

# Customer Challenge Group for Thames Water:

---

*Report to Ofwat on Thames Water Business Plan*

*2 December 2013*

## Statement by the Chair of the Thames Water Customer Challenge Group

I, the Chair of the Thames Water Customer Challenge Group, submit this Report to Ofwat for review and consideration.

A handwritten signature in dark ink, reading "David Bland". The signature is written in a cursive style with a horizontal line underneath the name.

.....  
**David Bland**  
Independent Chair

2 December 2013

## Contents

Executive Summary .....	3
1 Introduction .....	4
2 Customer engagement .....	7
3 Reflecting customers' views in business plans .....	9
4 Customer acceptability of final bill impacts.....	18
5 Areas of outstanding challenge to Thames Water .....	19
6 Note to Ofwat .....	20
Annexes .....	21
1 CCG arrangements.....	21
2 CCG work .....	23
3 Submissions from statutory regulators .....	24

## Executive Summary

The CCG is content with the way the Company has embraced the work of the CCG to aid its business planning process. The Company has been open and transparent with the Group throughout the process. The CCG is satisfied that **Thames Water has engaged effectively with its customers** in preparing the 2014 Business Plan. The Company showed great willingness to adapt its already developed research strategy to meet the requirements of the CCG. In particular, the CCG was able strongly to influence the segmentation of customers for research and to ensure that hard-to-reach groups were properly included. The Company is to be commended for responding to the CCG challenge to be more open to receiving customer views. The scale and scope of the inquiries undertaken by the CCG have been substantial.

The Company has shown **significant positive responsiveness to customers' opinions**, most notably by increasing the allocation of resources for the reduction of leakage. The CCG accepts Thames Water's rationale for not meeting customer desire for softening of hard water, and its alternative plan to undertake a study to understand better customer preferences on drinking water hardness.

Thames Water has conducted very extensive research with its customers on the **acceptability of various possible price levels** and the level of customer acceptance sufficient to vindicate the Plan. In response to a direct and open question, customers stated that 65% acceptance was adequate support. The Plan takes account of customers' preference for leakage reduction and metering as the preferred methods for water conservation. Customers broadly accept the duty of their water and sewerage supplier to protect and enhance the environment, provided this objective can be met cost-effectively, without excessive burdens being placed on customers, and this view is reflected in the Plan.

In respect of **Final Acceptability Testing**, the Group was involved from an early stage in the process, commencing with the pilot testing through to final testing. Following challenge by the CCG, the Company included inflation, added an 'uninformed' question, made changes to quotas and agreed to consult with both business and waste only customers in the final testing piece. The CCG remains concerned, however, that acceptability has not been tested with customers of all the water-only companies who receive their sewerage service from Thames.

In respect of the **bill impact**, Thames Water has proposed a small reduction in the water bill for the 2015-20 period, and an increase in the typical sewerage bill, resulting in 'flat' bills for Thames water-and-sewerage customers before inflation and the cost of the Thames Tideway Tunnel (TTT) are accommodated. The CCG notes that **this level of charging is acceptable to more than 70% of customers**. The Company has taken account of the fact that customers are satisfied that the Company's water and sewerage services are of good quality and affordable, that they do not wish to see any deterioration of service, but that they are keen not to pay more than is absolutely necessary for water and sewerage supplies. The need for the TTT, despite the addition of a significant sum (up to £40 by 2020) to the typical bill, is accepted by most customers throughout the Thames sewerage service area.

With regard to **the structure of Thames Water's Plan around Outcomes**, the CCG has been heavily involved in challenging the Company throughout the process. The CCG considers that it has helped the Company to develop a coherent Plan which is focused on Outcomes, from high level statements through to detailed measures. The CCG does have some concern, though, about how proposed incentives which apply to the Wholesale business will feed through into targets and incentives for the Retail business, and ultimately into better outcomes for customers.

Comments from the **environmental regulators** on the Plan are appended to this Report, and the CCG is pleased to acknowledge the constant and positive participation of the Environment Agency, Natural England and the Drinking Water Inspectorate in the work of the Group.

# 1 Introduction

## 1.1 CCG purpose and scope

To ensure that the customers of water companies have a greater voice and influence in shaping company plans for the forthcoming price control period 2015-2020, Ofwat has required that each company establish a Customer Challenge Group (CCG<sup>1</sup>) to provide an independent oversight of this customer engagement. In August 2011, Ofwat defined the role of the CCG as follows (in 'Involving customers in price setting – Ofwat's customer engagement policy statement'):

- To review the company's engagement process and the evidence emerging from it. This is to ensure customers' views are considered as the company develops its business plan;
- To challenge the phasing, scope and scale of work required to deliver outcomes, including legally prescribed standards and the requirements of other regulators; and
- To advise Ofwat on the effectiveness of the company's engagement, and on the acceptability to customers or otherwise of its overall business plan and bill impacts.

Later guidance from Ofwat ('Setting price controls for 2015-20 – business planning expectations - a consultation', April 2012) stated:

- As part of the risk based approach, Ofwat expects CCG reports to highlight both consumer and environmental concerns and how companies have addressed these.

In Ofwat's final methodology for PR14 and expectations for companies business plans (July 2013), it stated:

- Company CCGs will need to submit a report including views from environmental and quality regulators.

The CCG has reviewed Thames Water's Business Plan, consisting of the following four elements: Wholesale Water, Wholesale Waste Water, Retail Household and Retail Non Household. The CCG has noted Ofwat's principle for the Price Review of ownership, accountability and innovation, with the onus on company boards to own and be accountable for the company business plan. Throughout its work, the CCG has considered how Thames Water<sup>2</sup> has assessed and addressed both consumer and environmental concerns and also taken into account Ofwat's focus on customers in relation to Outcomes, Costs, Risk and Reward, and Affordability and Financeability.

In particular the CCG has considered whether the Company's Business Plan reflects a sound understanding and reasonable balance of customers' views. It has also considered to what extent the phasing, scope and scale of work required to deliver the outcomes, including legally prescribed standards and other regulators' requirements, is socially, economically and environmentally sustainable. The CCG has pressed Thames Water to ensure that outcomes are defined in a way that enables the Company to seek out the most acceptable, cost-effective and sustainable means of delivering them. It has advised and challenged the Company as it explores and considers innovative solutions, including catchment management.

## 1.2 CCG composition and support

The CCG has acted and spoken independently of the Company. The proceedings of the Group have necessarily included the presentation of significant confidential and business-sensitive information and in signing a Confidentiality Agreement each member of the Group confirmed that such material was not to be shared with the bodies that members of the CCG represented.

---

<sup>1</sup> Also referred to as the Group herein

<sup>2</sup> Also referred to as the Company herein

Members found that they needed to devote more time to this work than some had anticipated and not all members have been able to attend every CCG meeting due to their primary responsibilities. Members have been circulated with papers for all main meetings and the relevant sub-groups and asked to comment even if they were not able to attend in person. Inevitably, there have been limitations on time and different levels of understanding within the Group, not through lack of information from Thames Water but as a result of varying backgrounds of Group members and hence varying initial understanding of the water industry.

The representatives of statutory regulatory bodies - the Environment Agency (EA), Natural England (NE) and the Drinking Water Inspectorate (DWI) - have contributed valuably to discussions of the Group. The regulatory bodies have each submitted their own letters summarising their respective views on Thames Water's Business Plan, as reviewed via the work of the CCG: these are included in Annex 3 to this report. In addition, Natural England and the Environment Agency comment as follows:

#### **Natural England**

*Natural England's representative has regularly attended the CCG and the environment sub-group. Included in the Annexes of this report is a copy of a letter dated 21<sup>st</sup> November 2013 received from Natural England. The comments in the letter were made following correspondence and dialogue with the Company throughout the WRMP process including the Statement of Response and business planning process to the date of the letter. These comments were made without having seen the complete and final proposed business plan. Natural England expects to continue to work with the Company on some of the details of proposals. However, it does not anticipate any material changes in its overall response. In Natural England's view, the proposals within the business plan and the revised WRMP with regards to landscape and biodiversity are a significant improvement upon the previous water resource plan and accompanying Asset Management Period (AMP) 5 business plan. Overall, Natural England is broadly satisfied with the proposals for AMP6 as far as they relate to Thames Water's statutory responsibilities regarding landscape and biodiversity including designated sites.*

#### **Environment Agency**

*Environment Agency representatives have regularly attended the CCG. Included in the Annexes of this report are copies of the relevant correspondence between the Agency and Thames Water (dated 1<sup>st</sup> and 21<sup>st</sup> November). The comments in this correspondence were made following dialogue with the Company throughout the business planning process and WRMP process, including the Statement of Response and up to the date on the relevant correspondence. These comments were made without having seen the complete and final proposed business plan. The Environment Agency expects to continue to work with the Company on some of the details of proposals. However, it does not anticipate any material changes in its overall response. In the Environment Agency's view, from the information provided, it understands that the Company is planning to meet its statutory environmental requirements set out in Defra's Statement of Obligations, and it welcomes the Company's commitment to meeting them.*

The role of the Consumer Council for Water (CCWater) as a statutory body was recognised by the Company in forming the CCG. The CCWater representatives contributed effectively to all meetings of the CCG and of its sub-groups, and the Group recognises the benefit that was derived from the experience and independent research that they could bring to our deliberations.

The support of the Company was essential and was very welcome in the following areas:

- providing a Secretary for the CCG who would work explicitly and exclusively for the Group, being provided with a stipend, office and other facilities by the Company;
- the preparation of papers and delivery to the group of presentations and explanations about the operation of the company in general;
- the preparation of papers and delivery to the group of presentations and explanations about the PR14 process, including the customer engagement programme;

- providing responses to questions and challenges from the Group on any matters within the scope of the CCG and on occasion responding on matters outside the remit of the group, for information on and a deeper understanding of the Company and the Business Planning process;
- in order to deliver the vast range of papers and aid debate, the Company has been open and transparent in its dealings with the CCG throughout the process, sharing information in its very early stages, to allow the Group to input, challenge and really make a difference.

In order that the CCG could fulfil its role, Thames Water has supplied an immense range of data including specific answer to over 385 questions. These have been recorded by the Company in a Library of Questions and Challenges which can be referenced via Annex 2 to this report.

### **1.3 How the CCG undertook its work**

The first main CCG meeting took place over 28 and 29 February 2012 and the main Group has met monthly since. From May 2012, three sub-groups were established (Environment, Customer Engagement and Finance) to allow some members of the CCG to develop a deeper understanding and challenge in particular matters. The sub-groups provided regular written and oral reports of their proceedings to the monthly main CCG meetings. It was explicitly noted by the CCG that the Environment and Finance sub-groups would enter areas that Ofwat had suggested were outside the main scope of the CCG. The CCG itself and all the sub-groups were charged to explore issues that would significantly influence the Business Plan on which Thames Water's customers were to be consulted.

It was essential that the CCG understood the issues well enough to ensure that the customer engagement was full and fair and based on best possible information. The sub-groups all called upon the Company to present data, to engage closely in dialogue and to enter significantly into commercially confidential areas. The CCG is especially appreciative of the way in which the Company responded to these inquiries and investigations.

Over 22 months of intensive work the CCG built its central programme so as to be able to respond quickly and in a well-informed manner to the 'milestones' that were crucial to the Company's own working schedules, and took into account the dramatically shortened timescale due to the submission date for both the Company Business Plan and CCG Report having been brought forward by Ofwat. This made the final stages of acceptability testing very close to the date for submission of this Report.

The Terms of Reference, Minutes, Matters Arising and papers from all meetings of the CCG and its sub-groups are available via a dedicated website: details of how to access this database are set out in Annex 2 to this report.

## 2 Customer engagement

### 2.1 How well has Thames Water engaged with its customers?

Thames Water has conducted a programme of direct customer engagement specifically focussed on the Business Planning Process for 2015-20, and with a view to the longer term concerns and interests expressed by customers. The CCG has advised the Company on how to optimise its customer research, and has challenged how the company has responded to this evidence in its Business Plan. The Company was fully cooperative in enabling the Group to input at the design stage of research specifications and to attend research events.

