater than 40% maximum penalty).

3. That the timeliness incentive will be flexible to account for project developments, and the quality incentive will take account of project-specific factors which influence the content suitable for each Stage submission.
Although we recognise the need for timely solution development, the incentive should reflect that project development timelines change, and it may in some cases be beneficial to allow flexibility in the timing of stage submissions to enable them to be submitted at the right time for each project.

We also consider that quality should be assessed based on the specifics features and needs of each project. DPC projects differ from SIPR projects in many areas, and projects vary again within each of those categories. There is also no published regulatory guidance on the requirements for SIPR schemes at stage submissions, meaning there is no clear quality standard against which SIPR stage submissions will be assessed.

Quality should therefore be assessed by considering the appropriate level of development at the time of submission by reference to that project's features and strategy. For example, although the requirements of a DPC stage submission may be of use in considering the level of development appropriate for a SIPR submission of the same stage, they should not be applied without due consideration of how a SIPR project differs.

4.6 DPC success fee

We welcome the steps Ofwat has taken to incentivise competitive delivery of major projects and have assumed that a success fee is applicable to SIPR. We note that under competitive delivery models, an Appointee does not make a RCV linked return and as such it is appropriate that Ofwat provides an appropriate incentive for successful SIPR delivery.

Based on the Draft Determination detail provided in relation to the DPC success fee, we have assumed that the success fee will be applicable to both DPC and SIPR projects.

Although we note that Ofwat continues to develop its incentive regime (as per query response OFW-IBQ-TMS-014), we consider it appropriate that Appointees be positively incentivised to deliver major projects, regardless of a competitive delivery route taken. This creates a more balanced incentive profile overall.

However, to ensure that the success fee operates effectively, we believe two clarifications are required:

1. To ensure that the success fee creates an effective incentive, the success fee should be applied against the development phase only and should not be used as a funding mechanism to remunerate future Appointee liabilities in the delivery phase.
We agree that Appointees should be incentivised towards timely and high-quality delivery of the development stage and consider that this is achieved through the RAPID delivery incentive, DPC stage incentives and the success fee.

However, an Appointee's performance post-financial close is best incentivised, and risk exposure remunerated, through a project's commercial arrangements (e.g. liquidated damages and 'economic profit' on supply of water) and through future regulation (e.g. at periodic reviews), not through the potential clawback of the success fee.

If the incentive is potentially "at risk" against future incentives in the construction and operating phases, the effectiveness of the success fee incentive to Appointees in the development phase is reduced.

This is because at the time a success fee would be awarded, it would not be possible to determine an Appointee's overall risk exposure across the life of the project, making it hard to size the success fee against the potential downside exposure.

This is particularly the case if the 'success fee' is seen to remunerate operational phase risks that are unique to multi-party arrangements, and would mean that appointees developing DPCs for their own customers' benefit are advantaged as compared with 'lead parties' developing DPC schemes for the benefit of multiple undertakers.

Further, there would be challenges in assessing the time value of money of a success fee (awarded at a single point in time) against an enduring incentive regime (wherein penalties will likely be variable and index-linked), particularly under SIPR whose arrangements may be in perpetuity.

2. It should be clear how the incentive is calculated and applied with respect to multi-party schemes.

We assume that the success fee is intended to reward the lead developer for a major project, as the party responsible for the development phase, upon achieving a successful outcome. However, as RAPID funding is divided between the sponsors to the scheme, we would welcome clarification as to whom the success fee would be paid, and in the event that the success fee is "at risk" (noting the arguments made above the we do not consider this to be appropriate), how this would be administered across Appointees.

Overall, we consider that the success would best operate as a potential reward for a project's lead developer Appointee for a well-delivered development phase, with construction and operating phase incentives addressed through other commercial and regulatory mechanisms. We therefore seek further clarity on how the success fee will be calculated under SIPR, how it will be funded, its purpose (and the risks it covers), and how it will be applied (including across multi-party solutions), so we can take an informed view on the balance of risk and reward under competitive delivery.

