Thames Water Utilities Limited

PR24 CMA Redetermination

Third Party Submission in Response to Disputing Companies' Statements of Case

Submitted 22 April 2025

1 Introduction

(1) On 14 February 2025, Thames Water Utilities Limited ("**Thames Water**") announced that it had asked Ofwat to refer its Final Determination ("**FD**") to the Competition and Markets Authority ("**CMA**") for a re-determination, after Thames Water's Board concluded that the FD does not appropriately support the investment and improvement that is required for Thames Water to deliver for its customers, communities and the environment. Five other companies (the "**Disputing Companies**") resolved that they were also unable to accept the FD and asked that it be referred to the CMA for re-determination.

(2) Following constructive discussions with Ofwat, Thames Water and Ofwat agreed on 18 March 2025 to defer making Thames Water's reference to the CMA for a period of up to 18 weeks. Thames Water remains of the view that the FD is not in the interests of our customers or the environment; but we believe that recent conversations with Ofwat hold out the prospect of unlocking a market-led solution for the recapitalisation of the company, including through an equity raise, which would support the turnaround of the company. This would be in the interests of all relevant stakeholders, including our customers, communities and the environment. If no resolution emerges from that process, Ofwat will proceed with the reference of the FD and Thames Water's price control will be re-determined by the CMA.

(3) We welcome the opportunity to comment on the Disputing Companies' statements of case. Given our rejection of the FD, the common framework used by Ofwat in setting the PR24 price controls and the plausible scenario that Ofwat refers the FD to the CMA later this year, Thames Water has an inherent interest in the CMA's process and the Disputing Companies' positions. We appreciate that unless and until our FD is referred to the CMA by Ofwat, Thames Water remains a third party in relation to the CMA's re-determination process. Additionally, the issues that the CMA will consider in relation to the Disputing Companies are of significant importance to Thames Water and the sector more generally. Moreover, we believe that there are several issues where our perspective and evidence would assist the CMA in its re-determination, regardless of whether Thames Water's FD is referred to the CMA.

(4) This submission is intended to assist the CMA by providing Thames Water's perspective on matters which are relevant to the sector/Thames Water without prejudice to any future submissions that Thames Water would make in a statement of case or thereafter should a reference be made. We focus on providing high-level observations on the issues raised in the Disputing Companies' statements of case which are also of relevance to Thames Water. We also highlight specific points raised by Disputing Companies where Thames Water has additional observations to which it considers that the CMA should have regard in assessing the arguments in the Disputing Companies' statements of case.

(5) For the avoidance of doubt, this submission does not purport to set out the issues, arguments and evidence that Thames Water would make in its statement of case if a referral of the FD is made. Moreover, Thames Water reserves its rights to comment further on the issues raised by the Disputing Companies in light of further submissions and more detailed consideration by the CMA and the Disputing Companies (e.g. in response to the approach document), or in its own statement of case if a referral to the CMA is made.

(6) We would be happy to provide more detailed observations on the issues set out in this submission, or discuss these with the CMA, should this be of assistance at this stage of the CMA's process for the Disputing Companies.

2 Background: PR24 is a critical price control for Thames Water and the sector

(7) Thames Water is the largest water and sewerage company regulated by Ofwat, serving approximately 24% of the UK population. Each day, we deliver 2.6 billion litres of safe drinking water to 10 million customers and treat 5.1 billion litres of wastewater for 16 million customers in London, the Thames Valley and the home counties. Our work is vital, and our success is critical to the UK (including to help unlock wider economic growth).

(8) PR24 represents an inflection point for both Thames Water and the industry. Customers rightly expect the delivery of safe and resilient water supplies and wastewater services, better service and lasting environmental improvements. Factors such as climate change, population growth and ageing assets, have increased operational and environmental challenges across the sector, resulting in outcomes that fall short of customer and societal expectations. At the same time, there has been a significant expansion and strengthening in the statutory and regulatory requirements to which the sector is required to deliver.

(9) To address these challenges, AMP8 will require a paradigm shift in investment compared to previous regulatory periods. Ofwat has allowed £104 billion in expenditure during AMP8 (compared to a total of £51 billion in PR19). Companies need to be able to deliver on this step-change at a reasonable cost, and in a timely fashion, in the face of significant supply chain constraints. Companies will need to attract significant levels of new private sector capital to do so.

(10) As has been discussed in detail in the Disputing Companies' submissions, PR19 was a highly challenging price review which has had financial and operational consequences for Thames Water and the sector. While PR19 saw significant average customer bill reductions, this came at the expense of much-needed longer term investment. In AMP7, almost all companies have overspent against their PR19 totex allowances (estimated by Anglian Water at £8.6bn[1]) and also incurred net ODI penalties (forecast to total around £700 million[2]). Thames Water, for example, is forecasting an overspend of £900 million in AMP7, alongside a forecasted net ODI penalty of £400 million. We agree with the Disputing Companies that the experience at PR19 represents an important backdrop to the CMA's review. Thames Water highlighted its concerns about the PR19 Final Determination at the time to Ofwat, and with the benefit of hindsight, it transpired that the funding awarded was inadequate.

(11) The framework for water price control redetermination is showing considerable strain, and FD24 may not strike the right balance between elements that are common or consistent across companies, and those elements that are specific to individual operators but that have an important bearing on their efficient costs, expected or achievable outcomes or likely performance. Due to the particular characteristics of our operating region, Thames Water is subject to a number of region-specific challenges not faced by other water companies: we operate in the most densely populated area of England, placing our network under the most stress; our pipes are disproportionately susceptible to corrosion due to London's clay geology; our region has the highest proportion of fast-food establishments, resulting in high numbers of sewer blockages; and we operate some of the oldest and most complex assets of any water company. As a result of these unique regional characteristics, Thames Water's operating costs are higher than those of other water companies.

[1] Anglian Water, PR24 Statement of Case (March 2025), page 40.

[2] Thames Water's internal analysis. To calculate penalties over the full AMP, the level of penalty for AMP7 Year 5 is assumed to be the same as for AMP7 Year 4.

(12) Thames Water is experiencing well-publicised operational and financial difficulties and we are in the process of turning our business around in order to attract new capital and deliver on our business plan.

(13) From an operational perspective, Thames Water has made significant strides to improve our performance in recent years. There are notable green shoots – Thames Water was recognised by Ofwat in its 2024 sector-wide performance report as an "average" performer (no "leading" companies were identified).[3] In 2023/24, Thames Water met or exceeded targets for six of the 12 common PCs and has shown improvement in almost all of the remaining six.[4] However, there is significant work to be done to deliver on customer and public expectations – particularly in relation to wastewater where our performance is not where we want it to be.

(14) From a financial standpoint, Thames Water's equity owners have written down the value of their investment significantly. Thames Water is targeting a sustainable financial position through securing additional short-term liquidity to provide a runway to enable a wider restructuring of its debt and the completion of an equity raise. If a referral to the CMA is made for Thames Water, we expect that the CMA would want to understand this ongoing recapitalisation process in greater detail.

(15) In light of the industry-wide and company-specific factors, the PR24 price control comes at a critical time for Thames Water. We appreciate the challenges that Ofwat faces, but regrettably, we still believe that there are significant gaps between the FD and a deliverable settlement for Thames Water. These include a £4 billion gap in our total funding and a risk/reward balance that is disproportionately skewed to the downside (with anticipated wholesale ODI penalties of around £382 million over AMP8 when comparing our draft determination response to the FD, before considering any potential penalty from the Measures of Experience ("**MeXes**")). These are the considerations that led our Board to conclude that the FD is not workable for Thames Water.

3 Structure of this submission

(16) The remainder of this submission provides Thames Water's views on the arguments made by the Disputing Companies in their statements of case, highlighting significant areas of agreement with those submissions. This submission is structured as follows:

(i) **Section 4** explains that Thames Water supports several arguments made by the Disputing Companies regarding **base costs**, namely 'what base buys' and regional wages, the frontier shift efficiency challenge, National Insurance Contributions and the use of triangulation in cost modelling. We also explain that Thames Water does not believe that the specificities of its appointment area are adequately reflected in the FD's cost modelling. We comment specifically on points made by Southern Water in relation to energy cost drivers and economies of scale in wastewater treatment.

(ii) **Section 5** explains that Thames Water shares the concerns raised by several of the Disputing Companies in relation to **enhancements costs,** namely regarding the quality of the scheme-level enhancement models. We also support the arguments in

[3] Ofwat, Water Company Performance Report 2023-24, (October 2024), page 6: https://www.ofwat.gov.uk/wp-content/uploads/2024/10/WCPR-23-24.pdf.

[4] Ibid.

respect of the impact of Price Control Deliverables ("**PCDs**") on enhancement expenditure.

(iii) **Section 6** explains that Thames Water agrees with a number of the Disputing Companies that the **Outcome Delivery Incentive** ("**ODI**") package is skewed too heavily to the downside and that the CMA should consider the calibration of ODI rates, the aggregate sharing mechanism and supply interruptions. We also provide additional evidence to supplement the arguments made by Southern Water and South East Water regarding the MeXes, which Thames Water considers are overly powered and result in disproportionately high penalties (including in the **Annex** to this submission).

(iv) **Section 7** explains that Thames Water shares a number of the concerns raised by the Disputing Companies regarding the calibration of the **PCD regime** and considers that the regime results in excessive downside delivery and cost risk.