At the initiation of the CCG's work, Thames Water presented its Customer Engagement Strategy, which was reviewed carefully by the full CCG and analysed in detail by the Customer Engagement sub-group. The Company was open throughout to suggestions and challenges resulting in a number of changes being made to the Customer Engagement Strategy during the formulation of the Business Plan.

In summary, the CCG is satisfied that Thames Water has conducted an effective consultation of its customers in preparing the 2014 Business Plan. The Company showed great willingness to adapt its already developed research strategy to meet the requirements of the CCG. In particular, the CCG was able strongly to influence the segmentation of customers for research and to ensure that hard-to-reach groups were properly included. The CCG has applied its full rigour to ensuring that the research outcomes reported within the Business Plan are the outcome of the research as discussed with the CCG and that the Company did not include any predetermined expectations.

### 2.2 CCG challenges to Thames Water's engagement programme

The customer engagement undertaken by the Company shows that the views and attitudes of customers are heterogeneous and sometimes divergent. They want to 'flush and forget' (Waste Water Plan) and 'most customers rarely have contact with us and mostly want to have little direct engagement' (Wholesale Water Plan), but they also express a desire to be educated and informed e.g. on water efficiency. The Retail Plan seeks to improve ease of communication on billing and operational problems which was a significant requirement of many customers. The provision of a water efficiency strategy is simply an output. At a late stage in the preparation of the Retail Plan, Thames Water has responded to specific communication issues raised in research on seldom heard customer groups, including a programme of home visits.

#### 2.2.1 Research methodologies: quotas and sample sizes

Throughout the customer engagement process, the CCG has repeatedly pressed Thames Water to ensure it engages with its customers across all geographical areas of its region.

On the question of uniform pricing, it is unclear to the CCG from the research conducted by the Company whether customers accept the principle that those outside London should pay for the Thames Tideway Tunnel (TTT) or that those in London should pay for work in another part of the region. Some deliberative research and focus groups results suggest that customers do accept this. But Thames Water confirmed that no specific research had been carried out on whether customers across all areas of the region were prepared to pay for the TTT, and an information flyer from the Company sent to all customers outside London explaining TTT charges did not provoke a response to add to the evidence on customers' views. Thames Water said in respect of targeted investment in geographical areas that customers were willing to share costs across the supply region.

In response to a request from the CCG, Thames Water held roadshows on its Business Plan for Consultation (BP4C) at additional venues to cover a better geographic spread of customers. The Company also revised its list of 1250 stakeholders, which had lacked representation of certain interest groups and duplicated others.



Following challenge from the CCG on how Thames Water would communicate with waste-only customers on the BP4C, the Company agreed to add a section to the web consultation for these customers.

Quotas, weighting and sample sizes were challenged by the CCG (e.g. changes in sample size due to the 2011 Census results, and whether quotas for social groups D and E would be met in Willingness to Pay refreshed surveys, these groups having been under-represented in earlier research). Thames Water amended its research plans accordingly.

The CCG also queried ethnicity and business quotas in Final Acceptability Testing. Thames Water reviewed and amended these quotas to reflect the most up-to-date information available.

CCG challenged Thames Water's proposal not to include businesses in Final Acceptability Testing. The Company agreed to include businesses.

The CCG had concerns during the customer consultation that the Company may not be giving adequate attention to the views of sewerage-only customers. The CCG is now satisfied that the views of these customers are appropriately taken into account in the Business Plan.

### **2.2.2 Transparency**

In addition to the transparency and openness between the Company and the CCG, Thames Water made positive efforts to emphasise to all consultees and stakeholders that it was genuinely seeking information and opinion. CCG members have attended various consultation events to observe the Company's practice of consultation. Media coverage has highlighted that Thames Water is a monopoly business that is largely foreign-owned and recently Thames Water's tax affairs have had considerable publicity. Customers are interested to know where their money goes, including returns to shareholders and debt financiers. Customer Q&As at the Company's deliberative research event in September 2012 reflected this. Transparency is vital to promote trust by customers in Thames Water. This matter was ruled by Ofwat to be outside the remit of CCGs, but that could not deny the fact that customers were aware of it and welcomed any opportunity to refer to it.

### **2.2.3 Effectiveness of customer engagement programme**

The CCG recognises that Thames Water undertook an extensive customer engagement programme and was cooperative with the Group on design of research specifications and allowing CCG participation in research events. The CCG focussed on the clarity of the information supplied to customers, the geographical spread of roadshows, and input being sought from as many types of customer as possible in the research activities. The Seldom Heard Customer research study was one example of good quality research that Thames Water conducted in response to challenges from the Customer Engagement sub-group. Another was in respect of the Universal Customer Segmentation research and the related study on Customers Born outside the UK.

As a result, the Company reflected in its draft Business Plan Consultation methodology the importance of connecting with hard-to-reach groups identified by the CCG, as well as building up the knowledge of its customer panels in order that the feedback could be meaningful. Extra roadshows to cover additional parts of the region and types of geographical areas were added to the programme for the Consultation. The Consultation documents themselves were revised following input from the CCG to make them more customer-friendly and understandable.

The CCG was disappointed that in presenting its Draft Business Plan for Consultation, the Company declined to include any data on shareholder dividends and directors' salaries, which had been raised by customers in deliberative sessions.

The CCG also regrets that the Company did not incorporate the estimated costs of the TTT in the predicted annual sewerage bills for the AMP6 period, preferring to show the potential cost of the tunnel as a separate element, hovering over the bar chart displaying predicted annual bills.

## 3 Reflecting customers' views in business plans

### 3.1 Introduction

This chapter discusses how well Thames Water has reflected the views it has received from its customers in constructing its Business Plan. We first discuss how well the Company has focused its plans on defined Outcomes (section 3.2 below), as required to do by Ofwat. We then consider Thames Water's responsiveness to customer views under the five key themes, epitomising the messages from customers, which were identified by analysis for the Company conducted by the Office for Public Management (OPM). These five themes are:

- 3.3 What customers want when they contact Thames Water
- 3.4 Customer satisfaction with clean and waste water services
- 3.5 Affordable services
- 3.6 Protecting the environment
- 3.7 Raising awareness and engaging with customers

The CCG has sought to represent the consumer throughout its consideration of the Company's Business Plan and as a result has, on occasion, chosen to consider issues on which customers have not been explicitly consulted. These include the relationship of shareholders through the holding company to the regulated Company, dividend policy and corporation tax. Thames Water co-operated fully in these inquiries, which enabled the CCG (especially its Finance sub-group) to reach a broad understanding of these issues.

### 3.2 Outcomes: a better focus for business plans?

Ofwat requires each regulated company to demonstrate that its Plan will deliver a set of Outcomes that in turn are structured to reflect customers' expectations and expressed opinions. Guidance from Ofwat has been provided to water companies as its thinking has developed over the past two years on the process for developing Plans focused on Outcomes, as opposed to Outputs. This guidance was delayed, arriving late in the business planning process.

The Outcomes identified by Thames Water are:

1. We will provide a safe and reliable water service that complies with all necessary standards and is available when our customers require it.
2. We will provide a safe and reliable waste water service that complies with all necessary standards and is available when our customers require it.
3. We will demonstrate to our customers and stakeholders that they can trust us, that we are easy to do business with and that we care.
4. We will provide the level of service our customers require, in the most economic and efficient manner, to ensure their bills are no more than necessary.
5. We will limit our impact on the environment, to achieve a socially responsible, sustainable business for future generations, including reducing levels of leakage.
6. We will provide our customers with a choice of easy-to-use contact options

The CCG has been involved throughout the development of Thames Water's proposed Outcomes and the underpinning structure, with the aim of ensuring that associated targets, measures and incentives were justified by the results of customer consultation. The Company presented a first draft of potential Outcomes to the CCG in July 2012. These comprised nine high-level Outcomes which were accompanied only by minimal detail. In October 2012, Thames Water described its approach to developing Outcomes which would be underpinned by UK Water Industry Research's 'suggested measures of success'. Further meetings between the Chair of the CCG and the Chair of the Finance sub-group with Thames Water explored the progress within the Company on how Outcomes would be structured from the high level as previously presented, to having a supporting structure underneath, related to the Business Plan and the Company's Strategy, and taking account of the expressed views of customers.

Thames Water has made progress in developing a coherent Plan which is focused, from high level statements to detailed measures, on delivering Outcomes. The CCG would highlight the following issues where some concerns remain:

- **Reputational versus financial incentives:** The Company used the combined research interpretation and consultation feedback (independent report by OPM) to develop their final outcomes. They then used Willingness to Pay research to value the incentive rates, i.e. a £ value per property for internal sewer flooding, removed from odour etc. If there had been more time available the CCG would have suggested further research. The CCG is concerned that there is insufficient evidence that customers support the final framework of financial rewards and penalties as their views have not been specifically sought in relation to service out-performance and the use of rewards and penalties. The Company has committed to further working with the CCG to develop research in this area and will conduct this after the submission of their business plan.
- **Environment:** The CCG, through the Environment sub-group, challenged Thames Water on the use of the word 'limit' in Outcome 5 ('We will limit our impact on the environment'), suggesting that 'minimise' or 'enhance' would better have reflected customers' opinions.

### 3.3 What customers want when they contact Thames Water

#### 3.3.1 Understanding customer preferences by different groups

The CCG agreed that socio-demographic profiling of the Company's domestic and business customers was fundamentally important in the engagement process to give a proper picture of the full range of customers' views, and was crucial in terms of looking at affordability and willingness to pay.

Thames Water had previously organised its engagement with customers according to a traditional segmentation approach (i.e. geography – in or out of London, and industry type by standard industry classification code). The CCG challenged this overall approach and the categorisation of social type. As a result the Company adopted a different approach in PR14, to understand better the make-up and motivations of its customers. Thames Water defined four customer groups, which it used to ensure that samples for quantitative research were representative, not just of demographic information, but also of the variety of customers' opinions and attitudes, and to recruit customers to qualitative research events such as focus groups to ensure the varying views of different segments were captured in its research. In future, this approach to customer segmentation will be used in the design of end-to-end customer journeys, for example when customers call to report a leak or pay their bill. This research will allow Thames Water to make improvements to the way it delivers its service across the entire range of interactions that customers have with the business.

At the CCG's request, the Company undertook a further analysis regarding segmentation of customers born outside the UK. The results showed a close correlation in most areas to the main results of customer segmentation. The CCG and Company considered this had nevertheless been a useful exercise to confirm what had previously been assumed.

#### 3.3.2 Consulting effectively with hard to reach and seldom heard groups

Early on in its work the Customer Engagement sub-group impressed upon Thames Water the need for it to ensure that it consulted properly those customers whose views might be difficult to obtain in view of their age, infirmity or disability, which may make usual means of communication difficult. Although in its Willingness to Pay and acceptability testing research, the Company asks whether the respondent considers himself/herself as having a disability, the CCG felt that this may not be enough to ensure such people's views are properly understood and factored into the Company's planning. Thames Water responded by commissioning a specific research project in early 2013 which, in the CCG's view, was professional, well planned and well executed. The researchers worked with members of the Customer Engagement sub-group, charities and carers in planning and conducting 43 face-to-face and 19 telephone interviews with customers with a range of physical, hearing and physical impairments, with a mental health condition, older customers and customers with a learning difficulty. An important finding was that, in terms of attitudes towards water and water usage, these customers are, in general, no different to the wider population. Few expressed significant concerns about water use in connection with their condition or disability, and the majority thought Thames

Water provides a reliable service. However the research also revealed some important findings, especially around how the Company communicates with such customers, which it should bear in mind in its dealings with such customers. There is no specific spend in the Business Plan associated with such communications.

## **3.4 Customer satisfaction with clean and waste water services**

### **3.4.1 Leakage**

Customers' concern about leakage has been noted by the Group from very early days. Although the leakage target has been improved by the Company, based on customer feedback from both the draft Water Resources Management Plan (WRMP) and Business Plan Consultations, the CCG notes that many customers would wish the Company (rather than its customers) pay for this enhancement of its assets. Thames Water did not undertake customer research dedicated specifically to the cost beneficial options for reducing leakage, though the topic was addressed as part of the deliberative research in September 2012, and arose in focus groups.