We have summarised our understanding of how the proposed incentives and penalties would apply across major projects progressed via different delivery models in Table *16* below. For SROs delivered via competitive delivery, the scope for penalties to be applied is greater.

Table 16 – Our understanding of the application of incentives and penalties across different delivery models.

Delivery route	Rapid penalty (downside)	DPC stage penalty (downside)	DPC success fee (upside)	Comment
SRO delivered via competitive delivery (e.g. SESRO)	✔	✔	✔	Risk of double exposure to downside penalties. Lead party may bear additional downside risk compared with non-SRO incentives.
SRO delivered in house (e.g. Teddington DRA)	✔	✘	✘	Downside only incentive. (Upside through RCV growth on development and delivery costs).
Non-SRO delivered via competitive delivery	✘	✔	✔	Not subject to RAPID penalties during development phase.
Non-SRO delivered in house	✘	✘	✘	Incentives via standard regulatory mechanisms e.g. PCDs.

5 Partner and future SROs and regulatory reform

5.1 Partner SROs

We are committed to working collaboratively with our partners in delivering the SRO programme. For SESRO, Thames Water is acting as the lead sponsor during the development phase with Affinity Water and Southern Water acting as co-sponsors. In line with our approach set out with RAPID, we are contributing a proportion of the development costs in line with the expected proportion of the SESRO benefits realised, with Thames Water contributing 55% of the development costs, Southern Water 30%, and Affinity Water 15%. We are supportive of the approach of investing appropriately in the development phase as to de-risk the construction phase. This is aligned to Ofwat's guidance and will represent the best value for customers.

Where other water companies' SROs interact with our network or SROs within our portfolio, we will continue to identify and explore viability of opportunities through AMP8 to ensure the systems are optimally developed, delivered, and operated to protect customers' bills. Should mutually agreed, viable opportunities to transfer scope between these inter-connected projects arise, then we will liaise with RAPID and/or Ofwat as appropriate, to ensure customers' best interests are protected.

5.2 Future SROs

Our customers should have a resilient water supply that is protected in drought conditions, in the face of climate change and population growth. Therefore, we will continue to identify potential future SROs through the Water Resources Management Plan (WRMP). Any newly identified SRO candidate schemes will be promoted through the RAPID gated processes if they meet the required criteria, as defined in the letter sent from Ofwat on 19 April 2024. For new SROs we accept that expenditure to Gate 1 will be funded by companies' Botex allowances, however, funding for Gate 2 onwards must be treated as enhancement. This is on account of:

- the SROs progressing through a regulated gated process which entails enhanced assurance and governance processes;
- the strategic nature of SROs with the impacts felt at a regional level, rather than localised;
- the requirement to fund NAU expenditure;
- greater collaboration required between companies and stakeholders to develop and deliver the schemes efficiently.

We will continue to engage with Ofwat and RAPID on the development and progression of any potential new SROs.

5.3 Regulatory reform

RAPID's establishment has enabled the efficient development of SROs in AMP7, and we look forward to the continuation of this process into AMP8. However, the current regulatory framework is not structured to optimally deliver these complex infrastructure projects and therefore does not currently represent best value for customers. The framework needs to be

adaptable to reflect the individual characteristics of a project or programme to drive efficient delivery. Changes to the regulated framework could include:

a) Decoupling of major projects from the current price review cycle by moving towards longer-term regulatory frameworks.
5-yearly price controls provide protection for investors but also create uncertainty. There is scope to move away from a 'one-size-fits-all' approach to have longer term settlements which would enable more efficient or innovative delivery and offer investors more certainty about the value-proposition of their investment.

b) Reviewing the scope for more use of SIPR/DPC to enable financing of investment.
DPC and SIPR offer a route for infrastructure development that sits outside of the traditional water company. Reviewing and expanding the scope of projects or programmes that could be delivered through DPC and SIPR could enable greater innovation in the delivery of multi-AMP programmes, such as SuDS. Delivering more through DPC and SIPR would also enable the development of capability in the supply chain.

We look forward to working with Ofwat and RAPID in developing these potential regulatory reforms to help ensure we are efficiently delivering major projects to best meet the needs of our customers and the environment.

It's everyone's water