(v) **Section 8** explains that Thames Water agrees with the Disputing Companies' arguments in relation to **returns** and **financeability**.

4 Thames Water's submissions on Disputing Companies' arguments in relation to base costs

(17) The following points are made to assist the CMA in its consideration of base costs in relation to the five companies. The context is that base cost is also likely to be a focus in any Thames Water redetermination: Thames Water received a base cost allowance of c.£11.3 billion in the FD in comparison with the c.£13.2 billion we requested, leaving us with a shortfall of c.£1.9 billion to fund our wholesale activities. Given the materiality of the shortfall in the FD, this is an area that Thames Water would address in detail if Ofwat refers Thames Water's FD to the CMA.

4.1 Base cost modelling

4.1.1 Approach to base cost modelling

(18) Southern Water,[5] Wessex Water[6] and South East Water[7] identified concerns with the approach to the base cost assessment in the FD.

(19) Thames Water also considers that the assessment in the FD did not adequately account for its unique cost factors, which are largely beyond management control, and the unusually high costs associated with operating utilities in London and Thames Valley. For example, the assessment of base costs did not adequately account for:

(i) London's labour market, which pays the highest wages in the country;

(ii) London's high density, which leads to a greater complexity of working underground (e.g. due to high levels of underground utilities congestion);

(iii) The narrow gaps between buildings and high prevalence of cellars (which results in a greater number of utility assets being located under carriageways rather than under

[5] Southern Water, PR24 Statement of Case (March 2025), pp 111-131.

[6] Wessex Water, PR24 Statement of Case (March 205), pp 45-51.

[7] South East Water, PR24 Statement of Case (March 2025), pp 37-42.

footpaths or grass verges), and the thicker and more costly street surface materials in London, which increase the costs of excavation and reinstatement works;

(iv) More onerous traffic management and streetworks regulations; and

(v) Thames Water's asset infrastructure, which is the oldest in the industry, with a high proportion of cast iron pipes that are susceptible to corrosion.

(20) Thames Water does not believe that the specificities of its appointment area are adequately reflected in the FD's cost modelling. We would be happy to provide our detailed observations on the issues with the FD's base cost models, should this be of assistance at this stage of the CMA's process for the Disputing Companies. For the purposes of this submission, we have focused specifically on (i) energy cost drivers; and (ii) economies of scale in wastewater treatment, given that they are relevant to points raised by the Disputing Companies (namely Southern Water) and we believe it important for the CMA to have regard to Thames Water's perspective in its re-determination for the Disputing Companies.

4.1.2 Energy cost drivers

(21) Thames Water disagrees with the contention that the CMA should use the number of booster pumping stations ("**BPS**") per kilometre of main as the sole cost driver for energy costs in treated water distribution models and not use the average pumping head ("**APH**") variable. Contrary to Southern Water, we contend that BPS should not be used in the models and should instead either be removed or replaced with an alternative variable. We believe the CMA to consider that booster pumping capacity ("**BPC**") is a suitable, and, preferable alternative to BPS.

(22) APH and BPS aim to control for variations in water companies' energy/pumping requirements imposed by the topography of their respective region. To this end, we would expect these variables to positively correlate with power costs and energy consumption. However, while this is the case for APH, it is not the case for BPS. Indeed, BPS negatively correlates with power costs (or energy consumption) per kilometre of main.

(23) Our analysis reveals that the negative correlation of BPS with power costs remains in the context of Ofwat's models' specifications: if the dependent variable – botex – is replaced with power costs, we get a counter-intuitive negative coefficient on BPS. The sign of BPS turns positive only when capital maintenance is added back to the dependent variable. However, BPS is not aimed at explaining capital maintenance costs: it is aimed at explaining the power cost component of base costs. This suggests that BPS does not capture what it is intended to capture and is the wrong proxy for energy requirements. Its statistical significance in Ofwat's models is accidental rather than based on engineering rationale.

(24) BPS is also highly correlated with density measures. High correlation between explanatory variables has negative implications on the quality of econometric models, as it increases the standard errors of the estimated coefficients, resulting in their estimated value becoming sensitive to the sample at hand and predicted costs for individual companies that may be materially distorted. While there are circumstances where it may be appropriate to use correlated variables in econometric models, given the availability of variables which are uncorrelated with density (e.g. APH), Thames Water considers it inappropriate to use BPS in this instance.

(25) For the reasons above, we do not consider BPS to be fit for purpose as a variable to control for variation in energy costs across companies.

(26) Unlike BPS, APH is an appropriate cost driver. The data quality for the variable has improved since PR19. It is econometrically robust and has the expected positive correlation with power costs. Compared to BPS, APH is more exogenous, has a stronger engineering narrative, and a low correlation with the density variables.

(27) Thames Water recommends that the CMA removes BPS from the models. We acknowledge that there may be merit to triangulation in this case, in light of residual concerns about the data quality of APH (although the variable has improved since PR19 and is no less robust than other variables used in the FD models). Accordingly, we consider that, rather than relying on APH alone, the CMA could consider triangulating models that use the APH driver with models that use BPC. BPC is a more intuitive driver than BPS: it is used in wastewater models, its correlation with energy costs is positive, and it is statistically significant in the models.

4.1.3 Economies of scale in wastewater treatment

(28) In its wastewater models, Ofwat uses two variables to capture economies of scale in wastewater treatment. The first is the percentage of load treated in wastewater treatment works ("**WWTWs**") of size bands 1 to 3 ("**PCTB13**"). These bands represent relatively small WWTWs. This variable aims to capture the high cost of treating load in small treatment works (due to the lack of economies of scale in these bands). This variable has been used in previous price controls, for example at PR14 and PR19.

(29) The other variable is the Weighted Average Treatment Size ("**WATS**"), which is a new variable introduced at PR24.

(30) Southern Water suggests removing the sewage treatment model that uses PCTB13, but not the wastewater network plus model that uses the same variable.[8] This is because, in sewage treatment models, the PCTB13 variable is not statistically significant and the efficiency scores range is wider when compared to the model with the WATS. In wastewater network plus models the PCTB13 is significant.

(31) Economies of scale (that is, the impact of scale on average cost) are typically non-linear: they tend to be large at small scales (that is, average cost tends to decrease rapidly as scale increases from a small starting point) and diminish as scale increases, sometimes turning to diseconomies of scale at very large scales for example due to meeting topographical constraints and/or operating in highly dense areas. This is partly why Thames Water advocate using a square density term in price control models.

(32) The WATS variable does not capture non-linearities in the relationship between scale and average costs. It is linear in nature—its value increases linearly as the average size of WWTWs used by the company increases. Using the WATS as the sole variable approximates the true non-linear relationship with a linear one. This can cause material harm (to companies or customers), particularly to companies at the extreme, with very small or very large WWTWs.

(33) The presence of outliers can further aggravate the distortion created by the linear relationship. Outliers may appreciably change the gradient of the linear relationship, making it steeper or flatter, again, with material implications to companies at the extremes of the distribution.

[8] Southern Water, PR24 Statement of Case (March 2025), pp 114-122.

(34) Thames Water considers that the PCTB13 variable plays an important role in the price control's modelling suite. When the relationship between a continuous variable (such as WATS) and the dependent variable is non-linear, a threshold variable (such as PCTB13) can help capture non-linearities and 'threshold effects' (where the unit cost materially changes at specific thresholds). A threshold variable also reduces the impact of outliers, which is critical in a small sample.

(35) Data available in business plan tables CWW4 supports this.[9] The evidence shows that the unit cost of sewage treatment is decreasing by WWTW size band in a non-linear way: while the reduction is material at the lower bands, it becomes small and fairly flat in bands 4-6.

(36) We recognise that with the data at hand, WATS is statistically more significant than PCTB13. However, PCTB13 passes Ofwat's model selection criteria and has qualitative advantages, as set out above, which makes it a useful variable for triangulation in wholesale wastewater models.

4.2 Additional base costs arguments made by the Disputing Companies

(37) Thames Water endorses several arguments raised by the Disputing Companies in relation to base costs:

(i) **'What base buys':** The Disputing Companies raised various concerns about the assumptions underpinning the estimates in the FD as to 'what base buys', in particular for mains renewal.[10] Thames Water agrees that the approach to 'what base buys' is inappropriate and should be re-considered by the CMA. Thames Water also considers that unit costs for mains replacement are based on unreliable data and do not reflect rates that it faces for mains replacement in London and Thames Valley.

(ii) **Regional wages:** Southern Water[11] and South East Water[12] raised concerns with the omission of regional wages from the cost assessment framework in the FD. Given that labour costs have a material impact on Thames Water's cost base and are significantly higher in London, we agree that the effect of regional wages should be reflected in the cost assessment framework.

(iii) **Frontier shift:** All Disputing Companies raised concerns with the frontier shift efficiency challenge set in the FD. Thames Water agrees that the CMA should set a frontier shift which is realistic and reflects the latest evidence. Thames Water believes that the CMA should have regard to the expert report produced by Economic Insight, which was jointly commissioned by Thames Water and the Disputing Companies in this respect.

(iv) **National Insurance Contributions:** Anglian Water[13] raised concerns with the approach taken in the FD to employers' national insurance contributions ("**NICs**"). Thames Water agrees that provisions should be made in the FD (such as an uplift to base allowance at the expected rate in NIC costs and a true-up with the actual increase in NIC costs at the end of the AMP) to recover the increase in NICs.