Following CCG concern and consultation feedback, the Company undertook further work to test Outcomes against customer findings, and the reduction of leakage was added as a separate Outcome by Thames Water in September 2013.

### **3.4.2 Sustainable drainage**

Thames Water's strategy on sustainable drainage, as stated in the Wholesale Plan, is 'to consider sustainable drainage wherever possible'. Currently the provision is for the Counters Creek pilot of 3 streets in AMP5 plus £18m for 20 hectares in 2020.

### **3.4.3 Population growth**

The CCG has noted the effort being undertaken by the Company to produce a credible figure for the 2020 population of London, a capital city with a dynamic population size and composition that is a magnet for national and international immigration. Predicted population figures being used by the Greater London Authority were at first significantly higher than those being used by Thames Water and there was concern over this discrepancy and how it might develop over the coming period. Thames Water has updated the sensitivity analysis undertaken for the revised draft WRMP and this has resulted in a closer correlation with predicted figures from the GLA.

### **3.4.3 Sewage treatment odour**

Customer opinion is polarised on the removal of odour from the vicinity of sewerage works, with those approving of such works only willing to support them if they result in the complete removal of any vestige of the nuisance. The Business Plan has included a modest incentive component to encourage out-performance by Thames Water in this area.

### **3.4.4 Sewer flooding**

The CCG noted that the GLA are currently working with Thames Water to understand better the life expectancy of the sewerage infrastructure in line with predicted population increases and foreshadowed climatic change as failure in any part of the system could result in serious harm to customers and their property. Customers regard sewerage flooding onto premises as unacceptable.

### **3.4.5 Drinking water hardness**

Early research by Thames Water for the Price Review 2014 indicated that hardness of water is regarded by an increasing proportion of customers as a significant inconvenience. However, when confronted with information on the potential solutions, customers were unwilling to pay for water softening. AMP6 includes £0.4m incremental opex for a study to understand better customer preferences in relation to hardness in drinking water, which would help inform future activities in advising and educating customers about water quality, and also provide evidence for future investment to reduce water hardness.

### **3.4.6 Innovation**

The CCG initially felt that there was little evidence of any culture of innovation within the Company. In response to pressure from the CCG, Thames Water has agreed that all prospective innovations will be

presented together in a single chapter of the Business Plan. The Group received the Company's supporting evidence document SE 05 Innovation in November 2013, and noted the recent top-down audit gave a green status against the Ofwat principle of 'The plan is innovative and stretching compared with past practices and performances', with the test being 'Innovation has been widely used in building the plan, the benefits compared with historic practice and demonstrated and incorporated into service and efficiency targets'.

#### **3.4.7 Risk and reward between Company and Customer**

The CCG, through its Finance sub-group, has provided a significant level of challenge to Thames Water on the Company's understanding and articulation of the balance of risk in the Business Plan for AMP6, in particular with regards to the sharing of risk with customers. Over and above the requirements laid out in the Ofwat guidance, the CCG critically reviewed a number of presentations and, as a result, Thames Water has credited the Group with helping to develop its approach, through ensuring that there has been adequate focus on the key issues in the Business Plan from a customer perspective.

In September 2013, the CCG Finance sub-group confirmed to Thames Water that it was content that the processes it was expecting of the Company on risk and reward were being carried out satisfactorily, particularly by the commissioning of additional commentary and analysis from consultants Oxera.

### **3.5 Affordable services**

#### **3.5.1 Social tariff**

The Social Tariff concept was communicated to customers as part of an initiative to identify a means by which those who struggled to pay their bills might be assisted. Thames Water's approach offered options for different levels of support and demonstrated well how this would impact on the overall bill for a typical consumer. Overall, customers expressed a willingness to pay a modest sum within their annual bills to assist those other customers who genuinely had difficulty in paying their bills.

The Customer Engagement sub-group was involved in the social tariff research and discussed whether the burden of social debt associated with bills should be made known to customers. The Group also specified that, in its Business Plan for Consultation Document, the Company should show the estimated cost of the social tariff as part of the Thames Water's Customer Service costs (£20 in the illustrative £370 bill shown in the document) separately from the bill impact of bad debt (shown as £11 in the document).

In October 2013, the CCG questioned how waste-only customers would benefit from the social tariff where the water-only company that supplied them had a different basis for determining its social tariff. Thames Water confirmed it was working with the relevant water-only companies and Ofwat to clarify this. Similar considerations affected the assessment of willingness to pay for the TTT by customers of water-only companies.

#### **3.5.2 Willingness to pay and affordability**

Willingness to pay and affordability were constant themes in discussion between the CCG and Thames Water in determining how to consult customers on these issues. The CCG encouraged the Company to explore the increasing pressure on customers to manage their household budgets, particularly in the current economic climate, through substantial research into household finances, the economic downturn and what effect a bill increase would have on affordability. The feedback on these questions is a central feature of the customer response to Thames Water's business and pricing proposals, which in turn, has notably affected the Company's final decision-making on the balance between investment, service and bill impact.

#### **3.5.3 Bad debt**

Thames Water explained to the CCG the increasing problem it faced in managing customer bad debt. Customer research showed significant unwillingness by the majority of customers who do pay their bills to subsidise those who chose not to. Thames Water provided a full explanation of its debt management system along with information on the increasing problem of collecting from a transient

population. It was noted that even a small increase in bills, without the cost of the TTT, could put some customers into bad debt. The CCG continued to express its concern that such high and increasing bad debt levels were a burden on those customers who pay their bills and should be avoided wherever possible, with shareholders bearing at least part of the cost. The CCG encouraged the Company to look at the geographical trends of bad debt and the Company presented back on this topic to the Group.

#### **3.5.4 Thames Tideway Tunnel**

The Thames Tideway Tunnel (TTT) represents the single largest contribution to the projected increase in Thames Water's bills during AMP6, yet it has been treated throughout the business planning process as a special project, beyond the scope of the CCG. Whilst the CCG and Thames Water disagreed on how the bill impact of the Thames Tideway Tunnel should be recorded in the statistical data in the Business Plan for Consultation, the CCG recognised the Company's dilemma in adhering strictly to the broad bill impact figure accepted as accurate by Ofwat and DEFRA. Even though consideration of the TTT scheme was outside of the Group's remit, the potential impact it will have on the bills of Thames Water's waste water customers had to be taken into account when considering the Company's customer engagement proposals, Willingness to Pay and acceptability testing. A key consideration cum requirement for the Group was to ensure that Thames Water's customers, particularly their waste water customers, understood the significance of this project in relation to future bill levels. The Group in fact encouraged and pressed the Company to liaise with the water-only companies that operate in its area to ensure that their research also took account of this future uplift in sewerage bills. Some five million more people, who are not directly billed by Thames Water, will pay also for this project through their wastewater charges. This could finally add up to £40 to the bill, per connection per year during AMP6. The full impact of bill increases will not be felt until completion in 2023.

Final acceptability testing presented customers with bill projections that included the latest estimate for the cost of the TTT and gave a 70% acceptability figure.

The CCG notes that, given that the costs of the TTT have to be borne increasingly over the coming decade, it would be impossible to maintain customer bills at current levels in real terms through AMP6 and 7. This is especially true as customers have made it very clear that they do not wish to be confronted by any deterioration in services generally, which could arise from any reductions in expenditure by the Company on essential maintenance.

#### **3.5.5 Service to customers**

Customer satisfaction with the service provided by Thames Water appears varied. Customers emphasised their wish for speedy attention to problems of sewer flooding and blockages, as well as prompt attention to reported leaks, including flexible appointments to suit customers. Customers report frustration and irritation at having to make repeated contacts with the Company to resolve a single issue: they want issues to be resolved first time.

The CCG tested the resolve of Thames Water to improve its service levels through the Business Plan. Customer complaints handling, meeting customer expectations regarding leakage and odour, sewer flooding and water quality were all areas where customers sought maintained and improved services. The CCG challenged the Company to ensure that the Business Plan responded to customers' priorities in these areas and that it delivered a measurable improvement by way of the Statement of Commitments.

#### **3.5.6 Interim adjustment to price limits (IDoK) – implications**

For several months while the CCG was working there was considerable media coverage of the application by Thames Water for an interim adjustment to price limits (so called IDoK) that would raise prices by about 10% for the year 2014-15. If granted, this would set the baseline from which prices would be set in the first and subsequent years of AMP6, with the effect that the probable pattern of prices in the period under review would be for an early downward movement, followed by net price increases (including inflation) in the middle and later years of AMP6. While that IDoK application related to prices in the last year of AMP5, and was thus outside the remit of the CCG, it



would affect the pattern of prices in the period of concern to the CCG. Customers showed themselves to be well aware of this issue, and the CCG had to form an understanding of the implications for AMP6 if the whole or a part of the price increase was granted.

Ofwat's decision not to allow Thames Water's application for an interim increase in 2014-15 prices was announced on 8 November 2013, very late in the process of the Business Plan being drafted in final form. It will not be known until after the Plan has been submitted in early December 2013 whether Thames Water will appeal against the decision.

The Finance sub-group received presentations from Thames Water on this matter in October 2012 and April 2013 and the main CCG in July 2013. We also discussed whether the combined impact of the IDoK, if granted, and the TTT project would be itemised on customers' bills. The CCG expressed concern at the implications of these significant potential increases in customers' bills, reflecting considerable customer concerns on the issues.

### **3.5.7 Company finance**

The changing ratio between debt and equity in company capital structures and corporation tax issues in the water industry have, as a result of much media attention, become widely known to customers and are likely to be matters of concern to them. The CCG considered that it was relevant for it to address these active concerns of customers in respect of their bills during AMP6, even though they lie outside the original scope of the CCG. Some customers may have expected the Company to show sensitivity to these concerns in the business planning process, and the CCG has necessarily taken an interest in these aspects of the process. The Finance sub-group has been assisted by the Company in gaining significant understanding of these matters

#### **3.5.7.1 Customer pain versus investor gain**

Recent political and regulatory pressure on utility providers has attracted media and public attention in the context of political debate on the cost of living. This has inevitably sharpened customers' interests in the question of bill increases versus investor gain. Whilst the CCG acknowledges the importance of investment in the water and sewerage infrastructure, it wanted the balance of risk and reward to be addressed explicitly to ensure that the customer interest was properly incorporated when designing the Plan and setting pricing proposals. The Business Plan shows clear recognition of customers' views on this matter.

#### **3.5.7.2 Thames Water governance**

Whilst the CCG notes that governance of Thames Water is not within its remit, there has been much publicity of the Company and its governance which has provided media background to the work of the Group. Throughout the preparation of the Business Plan, the Group has looked at the complex governance, structures and ownership arrangements which may lack transparency to customers and as a result give rise to customers' concerns about the stability of Thames Water's operations.

Thames Water has been very open in sharing such information even though the CCG has not been charged with examining this part of the business. The CCG considers that the Company appreciates the need to be more transparent and open with its customers on issues before they hit the media.

The CCG has no evidence to suggest the current structure will have any significant effect on the delivery of water and sewerage services within the Business Plan.

#### **3.5.7.3 Gearing and tax**

The CCG notes that several water companies, including Thames Water, are highly geared with increasing amounts of debt on their balance sheets. The Company currently operates within the parameters for gearing that are permitted by Ofwat. Customers have shown a moderate level of awareness of these issues, and in some responses they have indicated that the maintenance and enhancement of the Company's assets should be met from shareholder funds rather than from customer bills. Thames Water has gone far beyond what is set out in the Ofwat guidance for CCGs to enable the Group to understand the position on capital structure taken by the Board and the shareholders in the holding company.

