

## Draft Determination Representations

WSH.DD.CE.10

DPC – Cwm Taf Water Supply Strategy

30 August 2019

## 1. Background

The DD identified our Cwm Taf Water Supply Strategy (Merthyr water treatment works) scheme as being suitable for Direct Procurement for Customers (DPC).

We welcome the DD in that it supports the needs assessment for the new works. We believe that it is imperative that the new WTW is provided as quickly and reliably as possible, as it is required to meet existing DWI statutory obligations and is essential in addressing key single points of failure in the south Wales water supply system.

The proposed use of the DPC route does raise uncertainties for us – in terms of a risk of delay to the delivery of the scheme, whether in practice it would deliver cheaper funding for our customers, and how to ensure the safe operation by a third party operating under contract of such a highly integrated network asset. We would therefore welcome further multi-party dialogue with Ofwat and the DWI on the best way to apply DPC in this case, to achieve the timely and efficient delivery of this strategically important scheme.

We await Ofwat's consultation setting out further details on the approach to DPC. We note Ofwat's expectation that companies should develop business cases for relevant projects to determine whether DPC represents value for money for customers. We will be seeking to progress this in discussion with Ofwat and other stakeholders in due course.

## 2. Base cost adjustment for existing works

In the DD, Ofwat made a negative adjustment to our base cost allowances of £17 million to account for the anticipated reduction in the maintenance allowance for existing works.

The deduction to the modelled base allowance for AMP7 is not justified. Maintenance of potable drinking water to the required legal standards is a clear statutory obligation on the company and it will not be possible to deliver that without maintaining the existing WTWs throughout the AMP7 period, given that the new WTW is not scheduled to come into production until well into the AMP8 period.

Cost assessment modelling already takes account of the ongoing asset management decisions companies make in the knowledge of planned major schemes in the data for the period used to create the cost assessment models and so the allowance derived from the modelling will have already taken this into account. It cannot see the justification for a further £17 million company specific adjustment.

Further, the base expenditure reduction was introduced in the IAP as a perceived consequence of the allowance for design and construction of the first phase of the Cwm Taf strategy. The proposal to pursue the scheme via DPC has fundamentally changed the scope of what is being allowed for and we believe that the £17 million reduction does not take account of this material change and is unwarranted. Any actual base maintenance savings should be taken account of when agreeing the DPC revenue allowance.

### 3. Uncertainty mechanism

Of the two options set out in section 3.1 we prefer a variation of the second option, we would need the adjustment to be an in-period adjustment rather than record scheme costs for consideration at PR24 otherwise there will be no funding available to start delivery in AMP7. The Business Plan has costs of £73 million to undertake design work for the whole programme and commencement of delivery of the first phase. The intervention in the DD disallowed most of these costs and only allowed for the costs of the detailed design phase with a view to putting the delivery out to tender or for delivery in-house if direct procurement was not the best option. The DD recognised that, as no costs have been allowed in the current period for in-house delivery, an uncertainty mechanism would be required.

A notified item is an entirely inappropriate uncertainty mechanism for this scheme. The scale of the residual expenditure and the workings of the IDoK process mean that there is little chance that it would reach Materiality. The overall investment for AMP7 as submitted was some £73 million. The DD allowed for £14 million for the project. The cost assessment feeder model suggests that Ofwat consider that the residual cost of this scheme will be a further £33 million capex over the period. (£73 million less allowed costs of £14 million, less adjustment for size of reservoir of £13m and programme overheads of £13 million.) Moreover, the case is underpinned by significant opex savings that will be achieved from 2025 which, when factored into the Materiality calculation, will substantially reduce this further.

The other proposal, as it stands, will also not be effective as there will be no funding available to start delivery until 2025 if consideration of expenditure was postponed until PR24. However, we believe that this option could work to the benefit of customers if the uncertainty mechanism operates as an in-period adjustment. We would be very willing to work with Ofwat to design a mechanism acceptable to both parties but believe that both of the options in the DD will result in significant delay to the programme of work or may skew the decision for delivery route to a potential inefficient solution which would not be in the interest of customers.