[9] Based on business plan tables CWW4 submitted by water companies to Ofwat as part of PR24. The information in the tables covers the period 2022-23 to 2029-30.

[10] The term 'what base buys' in this context refers to the volume of asset replacement that can be funded through a company's base allowance provided by the econometric models.

[11] Southern Water, PR24 Statement of Case (March 2025), pp 148-162.

[12] South East Water, PR24 Statement of Case (March 2025), page 37, 40.

[13] Anglian Water, PR24 Statement of Case (March 2025), page 108.

(v) **Triangulation of cost models:** Southern Water identified certain concerns with the approach to base cost modelling in the FD. Thames Water considers that, while triangulation can be appropriate (see e.g. paragraph 27 above), it should not be a substitute for appropriate consideration of the merit of each model criterion and cost driver.

5 Thames Water's submissions on Disputing Companies' arguments in relation to enhancement costs

(38) Thames Water received circa £2 billion less in enhancement funding in the FD than we requested to deliver our plan for customers and the environment. Enhancement expenditures is therefore an area that Thames Water would address in detail if a CMA referral is made. Many of our enhancement commitments are tied to statutory obligations which, if we are not funded to deliver, will have unfavourable knock-on implications for our ability to maintain the resilience of our service. Without prejudice to any submissions made following a reference, we make the following observations to assist the CMA in its consideration of the five redeterminations.

5.1 Enhancement cost modelling

(39) Several Disputing Companies raised concerns regarding the overall quality of the scheme-level enhancement models.

(40) Wessex Water presented detailed and compelling evidence about the inadequacies of the econometric models used for phosphorus removal.[14] It also noted that it disagreed with the approach taken in the FD to Sewage Treatment Works ("**STW**") Growth schemes and meeting Industrial Emissions Directive ("**IED**") requirements,[15] highlighting the inability of the models to adequately capture important factors that drive costs, scheme idiosyncrasies and the undue weight being placed on historical costs despite evidence that future costs can be expected to be more expensive.

(41) Thames Water agrees that the scheme-level econometric models used to calculate enhancement cost allowances in the FD for phosphorous removal, STW growth and IED lack robustness in material respects and that there has been an over-reliance on their outputs in determining allowances. If a referral to the CMA of our FD is made, we intend to evidence the inability of the models to capture the idiosyncrasies of such schemes; that historical costs do not reflect future costs; that the models used inappropriate data as a proxy for STW size and that investment to achieve ultra-low permit requirements or at large STWs have been disproportionately scored as inefficient.

(42) Thames Water believes that the CMA should reconsider the approach to determining enhancement cost allowances in light of the deficiencies in the econometric models (including, for example, consideration of deep-dive engineering assessments, improving the model performance or better accounting for company specific factors).

5.2 PCDs on enhancement expenditure

(43) We have commented on the Disputing Companies' submissions regarding PCDs more generally in Section 7 of this submission. In relation to the impact of PCDs on enhancement expenditure, Thames Water shares the views presented by several Disputing Companies.

[14] Wessex Water, PR24 Statement of Case (March 2025), Chapter 9 (Phosphorus removal).

[15] Wessex Water, PR24 Statement of Case (March 2025), Table 1 (page 8).

Notably, Thames Water considers that these discourage efficiency and innovation, overlap with existing penalties/incentives and increase RoRE downside risk.

(44) Anglian Water submitted that certain PCDs introduce the risk that companies do not receive funding if delivery is incomplete or is not received on time.[16] For Thames Water, this issue is very significant, particularly in relation to the PCD for the IED where it may not be technically feasible to deliver the full programme within AMP8. This is compounded by the funding awarded being significantly below forecast costs and additional scope requirements continuing to be identified by the EA as the permitting process completes. This means that, wherever a site does not fully deliver all of the Environment Agency expectations for IED by 2030, including both unfunded and underfunded scope items, Thames Water will have to return all associated totex irrespective of monies spent or constraints in completing delivery that are beyond its control.

(45) To address this, the CMA should reconsider the design of such PCDs to strike a fair balance between the legitimate need for customer protection on the one hand; and the requirements to provide appropriate incentives for innovative and efficient delivery outcomes by companies and to mitigate their exposure to excessive downside risk on the other.

6 Thames Water's submissions on Disputing Companies' arguments in relation to outcomes

(46) Southern Water,[17] Anglian Water[18] and South East Water[19] consider that the ODI package is punitive and skewed too heavily to the downside. Thames Water similarly considers that the ODI package exposes it to excessive downside risk and believes this should be carefully re-considered by the CMA.

6.1 MeXes

(47) In particular, Thames Water, shares the concerns raised by Southern Water[20] and South East Water[21] regarding the MeXes. Thames Water agrees with Southern Water's position that *"the proposed ODI rates for the MeXes are excessive compared to the revenue of the relevant price controls"*.[22] This has meant that all three MeXes are "over-powered", in the sense that they result in disproportionate penalties, which undermines the ability of companies receiving them (as is almost certainly to be the case for Thames Water) to invest to the benefit of customers and the environment. Similarly, Thames Water also supports the proposals put forward by both companies regarding the AMP8 PCLs for C-MeX.

(48) Thames Water has provided an Annex of additional evidence regarding the three MeXes. This information has been provided to assist the CMA in its review of the arguments made by Southern Water and South East Water. Should Thames Water be referred to the CMA, we would also provide additional evidence relating to the collar for the MeXes that is specific to Thames Water's position.

(49) The Annex sets out that:

[16] Anglian Water, PR24 Statement of Case (March 2025), Chapter G.1.

[17] Southern Water, PR24 Redetermination Statement of Case (March 2025), pp 376-378.

[18] Anglian Water, PR24 Redetermination Statement of Case (March 2025), pp 119-121.

[19] South East Water, PR24 Redetermination Statement of Case (March 2025), Chapter 5.

[20] Southern Water, PR24 Redetermination Statement of Case (March 2025), pp 401-406.

[21] South East Water, PR24 Redetermination Statement of Case (March 2025), pp 74-76.

[22] Southern Water, PR24 Redetermination Statement of Case,(March 2025), page 405, para 181.

(i) **The revenue at risk from C-Mex is disproportionately high**. It is disproportionate to the scale of: (1) retail activities; (2) other PCs in the FD; (3) in light of customer priorities; and (4) compared to other regulated industries.

(ii) **C-MeX is flawed, as penalties are driven by reputation rather than performance.** This is because: (1) capital expenditure across the sector on retail functions has been £240m over AMP7, but companies have been unable to materially change their C-MeX scores or ranking (given that performance is significantly impacted by brand reputation); (2) there is strong persistence in performance ranking over time; and (3) overall companies' performances have declined over time, despite strong financial incentives to improve.

(iii) **The revenue at risk from D-Mex and BR-MeX is disproportionately high**. It is disproportionate to the scale of: (1) the relevant activities; (2) compared to other ODIs in the FD and the approach at PR19 (in the case of D-MeX); and (3) in light of the fact that BR-MeX is a nascent measure to the extent that Ofwat has so far only published illustrative BR-MeX data for the sector (such that the CMA could consider introducing an interim reputation-only incentive for BR-MeX).

6.2 Additional outcomes arguments made by the Disputing Companies

(50) Thames Water notes the following points in relation to the other outcomes arguments raised by Disputing Companies:

(i) **ODI rates:** Thames Water supports Southern Water's suggested technical changes to ODI rate calculations for total pollution incidents, storm overflows and supply interruptions.[23] The proposals relate to aspects of Ofwat's performance range assumptions used to calculate ODI rates. Thames Water supports these proposals as changing a technical assumption in performance range calculations used to determine ODI rates can more accurately reflect the level of risk companies will face in AMP8, which in turn lowers the ODI rates. This would represent an improvement to Ofwat's existing suite of top-down ODI rates. Furthermore, Ofwat's top-down approach is being used for the first time and may therefore benefit from a more cautious calibration in areas at risk of high penalties.

(ii) **Serious pollution incidents ODI rate:** Thames Water would support a similar technical change to the performance range calculation for the serious pollution incidents ODI rate.[24] Ofwat's FD used the Environment Agency's targets since 2011-12 as the proxy PCL to determine the performance range. The target that will be in place for AMP8 is 0. Using 0 as the assumed proxy PCL will more appropriately reflect the expected performance range over AMP8. This increases the P10-P90 performance range and, as a result, the ODI rate would reduce by around 50%.

(iii) **ASM:** Thames Water believes that the aggregate sharing mechanism ("**ASM**") could be a good mechanism to protect customers and businesses, but is not calibrated

[23] Southern Water, PR24 Redetermination Statement of Case (March 2025), pp 386-390 (supply interruptions); 390 – 394 (total pollution incidents); and 396-401 (storm overflows).

[24] Southern Water, PR24 Redetermination Statement of Case (March 2025) , pp 394-396.

correctly in the FD. We refer the CMA to the arguments made by Thames Water in our draft determination response in this regard.[25]

(iv) **Supply interruptions:** Southern Water,[26] Anglian Water[27] and South East Water[28] consider that the baseline and PCL for supply interruptions should be adjusted to take account of the latest available reported performance data.[29] Thames Water supports this position and put forward evidence in its draft determination response in this regard.[30] In particular, Thames Water's draft determination response argued that *"Only companies with favourable characteristics have been able to meet PR19 targets. The PR19 target for WSI was overly stretching for most and should not be used as a baseline for PR24."* [31] The CMA should revisit the common 5-minute target that has been used each year of AMP8.