## 3.6 Protecting the environment

### 3.6.1 Water Resources Management Programme

Thames Water must be congratulated for delivering its draft WRMP alongside its draft Business Plan for Consultation in summer 2013, the first time this has been possible under revised statutory timetables. This was an important step in aligning long-term planning of water resources (under the aegis of the Environment Agency) with business planning (under the aegis of Ofwat), so that the public, including customers, can see more easily how the plans sit alongside each other.

### 3.6.2 Water efficiency

The CCG requested greater clarity and detail from Thames Water on its proposals for improving water efficiency, to be expressed with targets, measures and associated costs in each area: the Group was concerned that for the programme to deliver benefits to customers there should be a more robust expression of actions in the Business Plan. The Company addressed this area of concern following the main CCG meeting on 24 October 2013 and the outcome is within the data considered acceptable in the final customer consultation.

### 3.6.3 Responding to National Environment Programme 5

There remain uncertainties around the implications for Thames Water's Business Plan of NEP5 due to the as yet unconfirmed requirements of the Water Framework Directive. However, Thames Water has used the information provided by the Environment Agency to make an allowance for funding these uncertain obligations once they have been confirmed. The Company has shared with us their expectations and it has been noted there may be a variation from current expectations which the Company must implement (starting in the PR14 period). The CCG Environment sub-group reviewed work by the Company on the Water Resources Management Plan (WRMP) as it evolved. The Group also developed a broad appreciation of the work of the organisation Water Resources in South East England and the potential impact of EU Directives on water resources availability and treatment both in the PR14 period and beyond. The WRMP forms the supply and demand section of the Business Plan.

### 3.6.4 Water reuse versus developing new resources

Many customers are at first surprised to learn that water companies bear significant responsibility for environmental protection. Once the facts are appreciated, customers want their water and sewerage suppliers to conserve water; to reduce the impact of their operations on the environment, particularly on local rivers; to adopt energy-conserving technologies; and to be more active in educating consumers on the preservation of water supplies and the wider environment. There was a clear customer preference that water that has already been captured into supply should fully be used. Re-use of waste water is preferred to massive capital expenditure on new resources such as reservoirs.

#### 3.6.4.1 Leakage

Customers favour much more robust treatment of leakage, which they consider to be the most important and obvious means of conserving water resources. The strength of opinion reflected the very high profile coverage of leakage in the media, particularly in London. Many road closures over recent years, justified as being part of the 'replacement of our Victorian supply system', have enhanced customer awareness of this issue.

#### 3.6.4.2 Metering

A majority of customers accept that metering is a fair way of charging for the use of water, and that metering might have the impact of reducing some customers' excessive use of the increasingly scarce resource. For most customers this ranks second to the reduction of leakage among measures to conserve water.

The Company has been hesitant to specify whether it will in due course adopt rising-block or seasonal tariffs, and the CCG is concerned that these matters have not been considered integrally as the metering strategy has been devised.



### **3.6.4.3 Drought restrictions**

Customers showed awareness of the debate about climate change. Regardless of where they stood in the debate, they recognised that periodic droughts do occur. They considered that Thames Water's Water Resources Management Plan should provide for such periods, and held a strong opinion that severe water supply restrictions should never be necessary. There was a range of opinions whether hosepipe bans and other partial restrictions may be acceptable but only with a very low expectation of occurrence.

## **3.7 Raising awareness and engaging with customers**

### **3.7.1 Consultation documents**

The CCG has spent considerable amounts of time and effort working with Thames Water to improve the relevance, accessibility and usefulness of the Company's customer consultation documents, with the aim of helping influence the resulting Business Plan to reflect better the views of customers. This section summarises the CCG's main inputs into various Thames Water consultation papers. The CCG commends the Company for taking on board the majority of the Group's extensive input.

#### **3.7.1.1 Strategic Direction Statement - Making the most of the essential service**

The CCG made a major input to Thames Water on the drafting of this document. It also urged the Company to capture the views of as many different types of customers across the whole region in the main consultation.

#### **3.7.1.2 Draft Long Term Strategy and Business Plan for Consultation**

The CCG and Consumer Engagement sub-group provided early input in 2013 to the drafting of these documents. Members requested from Thames Water more information in the documents on: the themes of community, education and good neighbour; the cost for TTT; energy and climate change measures described as part of protecting the environment; how to approach disability groups for customer responses; linking to other consumer-focussed websites to disseminate information on the consultation; and figures on customer bills to be placed prominently at the start rather than the end of documents. In the main, the Company were receptive to, and took on board, the suggestions of the Group.

In spring and early summer 2013, the CCG had extensive dialogue and debate with Thames Water about the inclusion of information which the CCG considered to be an important frame for customers when responding to the Company's Business Plan. In particular, the CCG pressed for greater prominence for customer bill impacts, for the costs of the TTT to be shown more clearly, for the Company's financing costs to be set out, and for information to be provided on directors' and executives' salaries. In the end, information on shareholder returns and directors' salaries was not included in the draft Business Plan for Consultation on decision of the Company Board, as publication of the Company Annual Accounts coincided with publication of the draft Business Plan for Consultation. The CCG was disappointed that the Company had chosen not to reveal this information, despite the views of the CCG, and was concerned that in doing so the Company would not help build trust with customers. The CCG failed to see why the Company felt unable to provide this information to customers as part of its Business Plan consultation, when other water companies provided comparable information to their customers as part of their own consultations.

In mid-summer 2013, the CCG received a summary report prepared for Thames Water on the responses to the Company's Business Plan consultation.

#### **3.7.1.3 Business Plan Consultation Statement of Response**

The CCG considered the Statement of Response that Thames Water had developed in light of the evidence on customers' views received via consultation on the draft Business Plan. The CCG's primary observation to the Company was that the final Business Plan should set out clearly how these proposals had been changed as a result of customer research and the responses to consultation. The Company agreed with this approach and has provided detailed feedback in a variety of ways to the different types of respondent (i.e. domestic customer, stakeholder or business). The CCG considered that costs should be included to highlight the magnitude of the changes to plans. The plans should also make clear where customers' views indicated altruistic support for Thames Water to invest to

resolve problems for particular sub-groups of customers (e.g. those affected by sewage treatment odour).

## 4 Customer acceptability of final bill impacts

### 4.1 Summary

Thames Water has proposed a zero increase in the combined water and sewerage bill for the 2015-20 period before inflation and the cost of the Thames Tideway Tunnel (TTT) are accommodated, with a decrease in water bills and an increase in sewerage bills (including for the larger number of waste water-only customers). Final Acceptability Testing has shown this level of charging is acceptable to customers. The Company has taken account of the facts that customers are satisfied that the Company's water and sewerage services are of good quality and affordable, that they do not wish to see any deterioration of service, but that they are keen not to pay more than is absolutely necessary for water and sewerage supplies. The need for the TTT, despite the addition of a significant sum (up to £40 by 2020) to the typical bill, is accepted by more than 70% of customers throughout the Thames Water waste water service area.

### 4.1 Final Acceptability Testing on bill impacts

The Company has undertaken extensive testing of customer acceptability of final bill impacts. The Group was involved from an early stage in the process commencing with the pilot testing undertaken by the Company on final acceptability testing. The Company included inflation and added an 'uninformed' question to the data on which both business and waste water-only customers were approached, alongside retail water-and-sewerage customers in the final testing.

The final acceptability testing established that customers felt that 65% was a reasonable acceptability threshold for the proposed business plan and bill increase. The level of acceptability achieved was at least 70%, thus above this threshold. However, the Group note that up to 30% of respondents who found the plan unacceptable were those in the lower socio-economic groups: they indicated that their reasons for taking this view were based primarily on the proposed bill increase, citing the scale of profits, the current high level of bills and affordability of bill increases. This would appear to confirm the CCG and Company view that mitigation measures will be necessary to help customers in financial difficulty and for the Company to have an effective communication strategy to explain and justify the proposed increase in waste water charges. This requirement is further emphasised by the finding that only 24% of respondents supported the Thames Tideway Tunnel project and associated bill increase. 70% either did not agree with the Thames Tideway Tunnel, or agreed with the project, but did not find the associated bill increase acceptable. Overall, waste water-only customers showed lower levels of acceptability than those receiving both services from Thames Water. As the Company's waste water charges (excluding Thames Tideway Tunnel) are set to rise above inflation, this reinforces the need for Thames Water to work with the water-only companies in its region on billing and affordability strategies.

The Company has now proposed a bill impact which is flat in real terms, excluding the cost of the Thames Tideway Tunnel. The CCG notes that, while substantial testing has taken place, waste water-only customers who are served by the South East, Sutton & East Surrey, Essex and Suffolk water companies have not been consulted as part of the acceptability testing on the sewerage bill. The Company only carried out the acceptability testing with waste-only customers served by Affinity Water, stating that the preferences (valuations) of these waste-only customers are not found to differ significantly from those of the combined water and waste water customer base.

## 5 Areas of outstanding challenge to Thames Water

The CCG has the following outstanding concerns with Thames Water's consultation with and responsiveness to customers:

- First, whether there is sufficient evidence from customers to support financial rewards and penalties. In the time available the CCG has not had the chance to examine closely the Company's proposals and challenge the basis on which the targets have been set and incentives applied. The Company has used its Willingness to Pay research to support its outcomes selection; however, this research was not intended for that purpose. Customers' views have not been sought in relation to service outperformance and the use of rewards and penalties. The CCG would therefore question the evidence of customer support for the financial incentives proposed. Where measurement of performance is against Thames Water's own internal customer satisfaction scores - with reputational risk attached – the CCG questions how performance would be measured and published. If results are not widely publicised externally, the CCG questions how such performance measurement could provide a credible and enduring reputational incentive to deliver better customer service.
- Second, in testing the acceptability of final bill impacts, Thames Water only sought the views of those of its wastewater customers who receive their water supply from Affinity Water and not from the other water only companies.

## 6 Note to Ofwat

### 6.1 Serving London and the United Kingdom

The CCG wishes to record its view that Thames Water needs to play its part in sustaining the economic growth which is located in London, the south-east and the Thames Valley. This Region makes a major contribution to the economic well-being of the country as a whole. While economic development throughout the country is clearly politically and socially important, the central importance of London as a global city with unique economic assets should not be overlooked. London (and the very wide commuter zone surrounding it) is the main focus for migration both of UK citizens and of settlers from other parts of the world. Many of the people who come to work in this Region live in the supply zones of Thames Water and neighbouring water companies, and waste water-only customers of Thames Water number far more than the water customers. Other sub-regions of the Thames Water's water and sewerage territory in the M4 corridor are also of economic and social importance to the UK economy and society. Thames Water's customers show a high level awareness of these issues. The CCG notes the following statistic<sup>3</sup>: 'A recent independent economic assessment showed that imposing emergency restrictions on water use by businesses would cost London's economy around £290 million per day.' Should there be other issues arising for Thames Water, such as major infrastructure failure or flooding, there could be similar consequential costs to London's economy. These should be considered and mitigated as far as possible within the Company's Business Plan.

The CCG encourages Ofwat to work constructively with Thames Water to enable and encourage the Company to develop and implement investment and operational plans which serve the development of London and thereby helping to support the wider UK economy.

### 6.2 Bad debt

The CCG is seriously concerned at the probable increase in bad debt owed to the water and sewerage companies during AMP6, especially in greater London. Thames Water is well aware of the issue and has planned improvements for bad debt management in both AMP5 and AMP6. The factors that will influence bad debt (which is already significant) are the impact of metering on low-income households, the additional cost of the Thames Tideway Tunnel, a potential increase in inflation if the economic recovery continues, and the high degree of mobility among the London population. The CCG is concerned that both the Company's plans for dealing with the issue, and the parameters within which Ofwat expects the Company to address it, will be insufficient to meet the situation that is likely occur. The CCG notes a high degree of unwillingness by customers to pay, within their own bills, for the water supplied to customers who evade payment. There is though a limited willingness to contribute to a social tariff to assist customers who have genuine difficulty in trying to meet bills but who do make an attempt to meet their obligations.

---

<sup>3</sup> From Introduction to part A of the draft Water Resources Management Plan, citing 'A Non-Essential Use Drought Order for London: Economic Impact Assessment' (NERA, commissioned by Thames Water, April 2012).