7 Thames Water's submissions on Disputing Companies' arguments in relation to PCDs

(51) All Disputing Companies raise concerns with the PCD regime. Thames Water recognises the need for PCDs to protect customers where companies fail to deliver. However, it is also important that PCDs are calibrated properly to mitigate excessive downside delivery and cost risk.

(52) Thames Water endorses the following points made by the Disputing Companies:

(i) **PCDs currently restrict flexibility and innovation:** The PCDs in the FD inhibit companies' ability to respond to changing circumstances by penalising them if they fail to deliver specific projects and deter innovation by penalising companies if they depart from elements of the programme to which they have committed.

(ii) **PCDs duplicate other regulatory rules:** Several of the PCDs in the FD duplicate existing regulatory obligations imposed by both Ofwat and other regulators. Duplication across different regulatory regimes is widely recognised as a concern in water regulation and necessarily raises concerns about proportionality. The CMA will need to consider how those concerns should be reflected in its process and, in particular, whether to avoid duplication and double-jeopardy within the existing framework.

(iii) **PCDs are set at a level that distorts incentives:** The PCDs are set at a level which may lead to an excessive clawback of funding in circumstances whereby significant expenditure is incurred in progressing schemes that are subsequently removed from allowances through non-delivery incentive payments.

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[25] See Thames Water, Draft Determination Response: TMS-DD-041: Risk and Return (August 2024), section 4.1: https://www.thameswater.co.uk/media-library/home/about-us/regulation/our-five-year-plan/draft-determination-2024/thematic-chapters/TMS-DD-041-Thames-Water-Risk-and-Return.pdf

[26] Southern Water, PR24 Redetermination Statement of Case (March 2025), pp 386-390.

[27] Anglian Water, PR24 Redetermination Statement of Case (March 2025), pp 149-150.

[28] South East Water, PR24 Redetermination Statement of Case (March 2025), pp 68-74.

[29] Thames Water notes that South East Water's proposed PCL remedy differs from those proposed by Anglian Water and Southern Water.

[30] Thames Water, Draft Determination Response, TMS-DD-039: Thames Water PR24 DD response – Outcomes (August 2024), section 5 on Water Supply Interruptions: https://www.thameswater.co.uk/media-library/home/about-us/regulation/our-five-year-plan/draft-determination-2024/thematic-chapters/TMS-DD-039-Thames-Water-PR24-DD-response-Outcomes.pdf

[31] Ibid, page 27.

(iv) **PCDs should not apply to base expenditure:** The PCDs should apply only to enhancement programmes, not base expenditure.

(53) Northumbrian Water challenged certain PCDs introduced by the FD, which claw back allowances for activity that is deemed not to have been delivered under previous AMPs.[32] Thames Water agrees that it is inappropriate to clawback base costs funding as this amounts to retrospective regulation.

8 Thames Water's submissions on Disputing Companies' arguments in relation to returns

(54) Every Disputing Company raised concerns with the level of the weighted average cost of capital set in the FD. Thames Water agrees that the allowed return does not appropriately reflect the risks associated with operating a water company today and will not allow the sector to attract the level of investment it requires. To make the sector an attractive home for long-term equity and debt investment, a reasonable rate of return, which takes account of the level of risk inherent in the water sector, is required. Thames Water believes that the CMA should have regard to KPMG's Report on Estimating the Cost of Capital for PR24 dated March 2025, which was jointly commissioned by Thames Water and some of the Disputing Companies.

(55) Finally, Thames Water agrees with the Disputing Companies that – in particular noting the significant equity and debt capital required to unlock the step-change in investment at AMP8 and the fact that the UK water sector faces heightened regulatory and political risk – it is imperative that the CMA undertake a robust analysis to ensure that its re-determination is financeable.

[32] Northumbrian Water, PR24 Redetermination Statement of Case (March 2025), page 115.

Annex – Additional evidence regarding the MeXes

1 Introduction to the MeXes

(1) This Annex provides further information and evidence regarding the MeXes that Thames Water considers may assist the CMA in its assessment of the MeXes as part of the CMA re-determination process. This Annex is structured as follows:

(i) **Section 2** addresses the MeXes package as a whole;

(ii) **Section 3** addresses the Customer Measures of Experience;

(iii) **Section 4** addresses the Developer Services Measure of Experience; and

(iv) **Section 5** addresses the Business Customer and Retailer Measure of Experience.

(2) Thames Water agrees with Southern Water's argument that *"the proposed ODI rates for the MeXes are excessive compared to the revenue of the relevant price controls".*[33] The evidence provided in this Annex is intended supplement this position.

2 The Measures of Experience are overpowered

(3) Thames Water's principal concern is that the MeXes are overly powered. The size of the incentives is excessively large given the scale of the activities with which they are associated, the scale of incentives used in PR19 and in other regulated industries for similar measures, and compared to other parts of the PR24 outcomes regime.

(4) Table 1 sets out Thames Water's total level of forecast penalties in comparison to total appointee revenue over AMP8. It shows the FD penalty exposure to be far higher than at PR19 – doubling for water/waste and quadrupling for the MeXes. It also shows that the MeXes are disproportionately large even compared to other parts of the PR24 outcomes framework, at 15%-30% of relevant revenue, compared to 1%-5% for other areas. While the information provided in the table is specific to Thames Water, we maintain that similar underlying relationships would be seen for other companies.

[33] Southern Water, PR24 Redetermination Statement of Case (March 2025), page 405, para 181.

Table 1: ODI penalties for MeXes are not proportionate

	AMP8 relevant revenue[34]		FD ODI penalty exposure	% of direct revenue	PR19 penalties
	Direct	Indirect			
Water PCs	£7,237m	N/A	£51m	c.1%	£140m
Residential Water	£5,688m		-		
Business Water	£1,549m		-		
Wastewater PCs	£7,636m	N/A	£331m	c.5%	£150m
Residential Wastewater	£6,376m		-		
Business Wastewater	£1,260m		-		
C-MeX	£1,215m	£12,065m	£189m	16%	£70m
D-MeX	£316m	N/A	£94m	30%	£20m
BR-MeX	N/A	£2,809m	£94m	N/A	N/A – new PC
TWUL Total Appointee	**£16,404m**		**£760m**		**£400m**
of which MeXes	£1,531m		£378m	25%	£90m

3 Customer Measure of Experience ("C-MeX")

3.1 Background to C-MeX

(5) C-MeX was first introduced in PR19 to incentivise excellent levels of service in the sector.[35] Three of the design criteria were to "*encourage companies to improve customer experiences and innovate*", "*measure performance across companies consistently, reliably and fairly*", and "*be proportionate*".[36]

(6) C-MeX scores are given out of a total of 100 (with 100 being the highest score) and are based on two customer surveys, carried out during the course of each year:

[34] Thames Water has distinguished between direct and indirect revenue for the purpose of assessing the proportionality of MeXes penalties vs the 20 operational PCs. This is to recognise that Ofwat's MeXes penalties cover both: (1) direct revenue paid by customers to support Thames Water's operations in each area, which shows where total Thames Water's appointee revenue for AMP8 (£16,404 million) is generated across the customer segments residential customers, business customers and developer services; and (2) indirect revenue reflecting customers level of satisfaction with Thames Water's overall level of service, which shows the amount of revenue paid by customers, but where the revenue paid is primarily covered by the 20 operational PCs.

Thames Water's direct revenue assumptions are that the ten water and wastewater PCs covering company performance in Water and Wastewater Network+ price control allowed revenue, respectively, i.e. the C-MeX CSS survey covers Retail performance and the D-MeX surveys covers developer services price control allowed revenue. Thames Water receives no Retail revenue from business customers as it has exited this market.

Thames Water's two indirect revenue assumptions are that the C-MeX CES survey covers customers' general satisfaction with the Company, which therefore relates to total Water and Wastewater Network+ revenue from residential customers, and that the BR-MeX survey relates to business customers' satisfaction with Thames Water and therefore total revenue from business customers. Please note, Thames Water receives no Retail revenue from business customers as it has exited this market. All aspects of the D-MeX surveys relate to developer services price control revenue so it therefore does not have a secondary revenue.

[35] Ofwat, PR19 final determinations: Customer measure of experience (C-MeX) and developer services measure of experience (D-MeX) policy appendix (16 December 2019), page 4: https://www.ofwat.gov.uk/wp-content/uploads/2019/12/PR19-final-determinations-Customer-measure-of-experience-C-MeX-and-developer-services-measure-of-experience-D-MeX-policy-appendix.pdf.

[36] Ibid, page 6-7.

(ii) The Customer Service Survey ("**CSS**") is taken from a sample of household customers who have contacted their water company, which asks how satisfied the customer is with how the company handled their contact.[37] This includes water, waste and retail interactions, though in practice the vast majority of contacts relate to billing.[38] In PR24, it contributes two-thirds of the C-MeX score (compared to 50% at PR19).