## Annexes

### 1 CCG arrangements

#### 1.1 CCG membership

Thames Water followed Ofwat guidance<sup>4</sup> as a basis for determining the membership of the CCG. The table below provides details of the membership of the Thames Water CCG:

Main CCG Group	Organisation	Member of Sub-group
David Bland	Independent	Chair: Environment / Finance
Anthony Redmond	Independent	Chair: Customer / Finance
Howard Davidson	Environment Agency	Finance
Milo Purcell	Drinking Water Inspectorate	Environment / Finance
Jacky Atkinson	Drinking Water Inspectorate	Environment
Wanda Fojt (from 02.12 – 19.12)	Natural England	Environment
Adam Wallace (from 10.12)	Natural England	Environment
Rachel Crabbe	Natural England	Environment
Helen Charlton	Consumer Council for Water	Customer
Karen Gibbs	Consumer Council for Water	Environment
Harry Hodgson	Federation of Small Businesses	Environment / Finance
Rupert Ashby (from 02.12 – 03.12)	Country Land and Business Association	
Tim Brock (from 01.12 – 01.13)	Country Land and Business Association	
Robin Edwards (from 02.13)	Country Land and Business Association	
Duncan Munro	Fuller, Smith and Turner PLC	
Alex Nickson	Greater London Authority	Environment
Samantha Heath	London Sustainability Exchange	Customer
Carrie Hume	Blueprint for Water Coalition	Environment
Janina Gray	Blueprint for Water Coalition	Environment
Steve Bloomfield	Independent	Customer
Colin Stanbridge	London Chamber of Commerce	Finance
Alice Ellison (from 02.12 – 10.12)	London Councils	
Katharina Winbeck (from 11.12 – 04.13)	London Councils	
Nick Clack (from 11.12 – 10.13)	London Councils	
Nishma Malde (from 05.13)	London Councils	
Sarah Cosby (to 10.13)	Disability Alliance	Customer
Lesley Crisp (from 06.12)	Citizens Advice	Customer
David Richardson (from 06.12)	Age UK	

---

<sup>4</sup> Ofwat, Involving customers in price setting – Ofwat’s customer engagement policy statement, August 2011

## 1.2 CCG governance and structure

Ofwat provided the following guidance on governance of the CCG:

- The chair should be sufficiently independent of the company to be able to ensure it can be challenged effectively, to give proportionate assurance to Ofwat.
- The company will provide secretariat and administrative support and costs, including examples where appropriate.
- Work programme and *modus operandi* (approach) will be agreed with members of the group.
- Agendas and other materials will be provided in a timely and accessible way.
- Minutes will be kept and made publicly available.

The Thames Water CCG conformed to this guidance. The Chair and Vice-Chair were selected on the basis of both their experience and qualifications. It was agreed that the report of the Group – and any interim communication – would be submitted to Ofwat by the Chair on the basis that it had the consent of the Group. No minority report would be recognised, but the report may (at the discretion of the Chair and Vice-Chair) note that some proposition was agreed by a majority. Members agreed early in the process that the Group would not make the minutes of its meetings publicly available since they contained information confidential to the Company. To redact this confidential information and publicise the redacted version was considered not be a sensible option as the remaining text could be unclear to the reader.

## 1.3 CCG terms of reference

The draft Terms of Reference for the main CCG were set in line with Ofwat guidance<sup>5</sup>, and subsequently those of the three Sub-groups which were set up a few months after the inaugural meeting of the main CCG. These draft Terms of Reference were discussed, amended and agreed by the sub-groups and main CCG and have been periodically reviewed.

The Terms of Reference, Minutes, Matters Arising and papers from all meetings of the CCG and its sub-groups are available via a dedicated website, details of which are set out in Annex 2 to this report.

---

<sup>5</sup> Ofwat, Involving customers in price setting – Ofwat’s customer engagement policy statement, August 2011

## 2 CCG work

### 2.1 CCG meetings – access to documentation

The Terms of References, Minutes, Matters Arising and papers from each meeting of the CCG and its sub-groups are stored in a dedicated area of the Thames Water website. This can be accessed as follows:

Web address: [www.thameswater.co.uk/haveyoursay](http://www.thameswater.co.uk/haveyoursay)

Select: Who checks our plans? / Customer Challenge Group

Member log-in: username = customerchallengegroup, password = independent14

CCG member pages: contents

- Main Group, Customer, Finance and Environment sub-groups
- monthly meeting papers, agendas, minutes, terms of reference, and other documentation
- Library of Challenge: record of questions and challenges raised by the CCG and its sub-groups to Thames Water

### 2.2 Access to specific topics

A spreadsheet database “Report Headings Search” has been prepared (sent as a separate attachment to this Report) which identifies each topic addressed by the Group and cross-references to the relevant meetings and associated documentation. The attached document entitled “Data Filter” gives guidance on how to use the spreadsheet.



### **3 Submissions from statutory regulators**

#### **3.1 Environment Agency**

- Letter to Thames Water of 1 November 2013
- Attached report to 1 November letter
- Letter of 21 November of 21 November 2013
- Annex to 21 November letter

#### **3.2 Natural England**

- Letter to CCG Chair of 21 November 2013

#### **3.3 Drinking Water Inspectorate**

- Letter to CCG Chair of 21 November 2013

creating a better place



Martin Baggs  
Thames Water  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

**Date:** 1 November 2013

Dear Martin

**Thames Water Business Plan Evaluation Response**

I would like to thank Thames Water for providing the Environment Agency with material from your draft business plan.

In the attached report, we have used this information to assess the extent to which your business plan will meet your statutory requirements, and the environmental obligations set out in Defra's Statement of Obligations.

When making our assessment, we have reviewed how quickly you are planning to deliver your obligations, together with your overall level of performance. For your river basin management plan obligations in particular, Ministers are looking for assurance of early delivery wherever possible.

My team would be happy to discuss the report with you. We would be pleased to include any clarifications before we contribute to the Customer Challenge Group report and prior to our submission to Defra in mid November.

We look forward to continuing to work with Thames Water to help ensure that your investment protects and improves the water environment, for the benefit of your customers and the economy.

Yours sincerely

A handwritten signature in black ink that reads "Davidson".

**Howard Davidson**  
**Director South East Region**

Cc: Dr Paul Leinster CBE, Chief Executive, Environment Agency  
Ian Barker Head of Land and Water, Environment Agency  
David Bland, Thames Water CCG Chair  
Sonia Brown, Ofwat  
Tim Collins, Natural England  
Milo Purcell, Drinking Water Inspectorate





## Response to Thames Water

### Introduction

The final price review methodology confirms that Ofwat expect the Environment Agency to highlight in the Customer Challenge Group (CCG) report whether your business plan will meet its statutory obligations (section 4.2.1 Setting Price Controls for 2015-2020, Ofwat, July 2013). As part of our engagement with your Customer Challenge Group, we have been working with you to be assured that your business plan is in accordance with these requirements.

The following report summarises our views of the draft plan and evidence provided. These views are based on a high-level review of the processes as described in the letter explaining our expectations sent to you in August 2013.

### Overview

We have been pleased with the level of engagement with the company throughout the business planning process. As a result, we believe that we have a good understanding of Thames Water's plans for 2015-2020.

We have had very good engagement through the development of the National Environment Programme (NEP) and ongoing discussions over the Water Resources Management plan (WRMP). Thames Water has done a particularly good job on working with the information that we have provided to help manage the uncertainty around what actions may arise from the next River Basin Management plan (RBMP).

Engagement on flood risk has been particularly welcomed as this has been an area which needed improvement from the last Price Review in 2009. We have been able to identify opportunities for partnership working which bring multiple benefits to all parties.

However, we do have some outstanding concerns. In particular, relating to permit compliance and pollution incident performance.

We will continue to work with the company to resolve any outstanding issues throughout the remainder of the planning process.

### We welcome:

We are pleased to note that you intend to include all the measures in the third phase of the NEP (subject to fine-tuning) in your business plan and have made provision for managing the outcome of the second cycle RBMPs.. We have been impressed with your use of monte Carlo analysis in developing your approach to managing uncertainty. We consider this to be industry leading.

We welcome your continuing programme to identify and remedy misconnections and associated customer awareness activities, particularly around sewer abuse. We are pleased to note that your key performance measure for the sewer network is reducing the number of pollution incidents.

We are reassured that your WRMP forms the supply demand component of the business plan and there is no material difference between the two plans for the AMP6 period. We are also reassured that the updated WRMP will align with other water company transfers.

We are pleased to note that you have responded to customer and stakeholder views and increased your ambition on leakage reduction.

We are pleased to note that the company have been innovative in a number of areas, including:

- smart meters
- better targeting of leakage
- dealing with algae in reservoirs
- reducing energy use in wastewater treatment
- removing fats and greases
- renewable energy generation

We welcome your statement that you are firmly committed to working in partnership with other stakeholders as part of your role as a Flood Risk Management Authority. We are pleased that the Drainage Strategy Framework underpins your plans for the long-term management of sewers to reduce flooding and pollution. We are pleased that you are now working with our Flood Risk Partnership and Strategic Overview teams to share information and identify opportunities for partnership working.

**We do not support:**

We do not support your target of only 98.88% compliance with numeric permits at sewage treatment works. We would also like to you go further in reducing serious pollution incidents. We expect you to plan for a trend towards zero serious pollution incidents by 2020.

**We need to see:**

We note that you are intending to pilot a number of new approaches to reduce the runoff of metaldehyde and other pesticides to surface waters. Where this is shown to be effective, we would like to see innovative approaches adopted wherever such problems occur.

Through the Drainage Strategy Framework, we note that you plan to study five sewer catchments in detail in AMP6. We would like to see this approach rolled out across the network. We would like to see more detail on how you will be measuring success and the metrics that will be used.

**We have made more specific comment on the following areas:**

These are our observations on your draft Business Plan, CCG papers, and the replies you have made to the questions posed in response to the expectations letter.

**1. Delivery of statutory and environmental requirements**

We welcome your assurance that your company will meet its environmental obligations. We would like to see written confirmation from your board that you will deliver all your environmental obligations. This should include proposals for your transitional investment programme. In order for

us to be able to provide appropriate assurance to Ofwat and Defra it would be helpful to receive your confirmation as soon as possible.

## **2. Measures identified within the National Environment Programme (NEP)**

We are encouraged by your agreement to include all of the measures set out in the NEP within your final business plan. We believe that the programme will allow you to deliver what is best for both the environment and your customers.

### **2.1 Transition investment programme**

For the chemicals investigation programme and the national phosphorus trials we have set delivery deadlines early within the AMP6 period. These timescales enable statutory obligations to be met, as well as planning for PR19 and the delivery of river basin management plan outcomes.. We notice that you are considering the need for transitional spend on these aspects of your business plan and are pleased that your company recognises the importance of early planning to meet these important deadlines. We support the need for transitional spend on these aspects of your business plan and believe that there would be a significant risk of your company not being able to meet its regulatory delivery deadlines without this investment programme.

## **3. Provision for the outcome of second cycle river basin management plans and ambition for Water Framework Directive (WFD) obligations**

We are pleased that you have made provision within your business plan for achieving outcomes from the second cycle river basin management plan. The level of ambition is appropriate and your plans show consideration of how your company will meet Water Framework Directive (WFD) obligations to 2027.

## **4. Evidence of options and proposals for reducing the impact of a company's abstractions from the most seriously affected sites**

We are pleased to see that you are putting forward options and proposals within your business plan to reduce the impact of your abstraction from the most seriously affected sites. We note that you have:

- Included the confirmed and likely sustainability changes set out in NEP phase three in the water resources supply-demand component of its business plan.
- Made an allowance for currently unknown sustainability changes in your business plan.
- Assessed whether planned increases in abstraction may cause deterioration in WFD water body status.
- Considered which abstractions would fall within Ofwat's Abstraction Incentive Mechanism.

## **5. Alignment of the Water Resource Management Plan (WRMP) options and business plans**

Defra expects that the Water Resources Management Plan (WRMP) will form the water resources supply-demand balance component of the business plan. We welcome your assurance that the main water resources supply-demand components of your business plan will be consistent with your WRMP statement of response.

## **6. Fulfilling risk management authority duties**

It is important that your business plan demonstrates how you intend to secure compliance with your risk management authority duties. There is a real opportunity to build on your current work, such as at Counters Creek, and work with us on flood risk management plans, lead local flood authorities and strategic partners to deliver cost effective solutions for customers and the environment through effective cooperation. Water and sewerage companies have statutory duties on flood risk management. You have described what you have been doing now on these new duties and your commitment to continue to do this in the future. We look forward to working with you on these plans.

## **7. Reservoir safety**

We note your intentions to maintain reservoir safety although you have provided limited information on the programme of work. This is an important duty given the potential high impact your reservoirs pose to public safety. Your continued maintenance and capital investment is essential for public safety.

You have not referenced the recent changes in reservoir legislation. Please confirm how you will implement these changes during the next AMP.

Defra set out its expectation in the Statement of Obligations that companies will prepare reservoir plans. We would expect you to continue to develop and maintain on-site plans. You do not refer to incident planning and working with partners to reduce impacts to downstream communities, should an incident occur. We encourage you to co-operate with relevant authorities and partners on the development and maintenance of site plans and on incident planning.

## **8. Mitigation measures adopted to manage future risks**

You have provided some evidence that you plan to take appropriate measures to manage risks from natural hazards and climate change. However, we expected to see more details about your approach, and how you have used relevant guidance from Ofwat and others. It should be clearer as to how the risks revealed by your analysis are addressed in your business plan.

## **9. Environmental outcomes**

We are generally satisfied with the outcomes included in your business plan as they accurately reflect the important role that Thames Water plays in protecting the environment. However, we would prefer you to 'minimise' your impact on the environment, rather than 'limit' your impact on the environment.

### **9.1 Delivery and incentives**

We note the progress you have made in setting outcome delivery incentives to assist in the delivery of environmental outcomes. However, the lack of detail in particular around the units used to measure success means we cannot comment on whether your ambitions are sufficient or your incentives strong. Balancing the results of quantitative research on customer preferences with your own incremental costs is essential to ensure sufficient. Strong incentives should, wherever possible, financially reward or penalise delivery of environmental outcomes in line with customer preferences.

## **10. Pollution incidents and compliance**

We believe that the information provided on operational performance shows a lack of ambition. All water companies should be planning to achieve 100 per cent compliance for all licences and permits, as they are legal obligations. We expect to see this included as a target within your business plan. In addition, we expect your company to plan for a trend towards zero serious (category one and two) pollution incidents by 2020.

## **11. Change mechanism**

At previous price reviews, Ofwat has used the change protocol for managing in-period changes to the risks and costs. This time you are being asked to put forward proposals for dealing with such changes. It is imperative that new statutory requirements, for example schemes arising from the 2<sup>nd</sup> River Basin Management Plan can be delivered whilst maintaining levels of ambition around customer priorities. We would like to see a clear process for dealing with predictable but, nonetheless uncertain new commitment you could face during AMP6.

To be assured that important “discretionary” outcomes are not prejudiced by additional legislative requirements, we believe you do require an explicit change mechanism for dealing with such changes. We acknowledge your assurance that you are developing one.

## **12. Eel Regulations**

We are committed to working with you to ensure that the requirements of the Eel Regulations are fully met and welcome the positive strides you have taken to include eel screening measures in your plans.

We acknowledge that you have sought clarification regarding the costs and benefits associated with the implementation of Eel Regulation measures, particularly on the Lower Thames intakes. Any scheme can be put through an economic appraisal to validate the approach being proposed at any given site. This will always require a very site-specific discussion with you for each scheme. We would always expect that compliance will be achieved as soon as possible. We will continue to work with you to ensure that the requirements are met at all your sites.

## **13. Sewer flooding**

It is good to see that you are making some positive steps to deal with sewer flooding as we believe this is one of the worst service failures your customers can suffer. We welcome the partnership work you are involved in to prevent surface water entering the sewers.

## **Concluding remarks and recommendations**

Overall, we generally support the proposals contained within your business plan and we are reasonably comfortable that you have included appropriate environmental requirements. However, there are some areas where we disagree and our recommendations are as follows:

- The target for compliance with environmental permits should be 100%. This is a statutory requirement.
- We would like to you to go further on reducing serious pollution incidents, trending towards zero by 2020.

- We recommend that a suitable change mechanism is developed to make allowance for changes in requirements during the plan period.
- We also ask that we receive written board assurances regarding the delivery of the National Environment Programme at the earliest opportunity.

We look forward to working closely with you over the next few weeks to finalise your business plan. Our aim is to help you produce a plan that delivers its statutory obligations and facilitates the achievement of better environmental performance.

**Sarah Powell**  
**1 November 2013**



Martin Baggs  
Thames Water  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

**Date:** 21 November 2013

Dear Martin

**Thames Water Business Plan Evaluation Response**

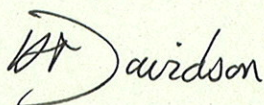
Thank you for your letter dated 15<sup>th</sup> November 2013, providing further information on your Business Plan.

From the information you have provided, we understand that you are planning to meet your statutory environmental requirements set out in Defra's Statement of Obligations. We welcome the commitment you have made to meeting them.

I have attached an annex which includes our comments on your responses, which you can include as an addendum to our original report.

I hope that you find this additional response useful. If you have any further queries please do not hesitate to contact us again.

Yours sincerely



**Howard Davidson**  
**Director, South East**

Cc: Dr Paul Leinster CBE, Chief Executive, Environment Agency  
Ian Barker, Head of Land and Water, Environment Agency  
David Bland, Thames Water CCG Chair  
Sonia Brown, Ofwat  
Tim Collins, Natural England  
Milo Purcell, Drinking Water Inspectorate



## Response to Thames Water

### 20 November 2013- Update following further communication with the company

Following receipt of our evaluation report on 1 November 2013, we have been involved in further discussions with you regarding our recommendations in the report. This note provides an update to our response based on those discussions.

The following table summarises the company's response to Environment Agency recommendations. Based on the further information provided to us, we now also make the following additional observations:

<b>Environment Agency recommendation/statement</b>	<b>Company response (15/11/13)</b>	<b>Environment Agency comment (20/11/13)</b>
Through the Drainage Strategy Framework, we note that you plan to study five sewer catchments in detail in AMP6. We would like to see this approach rolled out across the network. We would like to see more detail on how you will be measuring success and the metrics that will be used.	<p>We have selected five catchments at the highest risk of sewer flooding by considering a number of factors such as headroom (i.e. spare capacity) in the network, the number of historical flooding incidents that we have records of and the extent of properties with basements. Our plan is to follow the same approach that we took to developing a solution to Counters Creek and to apply the principles of the Drainage Strategy Framework. We are proposing sufficient funding in our plan to carry out surveys, modelling and optioneering to complete an assessment of benefits and costs to alleviate flood risk, but not the funding for each project to proceed to delivery (simply because we do not have the information to form robust estimates at this stage).</p> <p>In order for each of these projects to proceed to delivery in AMP6, we will need to agree any changes to our regulatory programme with Ofwat through a change mechanism. More detail on our current proposals for such a mechanism is provided in section 11 of this document. The AMP5 Change Protocol was used for the Counters Creek project and required us</p>	Thank you for the additional information.

	<p>to set out the costs and benefits of the programme to Ofwat as well as demonstrating the work was an urgent customer priority and had the support of the Consumer Council for Water. We found this process to work well with Counters Creek – it has allowed us to deliver some elements of our programme earlier than if we had waited until PR14 had concluded.</p> <p>We expect that some of the scope identified through the five catchment studies will be delivered by Lead Local Flood Authorities and we will support them in making any applications for levy funding.</p> <p>So in summary, success for the five catchment studies will be defined by the identification of cost beneficial programmes of work to alleviate flood risk in each area, with clear delineations of work and funding routes in place for each stakeholder to allow the programmes to proceed to delivery.</p>	
We would like to see written confirmation from your board that you will deliver all your environmental obligations. This should include proposals for your transitional investment programme.	Please see attached in Annex 2 written board assurance regarding the delivery of the National Environment Programme.	Thank you for the assurance letter from your Board.
We note your intentions to maintain reservoir safety although you have provided limited information on the programme of work. This is an important duty given the potential high impact your reservoirs pose to public safety. Your continued maintenance and capital investment is essential for public safety.	We take the management of these assets very seriously. We have a specialist technical team including our own Supervising Panel Engineers who have undertaken a detailed “failure modes analysis” review of all assets as part of a Portfolio Risk Assessment process, endorsed by an All Reservoir Panel Engineer. This has detailed a programme of major work activity predominantly around internal slabbing, crest road enhancements and key valve refurbishment. We take a proactive approach to investment in this area to ensure that there is always good asset availability and this is verified by our detailed inspection programme under the Reservoirs Act.	Thank you for the additional information.
You have not referenced the recent changes in reservoir legislation. Please confirm how you will	Our Reservoir Safety Manager is part of an Institution of Civil Engineers Panel that is reviewing the revisions to the <i>Guide to the Reservoirs Act</i> following recent regulation change. It is expected that the deregulation of	Thank you for the additional information.

implement these changes during the next AMP.	“not high risk” reservoirs will have no impact on the raw water reservoir stock we hold, with all being categorised as high risk reservoirs. The remaining changes to the administration of the Reservoirs Act around reporting requirements, incident reporting and maintenance items do not pose a significant change to our current management processes. The proposed Phase II requirements of the Act where it is proposed to reduce the threshold volume of a qualifying reservoir to 10,000m <sup>3</sup> has been considered. Thames Water has one reservoir that may be designated as high risk in this area. This reservoir is part of our extensive inspection programme and investment is planned to ensure that the reservoir continues to be operated safely.	
Defra set out its expectation in the Statement of Obligations that companies will prepare reservoir plans. We would expect you to continue to develop and maintain on-site plans. You do not refer to incident planning and working with partners to reduce impacts to downstream communities, should an incident occur. We encourage you to co-operate with relevant authorities and partners on the development and maintenance of site plans and on incident planning.	We already have in place On-Site Plans for all our Statutory Reservoirs under the Reservoirs Act detailing our procedures and activities in case of a reservoir incident. These plans are regularly tested as part of a wider business resilience portfolio to ensure they remain fit for purpose, along with ensuring the operational teams are familiar with the processes and assets required to undertake a reservoir drawdown. We have engaged with Local Resilience Forums for those reservoirs designated by the Environment Agency within their top 100 reservoir risks. We have worked specifically with Surrey County Council and Enfield Borough Council to assist in the preparation of their Off-Site Plans. We continue to co-operate with those councils and resilience fora who are preparing these plans and we do not envisage any changes to this practice going forward.	Thank you for the additional information.
You have provided some evidence that you plan to manage risks from natural hazards and climate change. However, we expected to see more details about your approach, and how you have used relevant guidance from Ofwat and others. It should be clearer as to how the risks	Our Business Plan only includes components of our response to natural hazards where we are asking for funding as part of PR14 to increase resilience. Where we are not asking for funding we have assessed potential risk and decided that the risk will be managed as “business as usual”. The two main current natural hazard risks associated with our business are either “too little water” or “too much water”. The former has been addressed by the WRMP process, whilst the latter has been accommodated through the current flooding risk assessment of all our	Thank you for the additional information.