(iii) The Customer Experience Survey ("**CES**") is taken from a random sample of the water company's customers. It asks customers to score how satisfied they are with their company out of 10. It contributes to one-third of the C-MeX score (compared to 50% at PR19).[39]

(7) For PR19, rewards and penalties were calculated for each company relative to the top, bottom and industry median score. For PR24, the company C-MeX score is compared to a cross-industry common benchmark target. Specifically, this is the UKCSI all sector benchmark median score for the relevant year, minus 5 for 2025-28 and minus 4 for 2028-30. Ofwat states that it made this adjustment "*because this is the long-term difference between the UKCSI all-sector average and the UKCSI utilities sector average*".[40]

(8) Ofwat has set an ODI rate of £4.57 million per C-MeX point.[41] It has also set a maximum penalty collar of 0.4% of notional equity in the appointee RCV each year.[42]

(9) Across the industry, as evidenced by Table 2 below, scores have **declined over AMP7 so far**. Every company's score fell between 2020/21 (the first year of full operation) and 2023/24.

Table 2: PR19 C-MeX scores[43]

Company	2020/21	2021/22	2022/23	2023/24
TMS	72.9	68.8	67.0	64.9
SRN	74.6	72.0	69.8	66.9
AFW	77.9	76.6	74.6	73.2
SES	79.0	76.4	76.0	72.5
SEW	80.7	76.6	73.5	70.8
SWB	81.0	78.5	76.5	72.8
HDD	81.4	78.8	80.0	77.4

[37] On 27 February 2025, Ofwat announced that the CES survey question had changed, instead of asking about satisfaction with the recent contact, it would now ask how satisfied the customer was with their water company. This could lead to a more general perception driven answer, rather than one related to service. The impact of this change, and the move to 100% digital surveys, is not yet understood but is anticipated by Thames Water to potentially reduce scores.

[38] The CSS is weighted with half of surveys for billing, one quarter for waste, and one quarter for water.

[39] Ofwat, PR24 final determinations: Delivering outcomes for customers and the environment, "**PR24 Delivering outcomes**" (19 December 2024, republished 6 February 2025), page 233: https://www.ofwat.gov.uk/wp-content/uploads/2024/12/7.-PR24-final-determinations-Delivering-outcomes-for-customers-and-the-environment-1.pdf.

[40] Ibid, page 238.

[41] Ofwat, PR24 final determinations: Key dataset 1: Outcomes data, "**Key dataset 1**" (republished 26 February 2025): https://www.ofwat.gov.uk/wp-content/uploads/2025/02/PR24-Key-Dataset-1-Outcomes-data-V5.xlsx.

[42] Ibid.

[43] Ofwat, PR24 final determination models: Customer measure of experience – C-MeX, (2024): https://www.ofwat.gov.uk/wp-content/uploads/2024/12/PR24-FD-PD02-Customer-measure-of-experience-C-MeX.xlsx.

Company	2020/21	2021/22	2022/23	2023/24
SSC	81.9	83.4	79.9	76.3
SVE	82.4	80.6	79.1	74.2
YKY	82.8	80.4	78.3	76.5
ANH	83.1	80.4	78.8	77.5
BRL	83.3	82.9	80.7	81.0
UUW	83.6	82.0	81.3	78.3
WSH	85.2	82.9	82.9	79.6
NES	85.8	84.5	83.7	81.4
WSX	86.1	84.8	83.0	81.6
PRT	86.2	83.8	83.2	82.9

Upper Quartile	83.6	83.0	81.3	79.6
Industry median	82.4	80.4	79.1	76.5
Lower Quartile	80.7	76.6	76.0	72.8

3.2 The revenue at risk from C-Mex is disproportionately high

(10) The revenue at risk from C-Mex is disproportionately high for the following reasons:

(i) **The revenue at risk is disproportionate to the scale of the retail activities.** For example, Thames Water's level of penalty exposure for C-MeX is approximately 1,000% larger than the allowed return in retail.

(ii) **The revenue at risk is disproportionate compared to other PCs in the FD.** The C-MeX penalty exposure is larger than for any other PC in the FD. Ofwat set a maximum exposure of 0.4% of appointee RoRE. This is used to calculate the ODI rate and to set the collar used (0.4% appointee RoRE). For Thames Water, this equates to a penalty exposure of £189 million over AMP8. This is 60% greater than most key PCs, which are typically set at 0.5% of *either* water or waste RCVs, equating to around £120 million over AMP7. The FD does not justify the disproportionate strength of the penalty compared to other aspects of the package, other than noting that "*strong incentives on C-MeX at PR24 to incentivise a step change in customer service performance*".[44]

(iii) **The revenue at risk is disproportionate in light of customer priorities.** Ofwat's own research places 'provide good customer service' only eighth out of ten customer priorities, as shown in Figure 1.[45] The performance commitments associated with "*providing clean, safe drinking water*", "*prevent sewage entering people's homes*", and "*prevent sewage entering rivers, streams and the seas*" have lower total revenue

[44] PR24 Delivering outcomes, page 239.

[45] Savanta for Ofwat, Customer Spotlight: People's views and experiences of water – Wave two (10 April 2024): https://www.ofwat.gov.uk/wp-content/uploads/2024/04/Customer_spotlight_Peoples_views_and_experiences_of_water_wave_two_Savanta_report.pdf.

at risk in Ofwat's FD outcomes framework. Thames Water's own research shows similar results (see Figure 2). This indicates that C-MeX is overpowered relative to other ODIs when assessed using the yardstick of customers' priorities.

Figure 1: Customer priorities, Ofwat/CCW study (April 2024)

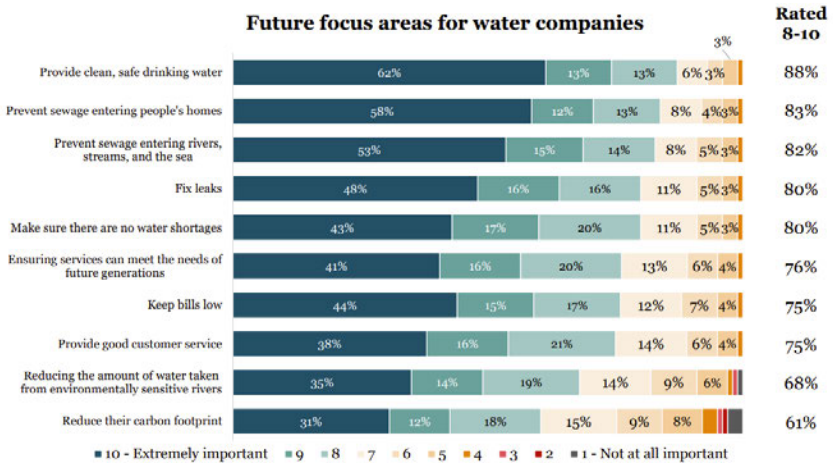


Figure 2: Customer priorities, Thames Water customer survey[46]

Figure 59 - Customer ranking of 'Wants'[67]

High priority	I want safe, high quality drinking water
	I want fair and affordable bills
	I want a reliable supply with minimal disruption
Medium priority	I want you to prevent sewer flooding and take waste away safely
	I want you to fix leaks and ensure there is enough water now and, in the future,
	I want you to stop polluting rivers and to improve their quality
	I want you to reduce your impact and restore the environment
Lower priority	I want you to reduce emissions and reach net zero
	I want an easy customer experience and tailored support
	I want you to have a positive impact on the community

(11) The approach used to set ODI rates for high priority PCs at PR24 is to apply a RoRE allocation of 0.6% of *either* water or wastewater regulated equity. It used 0.5% of RoRE for medium priority and 0.4% for lower priority areas such as leakage, river quality and per capita consumption.[47] By contrast, C-MeX uses appointee regulated equity, effectively doubling the size of the starting point for consideration of any financial incentives.

[47] Ofwat, PR24: Using collaborative customer research to set outcome delivery incentive rates (August 2023): https://www.ofwat.gov.uk/wp-content/uploads/2023/08/PR24-Using-collaborative-customer-research-to-set-outcome-delivery-incentive-rates-.pdf.

(12) In comparison to other regulated industries,[48] this makes C-MeX (and indeed D-MeX) an outlier. For example, at RIIO-GD2, Ofgem set a cap and collar for customer satisfaction survey – which encompasses both customer interactions and developer services – of 0.5% of revenue.[49] Revenue is generally much smaller than RCV. In gas distribution, 0.5% revenue would roughly equate to around 0.1% RoRE, compared to the 0.6% set in the FD, for C-MeX and D-MeX. Thames Water is not aware of any equivalent metric to BR-MeX in other sectors, which takes Ofwat's total FD MeXes RoRE exposure for water companies to 0.8%. Whilst noting that Ofgem's RIIO-GD2 pertains to energy networks rather than retail, paragraph 10 above evidences that this is not a priority for water customers.

Table 3: CSAT ODIs based on revenues in other sectors with smaller impact on RoRE vs C-MeX, D-MeX and BR-MeX

Framework	Sector	Service covered	Measurement	Financial incentive?	Basis	RoRE equivalent
RIIO-GD2	Energy	Gas Distribution	CSAT	Yes	0.5% of base revenue	**+/-0.09%**
RIIO-ED2	Energy	Electricity Distribution	CSAT	Yes	0.5% of base revenue	**+/-0.09%**
RIIO-GT2	Energy	Gas Transmission	CSAT	Yes	0.5% of base revenue	**+/-0.07%**
RIIO-ET2	Energy	Electricity Transmission	CSAT	Yes	0.5% of base revenue	**+/-0.06%**
FD	Water	C-MeX	Surveys	Yes	RoRE	**+/-0.4%**
FD	Water	D-MeX	Surveys / Quantitative measures	Yes	RoRE	**+/-0.2%**
FD	Water	BR-MeX	Surveys / Quantitative measures	Yes	RoRE	**+/-0.2%**

(13) Table 3 indicates that the scale of the C-MeX penalties is disproportionate compared to other sectors. By way of illustration, Thames Water's C-MeX incentive penalty exposure in AMP8 (£189 million) exceeds the customer satisfaction related ODIs in the entire electricity and gas transmission and distribution sector. These are forecast to sum to around £165 million for RIIO-2 across 14 companies. This is clear evidence that the scale of the C-MeX penalties is disproportionate.

[48] Whilst energy networks do not have a billing function, they have substantial customer facing activities including operational activities, connections, and supply continuity. It is also relevant that only one-third of the C-MeX survey sample relates to customer billing.

[49] Ofgem, RIIO-2 Final Determinations – GD Sector Annex (revised) (3 February 2021): https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_gd_annex_revised.pdf.

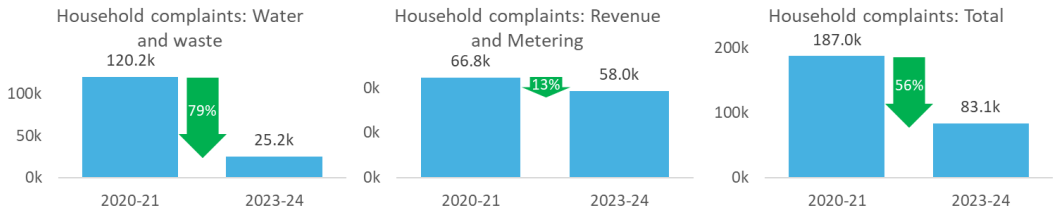
(14) Finally, it is also unusual for a qualitative, stated-preference survey to be used, when there are relevant quantitative metrics such as complaints and resolution rates available. We note that Ofwat decided against including the volume of complaints in C-MeX for PR24 due to concerns about the robustness of the current data across the sector.[50] The other parts of the MeXes regime – D-MeX and BR-MeX – use quantitative metrics as part of arriving at an overall score. Using a mixture of qualitative and quantitative metrics would be more consistent with regulatory good practice.

3.2.1 The C-MeX is flawed: penalties are driven by reputation rather than performance

(15) Many companies, including Thames Water, have invested heavily and exerted substantial management effort to improve customer experience, but have not managed to improve C-MeX scores. C-MeX is not an effective incentive to improve customer experience in AMP8, if companies cannot materially influence the score via operational improvements.

(16) By way of example, Thames Water has invested heavily and improved its operational performance, yet its C-MeX score has declined. Thames Water has improved its customer performance KPIs over AMP7, in particular with respect to customer complaints. Figure 3 shows that Thames Water's total number of household complaints reduced by 56% between 2020/21 and the end of 2023/24, with improvements made in both water and waste (79%) and billing and metering (13%).

Figure 3: Thames Water has significantly reduced complaints during AMP7

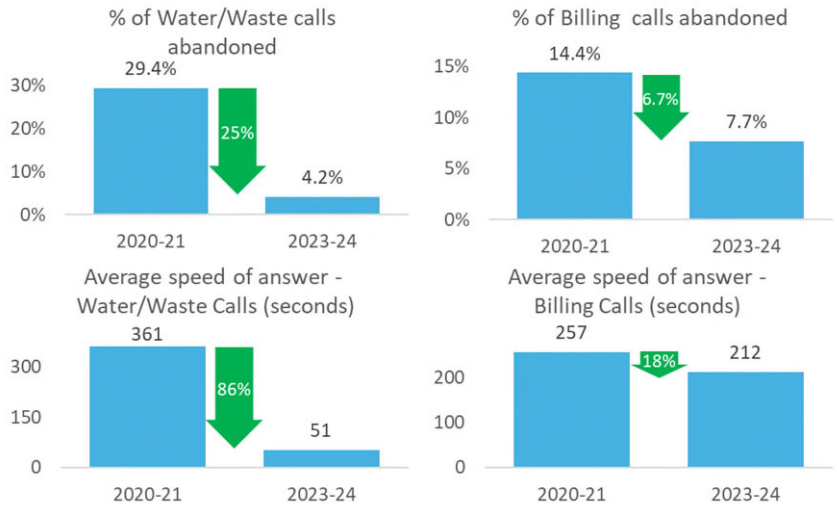


(17) Thames Water's investments and work to improve customer experience when contacting it have delivered significant improvements. Figure 4 shows that the number of calls abandoned by customers has reduced, with billing calls reduced by 6.7 percentage points and water and waste reduced by over 25 percentage points. The average speed of answer has also improved. The time that customers wait for Thames Water's Customer Service Agents to answer water and waste related calls has reduced from over 6 minutes in 2021/22 to 51 seconds in 2023/24, representing an 86% improvement. Similarly, billing related calls have seen an 18% reduction. However, these improvements have not been reflected in the CSS scores.[51]

[50] Ofwat, PR24 draft determinations: Delivering outcomes for customers and the environment (11 July 2024), page 72: https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Delivering-outcomes-for-customers-and-the-environment.pdf.

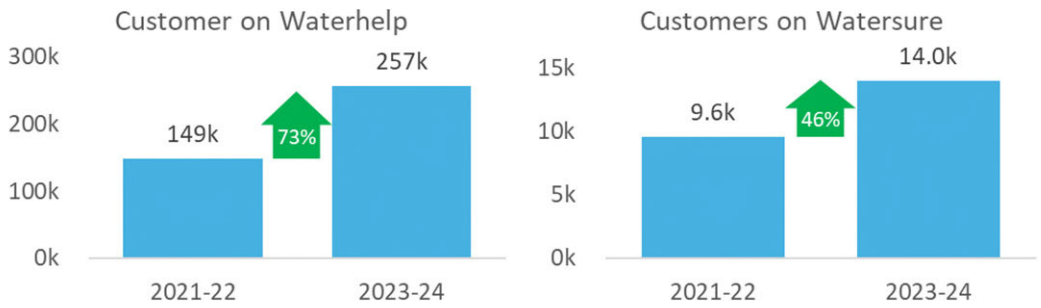
[51] Thames Water's internal analysis.

Figure 4: Thames Water's customers making contact are waiting shorter times and abandoning fewer calls



(18) Thames Water has also increased the number of directly billed customers receiving financial assistance during AMP7 by 71%. The vast majority of this increase is related to the 108,000 additional customers receiving WaterHelp – a 73% increase, as shown in Figure 5. The number of customers receiving WaterSure assistance has also increased by 46%. Neither of these increases have had a positive impact on Thames Water's CES scores.

Figure 5: Thames Water has almost doubled customers receiving financial assistance[52]



(19) Analysis of companies Annual Performance Reports ("**APR**") across the first four years of AMP7 shows that capital expenditure in companies' retail functions totals almost £240 million across the sector.[53] However, they have been unable to materially change their C-MeX scores or ranking.

(20) In practice, there is strong persistence in performance ranking over time. This is evident when examining C-MeX ranking for the four years of AMP7 data, as shown in Figure 6, which shows minimal changes in raking over the four years. While there is some movement for companies near the median – where scores are more tightly clustered – the top quartile and bottom quartile is highly persistent over time. Companies almost never "change lanes".

[52] Thames Water's internal analysis.

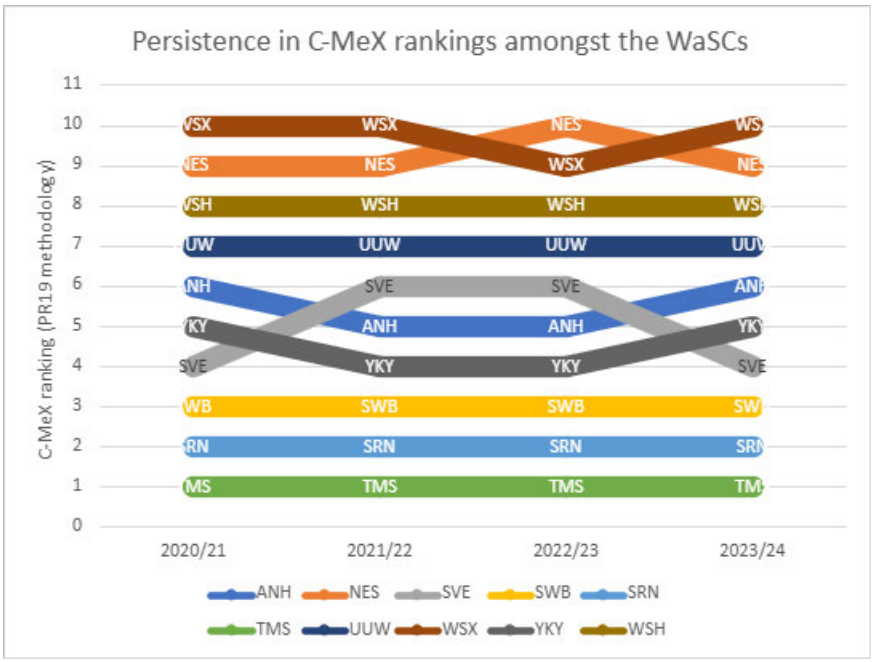
[53] Thames Water's analysis of company APRs.

Figure 6: Persistence in C-MeX rankings over AMP7

Source: Accent Report, 2024

(21) The persistence effects are particularly pronounced for WASCs. Figure 7 shows, in a league table using only WASCs, that all 10 companies are ranked the same in 2023/24 as in 2020/21. Five companies maintain the exact same ranking at all points during the four years of available data.