revealed by your analysis are addressed in your business plan.	<p>operational sites. Both assessments have also taken climate change into account. The attached paper to the CCG in Annex 3 outlines in a little more detail what we have done with the specific context of climate change.</p> <p>As described in our 23 September response, in order to understand the wider resilience status of our business we have undertaken a gap analysis assessment using Mott MacDonald who produced the Ofwat report on resilience principles published in 2012.</p> <p>Our plans for PR14 are consistent with the findings of the gap analysis and we use continuous improvement (principle 9 of the Ofwat document) to improve our wider resilience over time. The Ofwat report, the Cabinet Office's guidance "Keeping the Country Running" and the UKWIR resilience guidance have all been consistently applied.</p> <p>For surface water flooding needs, location based solutions have been identified to provide costs for the business plan. However, we are keen to explore alternative approaches and through our innovative approach to delivering the AMP6 programme it is intended that our delivery partners 'eight2o' will look at the potential for catchment based alternatives. In this context we will engage with stakeholders, including the EA, where opportunities present themselves as part of the detailed planning for delivery of AMP6.</p> <p>The approach we have been developing since 2011 is based on identification, delivery and application of new research, together with guidance from Government and our regulators. Our PR14 response is split into water and wastewater treatment processes, water and wastewater networks, flooding resilience, Water Resource Management Plan 14 and Thames Tideway Tunnel. Our approach effectively seeks to reduce the uncertainty associated with climate change and therefore weather-related natural hazards through developing and applying a variety of approaches as described in our 23 September response.</p>	
Environmental outcomes – We would prefer you to 'minimise' your	Our outcomes are clearly linked through to the wider body of customer research and consultation activities that we have undertaken for the	Noted

<p>impact on the environment, rather than 'limit' your impact on the environment.</p>	<p>development of our PR14 business plan submission. We have identified a number of primary themes that customers have been telling us are important to them, one of the key themes is affordability. This sets an inevitable tension between remaining affordable, delivering an appropriate level of service and aspiring to make sure our environmental impact is limited to the best of our ability, both for our customers today and in the future. It is on this basis that we feel that, in addition to meeting all statutory requirements, limiting our impact on the environment is an appropriate and achievable aspiration for our outcomes when faced with these conflicting tensions and our customers' views.</p>	
<p>Pollution incidents and compliance – All water companies should be planning to achieve 100% compliance for all licences and permits. We expect to see this included as a target within your business plan. In addition, we expect your company to plan for a trend towards zero serious (category one and 2) pollution incidents by 2020.</p>	<p>100% Waste water compliance</p> <p>Our clear and unambiguous aim is to achieve 100% compliance, just as it is for drinking water quality and, as a parallel approach, our 'triple zero' commitment for health and safety. Nonetheless we must be realistic and recognise the likelihood of permit failure for reasons that may be outside of our control. Furthermore, we do not have certain visibility of how permits may change in the forthcoming period, such as inclusion of additional parameters.</p> <p>We expect financial penalties should our asset serviceability fall below 'stable'. This is a wider regulatory definition that includes, <i>inter alia</i>, a compliance figure of 98.88%. We believe this is the appropriate level at which to set the penalty threshold and do not regard it as being in any way incompatible with our aim of achieving 100% compliance. Anything less would, of course, lead to reputational damage as well as Ofwat penalties. In any event, we remain liable to enforcement and possible financial penalties from the Environment Agency for any non-compliance.</p> <p>Pollution incidents</p> <p>Similarly, our aim is to achieve zero Category 1 and 2 pollution incidents and a declining trend in Category 3 incidents. We cannot guarantee zero Category 1 or 2 incidents due to the impact of external factors. Therefore during AMP6, whilst our aim is to have zero Category 1 and 2 pollution</p>	<p>We are pleased to note that your aim is to achieve 100% compliance and zero category 1 and 2 pollution incidents.</p>

	<p>incidents, our proposed threshold would not incur financial penalties from Ofwat unless the serviceability of our assets was to fall short of stable.</p> <p>The threshold for stable serviceability includes a pollution incident number reference level (for all Category 1, 2 and 3 incidents) of 92 for AMP6 for wastewater non infrastructure (STWs, storm tanks and pumping stations). At a poorer performance level our serviceability would fall short of stable and we would incur financial penalties.</p> <p>The threshold for stable serviceability also includes an equivalent pollution incident number reference level of 182 for wastewater infrastructure (foul sewers, rising mains and combined sewer overflows). At a poorer performance level our serviceability would fall short of stable and we would incur financial penalties. These numbers have been derived using our wastewater AIM model.</p> <p>We will retain our focus on reducing pollution incidents throughout AMP6. We are embedding additional Asset Health indicators to enhance risk visibility and improve targeting and prioritisation of investment and mitigation for pollution incidents. We look forward to reviewing our progress and performance against these indicators in our quarterly meetings with the Environment Agency through AMP6.</p>	
<p>Change mechanism – We believe you do require an explicit change mechanism for dealing with such changes. We acknowledge your assurance that you are developing one.</p>	<p>Our current proposed change mechanism has yet to be agreed with Ofwat, however it is intended to facilitate end-of-period financial adjustment for specific areas with known uncertainty, including accommodating future Water Framework Directive obligations. As we understand it, minor mutual agreed adjustments to the programme (for example to swap specific schemes within the delivery profile) will not need Ofwat approval as long as all outcomes are delivered before the end of the period.</p> <p>For other changes entailing additional expenditure we propose we will be liable for half of any additional expenditure, with the other half recovered within AMP7 price limits, until a materiality threshold is reached when our proposed change mechanism would apply. The threshold we propose is 2% of our annual service turnover, in line with the AMP5 change</p>	Noted

	mechanism. We anticipate that all costs incurred with a similar driver within the period can be aggregated for testing against the threshold. The IDoK mechanism will also remain available to us.	
--	--	--

Based on the further information provided to us, we make the following concluding observations:

Thames Water has provided additional information as requested. This provides greater assurance that the company are planning to meet their statutory environmental obligations. However, we have not yet seen the final business plan, so our views are based on information provided to date.



Date: 21 November 2013  
Our ref: cases 6255 and 6063  
Your ref: TWUL CCG

## Annex 3.2



David Bland  
Chairman Thames Water Customer Challenge Group

Customer Services  
Hornbeam House  
Crewe Business Park  
Electra Way, Crewe  
Cheshire CW1 6GJ  
T 0300 060 3900

### BY EMAIL ONLY

Dear David

### Thames Water's Business Plan 2015-2020

**Water Industry Act 1991 as amended by the Water Act 2003<sup>1</sup>, Wildlife and Countryside Act 1981 (as amended), Conservation of Habitats and Species Regulations 2010 (as amended) National Parks and Access to the countryside Act 1949 (as amended) and Countryside and Rights of Way Act (2000)**

Natural England is a non-departmental public body. Our statutory purpose is to ensure that the natural environment is conserved, enhanced, and managed for the benefit of present and future generations, thereby contributing to sustainable development. More information on our role in advice to the water sector can be found in Annex 2 to this letter. In our statutory role Ofwat expects Natural England to highlight in the Customer Challenge Group (CCG) report whether Thames Water's business plan will contribute to delivery of the company's statutory obligations<sup>2</sup> with regards to the natural environment. Natural England has engaged with the company directly and through the CCG to be assured that its business plan is in accordance with these requirements in so far as they pertain to landscape and biodiversity.

Annex 1 provides our views of the business plan and evidence provided to date. In summary Natural England is broadly satisfied with the proposals for the business plan as far as they relate to Thames Water's statutory responsibilities regarding landscape and biodiversity including designated sites. A summary of the main water company duties with regards landscape and biodiversity is provided in Annex 3.

A copy of this letter goes to Richard Aylard at Thames Water and Howard Davidson at the Environment Agency.

We would be happy to comment further should the need arise but if in the meantime you have any queries please do not hesitate to contact either myself or Louise Bardsley ([Louise.bardsley@naturalengland.org.uk](mailto:Louise.bardsley@naturalengland.org.uk) or 07717 427736).

Yours sincerely

A handwritten signature in black ink that reads "Adam Wallace".

Adam Wallace  
Area Manager  
Tel: 07900 608167  
[Adam.wallace@naturalengland.org.uk](mailto:Adam.wallace@naturalengland.org.uk)

<sup>1</sup> Other pieces of legislation are also relevant to water company responsibilities to landscape and biodiversity only a selection are referred to here.

<sup>2</sup> (section 4.2.1 Setting Price Controls for 2015-2020, Ofwat, July 2013).

## **Annex 1 Natural England's Response**

### **1: Water Resources Management Planning**

Natural England has provided detailed comments on the draft water resource management plan (WRMP) (22 July 2013) and the statement of response (SoR) (17 November 2013) and those comments are not repeated here, although they remain relevant. There is one material change since our comments on the SoR. Thames Water informed Natural England on 19 November 2013 that the artificial recharge Kidbrooke scheme is not in their preferred programme and was included in the executive summary in error. This removes the last remaining unaddressed concern that Natural England had with preferred option programme for the WRMP (draft and revised versions dWRMP and rWRMP respectively) with regards to designated sites.

In summary Natural England has advised:

- The preferred option programme is compatible with and has been influenced by the statutory environmental assessments (Strategic Environmental Assessment (SEA) and Habitats Regulations Assessment (HRA)).
- The potentially damaging options (for both protected landscapes and designated sites) are not included within the draft or revised WRMP preferred options.
- Natural England welcomes and supports the strong focus on demand management in the dWRMP and the enhanced leakage reduction proposed in the rWRMP which will reduce the pressure to develop a new resource that would otherwise take additional water from the natural environment.
- We welcome the inclusion of the Axford and Ogbourne sustainability reductions<sup>3</sup> in the baseline supply demand balance and look forward to the delivery of the licence reductions by 2016/17. These reductions are required to protect the River Kennet SSSI.

The relevant rWRMP proposals in so far as they relate to landscape and biodiversity including relevant investigations, assessment, mitigation and some limited enhancements are included in the business the plan.

### **2: Prevention of Pollution of Designated Sites**

In recent years Natural England has raised significant concerns with regards to the number of pollution incidents affecting designated sites. Sites affected included Sites of Special Scientific Interest (SSSI) and European sites (Special Areas of Conservation and Special Protection Areas). Natural England has been in detailed dialogue with Thames Water to ascertain the causes of the incidents and ensure Thames Water is implementing solutions.

At a meeting on 19 November 2013 Thames Water set out the suite of measures it is undertaking to help prevent pollution in future. Several procedural and operational measures have already been implemented (in 2013) and Natural England welcomes these actions. In particular Natural England welcomes the inclusion of designated sites in the assessment of impact consequences in the risk assessment of asset failures.

In particular Natural England welcomes the inclusion in the wholesale wastewater business plan of:

- Proposals for replacement of rising mains at high risk of failure, where these would impact designated sites. (Up to 14 at risk designated sites to be protected by investment in AMP6.)
- Overarching aim to have no pollution category 1 and 2 pollution incidents and a declining trend in numbers of category 3 incidents (we note Thames Water's explanation of why the incentive target falls short of these aims).

---

<sup>3</sup> Note the water resource sustainability reductions required in the Environment Agency Review of Consents (2008) are expected to be delivered in the current AMP5 by 2015 and are not therefore relevant to the business plan.

- Proposed work to address pollution hot spots and proposed investment to improve pumping stations.

Natural England is satisfied that the company's commitment to reducing pollution incidents that affect designated sites is reflected in the business plan.

### **3. Biodiversity and Designated Sites**

Natural England welcomes the commitment to delivery of the Environment Agency's National Environment Programme (NEP) which includes measures to contribute towards the objectives of the Water Framework Directive (WFD). In addition to the sustainability reductions, improvement in water quality as a result of the pollution prevention and WFD measures in the NEP, the business plan contains a number of proposals which aim to meet the company's biodiversity targets on the land it owns or manages.

In 2013 the company has updated habitat surveys and management plans on all the sites it manages including designated sites. On 19 November 2013 the company confirmed it has included funding to maintain the current condition of designated sites and to increase the area of its SSSI ownership in favourable condition to greater than 50% by 2020 in line with the government target.

There is a suite of other measures which will also contribute to biodiversity duty delivery including on-going funding of bee conservation work, conversion of rural treatment works to reedbeds and an on-going partnership to deliver a habitat restoration project. It would be helpful to see the company's Biodiversity Action Plan refreshed to capture the work it is doing and to make its contribution to this duty more transparent. Natural England is however satisfied the company is contributing to its biodiversity duties through the business plan.

### **4. Landscape**

The company has limited influence on protected landscapes in the operation of its land holding, but in so far as they are potentially impacted by the company's work Thames water has had regard to landscape in its assessment of new and upgraded assets.

## Annex 2

### Role of Natural England in Advice to the Water Sector

Natural England was established under the Natural Environment and Rural Communities Act 2006 (NERC Act). It is a non-departmental public body. Our statutory purpose is to ensure that the natural environment is conserved, enhanced, and managed for the benefit of present and future generations, thereby contributing to sustainable development.

Natural England has responsibility for ensuring that landowners and public bodies deliver objectives for European protected sites (Natura 2000 sites), Ramsar Sites (internationally important wetland sites) and the requirements for achieving and managing favourable or recovering condition for Sites of Special Scientific Interest (SSSIs). Of particular note to water companies are the objectives introduced through the Water Framework Directive for Natura 2000 protected areas, to achieve compliance with the standards and objectives (conservation objectives) of the water dependent features of those sites by December 2015 (Article 4.2 WFD).

Natural England is also charged with helping to deliver the Government's Biodiversity 2020 strategy. This strategy set out a bold ambition to "*halt overall biodiversity loss, support healthy well-functioning ecosystems and establish coherent ecological networks, with more and better places for nature for the benefit of wildlife and people*". In support of this, our response therefore provides advice on how the plan can embrace a ecosystem approach and can support the conservation of biodiversity at a landscape scale. Delivery of objectives towards Biodiversity 2020 outcomes is complementary to and in addition to the statutory duties toward biodiversity under the NERC Act (2006).

Natural England continues to aim to work with the water sector to ensure that requirements for the protection and enhancement of the natural environment are met and that there is adequate opportunity for the development of more sustainable solutions. Protection and enhancement of the natural environment including biodiversity depend critically on delivering improved, integrated and sustainable land and water management.

## **Annex 3**

### **Key water company duties with regards landscape and biodiversity**

The following is a summary of some of water company key duties with regards to landscape and biodiversity. This is not comprehensive and is to illustrate the key areas on which Natural England has engaged with the water company.

#### **1. European Sites and Species**

Regulation 9 of the Conservation of Habitats and Species Regulations 2010 (as amended) requires every competent authority, in the exercise of any of its functions, to have regard to the requirements of the Habitats Directive. Regulation 9A(8) places a duty on a competent authority in exercising any function, to use all reasonable endeavours to avoid any pollution or deterioration of habitats of wild birds. In addition, regulation 61 places obligations on competent authorities in respect of plans or projects likely to have a significant effect on a protected site.

Water Companies have a statutory duty to prepare WRMPs and so they are the Competent Authority for Habitats Regulations Assessment (HRA) of the WRMP. A HRA should assess the potential for a plan or project to have an adverse effect on the integrity of Special Areas of Conservation (SACs) or Special Protection Areas (SPAs). In England, as a matter of policy, sites listed or proposed under the “*Ramsar Convention on Wetlands of International Importance*” receive the same level of protection as SACs and SPAs. The business plan, as a financial plan is exempt from an HRA. However the options and actions within the plan must be compliant with the general duty to have regard to the purposes of the Directive.

#### **2. Sites of Special Scientific Interest (SSSIs)**

Section 28G of the Wildlife and Countryside Act 1981, as inserted by section 75 of and Schedule 9 to the Countryside and Rights of Way Act 2000, places a duty on public authorities, including water companies, to take reasonable steps consistent with the proper exercise of their functions to further the conservation and enhancement of SSSIs. These duties are mirrored in the general recreational and environmental duties placed on relevant undertakers in the Water Industry Act (1991) as amended.

Section 3.11.1 of the Statement of Obligations (SOO)<sup>4</sup> states “*where activities are being carried out by undertakers outside the boundaries of SSSIs but which have an impact on the special interest features of that SSSI, they will also need to review that activity and, where appropriate, cease or modify that activity in order to fulfil their S28G(2) duty*”. Section 3.11.5 of the SOO states “*...Statutory undertakers, in their business plans, will need to include those actions deemed necessary both to remedy adverse impacts on, and to maintain and enhance the condition of, SSSIs in 2015–2020 and beyond*”.

#### **3. Protected Landscapes**

Relevant Authorities (including water companies as a Statutory Undertaker) are to have regard to the purposes of National Parks (Section 11A (2) of the 1949 Act) and the similar duties towards Areas of Outstanding Natural Beauty (AONBs) (Section 85 of the Countryside and Rights of Way Act 2000) and the Broads (Section 17A of the Norfolk and Suffolk Broads Act 1988). Duties to further the natural beauty and rural amenity are also included within the general recreational and environmental duties placed on relevant undertakers in the Water Industry Act (1991) (as amended).

#### **4. Biodiversity**

Under Section 40 of the Natural Environment and Rural Communities Act 2006 every public authority, including water companies, must in the exercise of its functions have regard so far as is

---

<sup>4</sup> Statement of Obligations -Information for Water and Sewerage Undertakers and Regulators on Statutory Environmental and Drinking Water Provisions Applicable to the Water Sector in England - Defra 2012

consistent with the proper exercise of those functions to the purpose of conserving biodiversity. Conserving biodiversity in this context includes restoring or enhancing a population or habitat.

Section 4.2.6 of the SOO states “*Undertakers will need to take account of the duty under Section 40 of the 2006 Act with respect to existing and proposed abstractions. Defra has published guidance for public authorities entitled Guidance for Public Authorities on Implementing the Biodiversity Duty.*”



## Drinking Water Inspectorate Statement for Thames Water's Customer Challenge Group Report to Ofwat

### 1. Introduction

- 1.1 The Drinking Water Inspectorate (DWI) is the independent regulator of drinking water quality in England and Wales. We protect public health and maintain confidence in public water supplies by ensuring water companies supply safe clean drinking water that is wholesome, and that they meet all related statutory requirements. Where standards or other requirements are not met, we have statutory powers to require water supply arrangements to be improved.
- 1.2 We publish information about drinking water quality and provide technical advice to the Secretary of State for the Environment, Food & Rural Affairs, and to Welsh Ministers.
- 1.3 For PR14, water companies are expected to ensure that their business plans make provision to meet all their statutory obligations, including the need for public water supplies to be safe, clean and wholesome, and that provision is made for a sustainable level of asset maintenance to maintain public confidence in drinking water quality. Ministers summarised these requirements in Defra's Statement of Obligations<sup>1</sup>, and in their further guidance on PR14 matters to Ofwat. In addition, the Inspectorate set out in **DWI Information Letter 01/2013 – The 2014 Periodic review of Prices – Guidance for water companies**, published on 1<sup>st</sup> February 2013 supplementary guidance to companies on the regulatory framework for drinking water quality, statutory requirements, the Inspectorate's role in the Price Review process and our requirements for companies seeking technical support. The Inspectorate also published separate PR14 guidance on a range of specific issues. All of the Inspectorate's published PR14 guidance is available on the DWI website.
- 1.4 It is worth noting the particular emphasis that Ministers placed in their Guidance on the resilience of supply systems, and that the Inspectorate placed on existing duties to manage the introduction of new sources and to plan supply

---

<sup>1</sup> <http://www.defra.gov.uk/publications/files/pb13829-statement-obligations.pdf>

arrangements to protect consumers and ensure no deterioration in the quality of their supplies.

- 1.5 The Inspectorate has a position on all of the water companies' customer challenge groups in England and Wales. The Inspectorate's representative on Thames Water's Customer Challenge Group has supported the process by acting as an independent member with the overall remit of ensuring that the Company business plan proposals reflect the views of consumers and place drinking water quality at the forefront of such plans.

## 2. Formal Drinking Water Proposals Requiring DWI Technical Support

- 2.1 As with previous periodic reviews, water companies seeking technical support from the Inspectorate must demonstrate the need for each proposal. The case for justification must be accompanied by evidence of the company's options appraisal process to identify the most robust, sustainable and cost-effective solution, with evidence that the preferred solution will adequately address the risk and deliver the required outcome within an appropriate timescale.

- 2.2 Thames Water submitted five formal proposals for drinking water quality to the Inspectorate, listed in the table below:

PR14 DWI Ref.	Scheme Name	Quality Parameter(s)	Scheme Type	Preferred Option	DWI Final Decision
TMS022	Sturt Road WTW	Microbiological parameters (bacteriological & <i>Cryptosporidium</i> )	Treatment	UV	Regulation 28 Notice
TMS041	Catchment management, relating to 11 sites	Pesticides, including Metaldehyde	Catchment management	Various catchment activities	Undertaking
TMS063	Ashton Keynes Plumbosolvency	Lead	Treatment	Phosphate dosing	Regulation 28 Notice
TMS064	Chipping Campden Plumbosolvency	Lead	Treatment	Phosphate dosing	Regulation 28 Notice
TMS112	Lead Strategy	Lead	Company lead strategy	Package of measures	Regulation 28 Notice

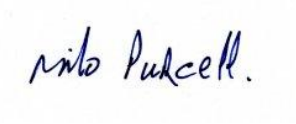
- 2.3 The Company is to be commended on the quality of the submissions to the Inspectorate, which were received in substantial part by our published deadline of 31<sup>st</sup> July 2013, and in the period up to 17<sup>th</sup> August 2013, and which complied with our PR14 guidance. The Inspectorate met with the Company on a number of occasions. Therefore we were broadly aware of the Company's plans for



drinking water quality and we are generally supportive of the Company's approach.

- 2.4 The Inspectorate has formally supported all five of the Company's proposals and we will put legal instruments in place to make the proposals legally binding programmes of work. Our final decision letters were sent to the Company on 15<sup>th</sup> and 21<sup>st</sup> October 2013. Additional information was subsequently provided by the Company relating to scheme reference TMS022 [Sturt Road WTW], and our final decision letter for this scheme was modified and reissued on 21<sup>st</sup> November 2013.
- 2.5 The proposal for Sturt Road WTW involves the provision of ultraviolet treatment as a risk mitigation measure for microbiological parameters including *Cryptosporidium*. The proposal makes provision for continuing catchment management activity to establish the source of raw water contamination and to put in place any potential mitigation measures appropriate, and further investigation of the stability of turbidity levels at the site to confirm the suitability of a UV treatment solution. This site has been removed from supply as a precautionary measure.
- 2.6 For 11 water treatment works, the Company has proposed a programme of catchment management activities to address the risk of contravention of the pesticide standard, in this case metaldehyde, in water supplied from the works.
- 2.7 Three of the Company's proposals relate to securing or facilitating compliance with the lead standard. The Inspectorate expects that the Company will have a strategy in place for managing lead in drinking water that should form part of a risk-based programme of work that includes a range of measures to address lead in identified high risk areas, and target high risk properties and vulnerable consumers.
- 2.8 It should be noted that these improvement schemes will make only a small contribution to enabling the Company to meet its legal obligations in respect of drinking water quality. These obligations are met overwhelmingly by the Company making sufficient provision for operational and maintenance requirements in its business plan, and by its use of those resources. These are matters for the Company to determine and deliver. For its part, the Inspectorate will continue to keep under review, and report on, the performance of the Company in meeting its legal obligations. Statutory powers are available to secure or facilitate compliance, if necessary.
- 2.9 The summary of improvement schemes above reflects the position at the time of writing this statement. Further discussions are needed with the Company to finalise details. We will advise the CSG and Ofwat of any material changes.

2.10 This statement will be copied to Graham Welland of Thames Water. Any queries arising should be directed to Jacqueline Atkinson, Inspector, Drinking water Inspectorate, telephone number: 03000686402; email [dwipricereview@defra.gsi.gov.uk](mailto:dwipricereview@defra.gsi.gov.uk).

A handwritten signature in black ink that reads "Milo Purcell". The signature is written in a cursive style.

**Milo Purcell**  
**Deputy Chief Inspector (Regulations)**

**Drinking Water Inspectorate**

Area 7e, 9 Millbank  
c/o Nobel House  
17 Smith Square  
London SW1P 3JR

**21st November 2013**