Figure 7: Persistence in C-MeX rankings amongst WASCs



(22) Recalculating C-MeX scores using the PR24 methodology, a similar pattern emerges.[54] The best performing companies remain at the top of the table, the worst at the bottom and the medium performers remain in the middle. The only company that would have moved more

[54] The difference between PR19 and PR24 methods for the purpose of this comparison is the change in survey weightings.

than two places in the first four years on AMP7 under the PR24 methodology is Hafren Dyfrdwy.

Table 4: Year-on-Year change in C-MeX rankings by company (applying PR24 C-MeX methodology)

	2020/21	2021/22	2022/23	2023/24	Change in ranking
WSX	1	1	3	2	-1
PRT	2	2	2	1	1
NES	3	3	1	3	0
WSH	4	6	4	5	-1
UUW	5	7	5	6	-1
BRL	6	5	6	4	2
ANH	7	8	8	7	0
YKY	8	9	10	9	-1
SSC	9	4	9	10	-1
SVE	10	10	11	12	-2
SWB	11	11	12	11	0
HDD	12	12	7	8	4
SEW	13	13	15	15	-2
AFW	14	14	14	13	1
SES	15	15	13	14	1
SRN	16	16	16	16	0
TMS	17	17	17	17	0

(23) There is also strong persistence in absolute performance. Overall companies' performances have declined over time, despite strong financial incentives to improve. Instances of improvements in C-MeX are rare and immediately offset the following year.

Table 5: Year-on-Year change in C-MeX scores by company (applying PR24 C-MeX methodology)[55]

C-MeX as per PR24 methodology	2021/22	2022/23	2023/24
ANH	-2.87	-1.23	-1.73
NES	-1.30	-0.27	-2.33
SVE	-1.75	-1.55	-5.21
SWB	-2.43	-1.94	-3.11

[55] FD Model C-MeX.

C-MeX as per PR24 methodology	2021/22	2022/23	2023/24
SRN	-1.16	-2.36	-2.97
TMS	-4.25	-1.71	-1.97
UUW	-1.16	-0.71	-2.95
WSX	-0.84	-2.03	-1.33
YKY	-2.44	-1.68	-2.27
WSH	-2.28	-0.11	-2.89
HDD	-2.24	1.30	-3.53
AFW	-1.91	-2.84	-1.13
BRL	-0.15	-1.88	0.29
PRT	-1.66	-0.59	-0.58
SEW	-3.91	-3.54	-2.68
SSC	2.20	-5.04	-3.74
SES	-2.67	-0.18	-4.28

(24) This persistence of negative C-MeX scores indicates that improving actual customer services does not materially improve C-MeX scores for water companies. Despite the investment across the industry, no WASC has improved C-MeX performance during AMP7 so far.[56] The biggest improvement in any year in AMP7 was from South Staffordshire, who improved by 2.2 points in 2021/22 (followed by a 5 point decline the subsequent year and nearly 4 points the year after).

(25) For instance, Thames Water notes that its performance would have to improve by around four times more than any company has ever improved, to even reach the collar (which is expected to be around 68 in 2025/26). Thames Water would then also need to sustain the improvement – something no company has ever done. We would argue that the high likelihood of earning the maximum penalty – regardless of making unprecedented improvements in performance – undermines the incentives on Thames Water to continue to invest and improve customer experience, a challenge which will also impact other companies near the bottom of the current performance range.

(26) In the long term, a metric that does not reward positive changes in operational performance risks those outcomes not being delivered, with consumers being disadvantaged as a result.

4 Developer Services Measure of Experience ("D-MeX")

4.1 Background to D-MeX

(27) D-MeX was first introduced at PR19. It was designed to ensure that water companies provide a good level of service to developer services customers, including small and large property developers, self-lay providers and those with new appointments and variations. The majority of developer services activity relates to the delivery of new water connections and

[56] There is no evidence before this period as C-MeX was introduced (alongside D-MeX) at PR19.

reinforcement of the mains/sewer network to upsize capacity for new development, diverting mains and sewers, and providing permission for developers to connect or build over network assets.

(28) D-MeX performance is measured by two types of customer survey and a quantitative Level of Service metrics score. The customer surveys cover: (1) small developer customers; and (2) large developer, self-lay providers ("**SLPs**") and New Appointee and Variation ("**NAV**") customers who have recently transacted with water companies directly. The surveys are carried out during the course of each year.

(29) A one-third equal weighting is given to the average of each of the two survey results and to the average of the service metrics result to give an overall annual D-MeX score out of 100. This score is then compared to a cross-industry benchmark of median water company performance.

(30) During AMP7, scores across the industry have increased – the upper quartile, median and lower quartile have all risen between 2020/21 (the first year of operation) and 2023/24. Company scores are shown in Table 6.

(31) Ofwat has set an ODI rate of £2.16 million per D-MeX point. It has also set a maximum penalty collar of 0.2% of notional equity in the appointee RCV each year,[57] which is equivalent to around £19 million each year for Thames Water.

Table 6: PR19 D-MeX scores[58]

Company	2020/21	2021/22	2022/23	2023/24
SES	60.2	77.4	84.9	87.0
YKY	62.3	55.1	80.1	83.6
SRN	73.8	77.8	80.6	83.5
TMS	77.6	79.6	80.5	74.5
SEW	79.9	81.3	82.7	87.0
WSH	82.7	83.9	84.7	87.8
SSC	83.6	84.4	87.6	88.5
AFW	84.4	85.5	86.4	87.0
SWB	85.9	85.0	85.9	90.0
BRL	86.8	85.3	90.0	91.1
NES	86.9	88.6	89.9	91.6
ANH	87.7	87.5	87.3	91.2
UUW	88.4	88.4	87.4	90.4
HDD	89.0	91.3	92.9	91.3
PRT	89.2	90.6	92.0	89.4

[57] Key dataset 1.

[58] Ofwat, PR24 Final Determination models: Developer measure of experience – D-MeX (2024): https://www.ofwat.gov.uk/wp-content/uploads/2024/12/PR24-FD-PD03-Developer-measure-of-experience-D-MeX.xlsx.

Company	2020/21	2021/22	2022/23	2023/24
WSX	89.5	89.7	89.9	90.2
SVE	89.7	90.9	91.4	91.9

Upper Quartile	88.4	88.6	89.9	91.18
Industry median	85.9	85.3	87.3	89.4
Lower Quartile	79.9	81.3	84.7	86.9

4.2 The financial exposure from D-MeX is disproportionate

(32) Thames Water considers that the increased financial exposure across the sector is disproportionate compared to: (i) the scale of developer services activity; (ii) other ODIs; and (iii) the approach at PR19. It also represents an exponential increase in exposure compared to PR19, which is not objectively justified.

(33) **The financial exposure is disproportionate compared to the scale of activity.** For example, Thames Water's D-MeX penalty exposure is worth approximately 25% of its developer services allowed revenue. By comparison, the only return that Thames Water earns is the RCV increase of these assets being added to the RCV, i.e. there is no allowed return beyond the cost of capital which remains very low. Other companies with performance across AMP8 that is towards or near Ofwat's collar would have penalties of similar scale, relative to the size of their RCV.

(34) **The penalty is disproportionate compared to other ODIs.** The revenue at risk used to set high-priority ODIs has generally been 0.5% or 0.6% of notional equity for either waste or water RCVs. At 0.2% of notional equity of the appointee RCV, D-MeX is around two-thirds of the size of high-priority PCs such as Sewer Flooding and Supply Interruptions.

(35) In the FD, Ofwat states that the D-MeX incentive "*is half the size of the C-mex incentives, which we still consider to be proportionate given the amount of revenue from residential retail and developer services*".[59] Thames Water respectfully does not believe that this is sufficient justification for three reasons.

(i) *First*, as set out above, the C-MeX incentive itself is overpowered relative to the scale of residential retail activities. Both C-Mex and D-Mex penalties (at around 25%-30% of revenue) are therefore overpowered in their own right relative to their respective revenues.

(ii) *Second*, Across the sector, the price control revenue for residential retail is considerably larger than for developer services. For Thames Water, the price control for residential retail revenue of £1,215 million is almost four times the developer services price control revenue of £316 million.

[59] Ofwat, PR24 draft determinations: Outcomes - Measure of experience performance commitments appendix, "**DD MoE appendix**" (11 July 2024), page 27: https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Outcomes-Measure-of-experience-performance-commitments-appendix.pdf.

(iii) *Third*, the comparison is not appropriate. Developer services, of which a large majority of work relates to the physical delivery of new connections, is more akin to the water and wastewater network price controls – which together total around £15 billion revenue, with less than 5% of revenue expected as penalty. Thames Water also notes that, with respect to its own business, the C-MeX incentive covers 10 million customers and around 130,000 interactions *every* week compared to a customer base of around 160 developers with a total of around 11,500 water and 1,500 wastewater connections a year.

(36) **The penalty for a low D-MeX score at PR24 represents a very large increase (4-5 times greater) than for a similar low score at PR19.** Ofwat has increased penalties substantially compared to PR19 in two ways.

(i) *First*, it has increased the maximum exposure, which at AMP7 was around £30 million for Thames Water to around £94 million at AMP8 – a threefold increase.

(ii) *Second*, the methodology has changed from a relative penalty (to the median) to one based on a dynamic PCL and on an ODI rate. This methodology change occurred very late in the PR24 process.

(37) Ofwat has increased penalties to far higher levels than at PR19 to "*promote focus*".[60] However, given evidence that water companies are materially improving their performance and that the developer services market has become more competitive during PR19 (as explained below), it is unclear that such large increases are objectively justified.

4.3 D-MeX has successfully driven companies to improve performance in PR19 and the market is increasingly competitive

(38) Unlike C-MeX, at an industry level, the D-MeX incentive (coupled with a competitive marketplace) has driven improvements in performance under the PR19 framework.

(39) Between 2020/21 and 2023/24, the upper quartile D-MeX score improved by 3.4 points, the median by 4.7 points, and the lower quartile by 7.3 points using the PR24 methodology. These are large increases, and shows that the industry is focusing on developer services and improving the quality of service received by developers. Improvements came in both the survey and quantitative metrics components.

Table 7: Sector improvement in D-MeX in AMP7

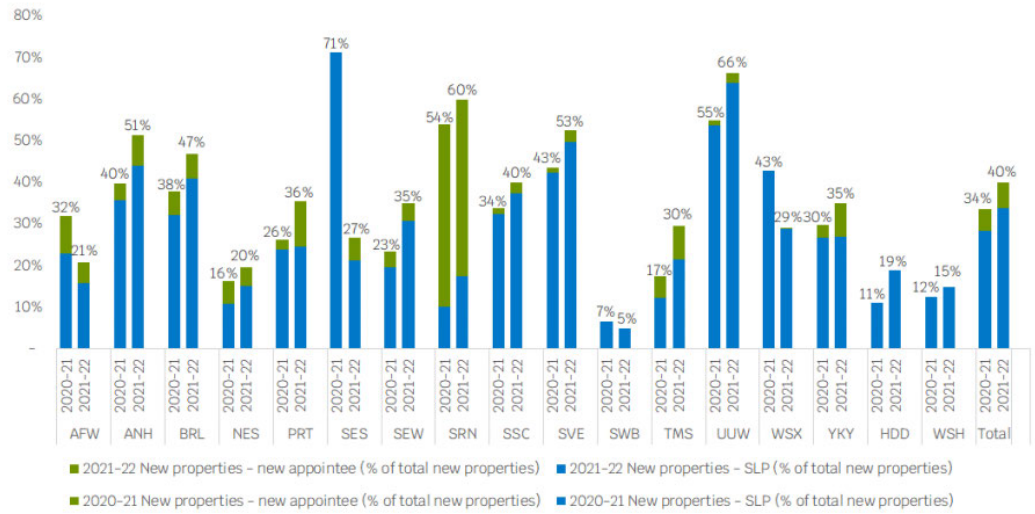
	2020/21	2021/22	2022/23	2023/24	Overall change
P90	86.6	87.9	89.2	88.6	2.0
UQ	84.7	85.4	86.7	88.1	3.4
Median	81.5	80.8	83.1	86.2	4.7
LQ	75.4	76.1	79.6	82.7	7.3
P10	65.9	72.6	75.4	78.3	12.4

(40) Competition in the developer services market is also growing, both in Thames Water's region but also in other water companies' regions. For example, Thames Water already provides relatively few wastewater connections each year – around 1,500 (compared to over 6.1

[60] PR24 Delivering outcomes, page 246.

million properties connected to Thames Water's wastewater network), while its share of new water connections is shrinking. Using APR data from water companies, the figure below shows that in the first two years of AMP7, there was already significant competition in some regions for new connections being held by alternative providers, mostly in the form of SLPs. This shows that: (i) the PR19 incentives are working; and (ii) it is disproportionate to increase penalties for a declining activity.

Figure 8: Properties connected by SLPs and new appointees in 2020/21 to 2021/22 (% of total new properties connected)



4.4 As companies' market share reduces, D-MeX penalties become even more disproportionate

(41) As set out above, the developer services market is increasingly competitive. This means that the D-MeX penalties (meant to simulate a competitive pressure) are increasingly duplicative to the competitive market. As companies' share of new connections shrinks, the scale of D-MeX penalties per developer services customer served grows correspondingly larger each year.

(42) This is especially acute for waste connections. In Thames Water's case, the ODI rate is calculated using 0.2% of equity from the appointee RCV, summing water and waste (£9,441 million on average in AMP8). This is done on the basis that developer services encompass both water and waste connections. If these were hypothetically separated, 0.2% equity of the waste RCV alone would imply a penalty of around £10 million a year for just 1,500 connections – or around £6,600 penalty for every single connection that Thames Water makes. This shows that the overall financial exposure is not proportionate and that the ODI methodology is divorced from reality.

5 Business Customer and Retailer Measure of Experience ("BR-MeX")

5.1 Background to BR-MeX

(43) The BR-MeX is a new measure for PR24, designed to incentivise a wholesale water company to provide an excellent experience for business (non-household) customers and retailers.

(44) BR-MeX measures the experience of business customers and retailers through surveys for each and a score for the Market Performance Framework Metrics ("**MPF Metrics**"). The total BR-MeX score is made up of the Business Customer Experience ("**B-MeX**") survey (50%), the Retailer Experience ("**R-MeX**") survey (25%) and the MPF Metrics (25%). The target will be the median company score. At this stage, Ofwat and the companies have almost no data on how each company (and so the median) may perform at all on B-MeX and only limited information on R-MeX, which together make up 75% of the BR-MeX score.[61]

(45) The MPF Metrics are an evolution of measures monitored by Market Operator Services Limited ("**MOSL**") during PR19.[62] The M15 and M18 metrics relate to wholesaler performance completing bilateral requests, and M12 relates to the quality of the address and premises data that the wholesale holds.

(46) R-MeX is a written survey of water business retailers. It is undertaken twice yearly by MOSL. These surveys have been ongoing in recent years though they have not been financially incentivised.

(47) B-MeX is new for PR24. It is a monthly telephone-based satisfaction survey of business customers who have contacted water companies. There was no historical performance data available for B-MeX at the time of the publication of the FD.

(48) The FD sets the target level as the annual median BR-MeX score. The ODI rate is based on 0.2% appointee notional RoRE at risk. A company's exact reward or penalty will depend "*on the distance between its BR-MeX score from the median BR-MeX score and either the top or bottom BR-MeX* score".[63]

5.2 BR-MeX financial exposure is disproportionate

(49) In the FD, Ofwat notes that "*we consider this level is proportionate to C-MeX and other ODIs*".[64]

(50) In its Final Methodology, Ofwat proposed incentive rates equivalent to 0.05%-0.1% RoRE.[65] Ofwat's Draft Determination states that its rationale for increasing the scale of incentive to 0.2% is "*to make sure that companies are sufficiently incentivised to improve the experiences of end customers, retailers and to support effective market functioning, we are increasing the size of the incentives from our PR24 Methodology to ±0.2% of RoRE and will move to symmetric incentives. We have set it at this level based on the relative size of incentives for the other measure of experience incentives*".[66]

(51) Conversely, however, the number of customers for Business Retail is far smaller than household retail – incentives that are 50% of the size of C-MeX are vastly overpowered. As set out in Section 4, the D-MeX incentives are also overpowered. This is particularly pertinent for BR-MeX given that it is a novel measure with limited to no data available on how companies will perform prior to the commencement of AMP8 (as explained below).

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[61] PR24 Delivering outcomes.

[62] Only M18 is a pre-existing measure used during AMP7. M12 shadow data has only recently been made available.

[63] PR24 Delivering outcomes, page 256.

[64] Ibid.

[65] Ofwat, PR24 Final Methodology - Appendix 8 Outcome delivery incentives (13 December 2022), page 56: https://www.ofwat.gov.uk/wp-content/uploads/2022/12/PR24_final_methodology_Appendix_8_Outcome_delivery_incentives.pdf.

[66] DD MoE appendix, page 32.

5.3 BR-MeX has been insufficiently tested with Ofwat only recently publishing illustrative performance data for the sector

(52) Ofwat's Final Methodology stated, "*We agree with respondents that we need to rigorously test and pilot this new incentive [BR-MeX] and will consider more detailed suggestions on design, as well as the relative costs and benefits, as part of this process*".[67] Introducing large financial incentives with very minimal shadow data on actual performance available is not consistent with rigorously piloting the BR-MeX incentive.

(53) There is regulatory precedent for new measures with high levels of uncertainty to be trialled initially on a reputational basis, in advance of financial incentives. For instance, C-MeX had an extended period of shadow reporting before PR19, which in turn built on CSAT at PR14. Many operational measures were reputational initially before becoming financial at PR19 or PR24. It also allows new methods and outcomes to be tested – such as the Event Risk Index at PR19, which was not taken forward to PR24. This reduces risk of miscalibration or of perverse incentives and generally improves the quality of regulation.

(54) Thames Water is not aware of any other metrics introduced at PR14, PR19 or PR24 (the price controls for which the "outcomes" regime has existed) with such large financial incentives without a relatively lengthy shadow reporting period or extended period of non-financial ODI reporting. Thames Water also notes that other regulators, such as Ofgem when introducing new incentives on emissions for energy networks, allowed for a period of reputational-only incentives.

[67] Ofwat, PR24 Final Methodology, Appendix 7 Performance commitments, December 2022, page 25: https://www.ofwat.gov.uk/wp-content/uploads/2022/12/PR24_final_methodology_Appendix_7_Performance_commitments.pdf.