

UUWR_40

PR24 Draft Determination: UUW Representation

Area of representation: Cost and PCD - Water Trading (Strategic Resource Options)

August 2024

This document outlines our representation on the Draft Determination outcomes for Strategic Resource Options (SROs)

Reference to draft determination document: 'Major projects development and delivery'

1. Key points

- **We are reducing our total funding request from £83.9m to £41.31m:** This is to reflect changes in the assumptions and scope associated with the NWT, STT and Kielder SRO projects detailed below.
- **North West Transfer SRO funding request reduced from £77.42m to £37.11m:** This reflects the removal of funding associated with source options which have been discounted following feasibility assessment post business plan submission. We are proposing further feasibility work on portfolio options to identify viable alternatives to support a 25 MI/d trade with Severn Trent and are also assuming a DPC procurement route due to the nature and scale of many of these options. Additionally, following engagement with RAPID, we are proposing additional feasibility activity to further develop NWT support for the Water Resources South East (WRSE) adaptive pathway which could require a trade volume of 180 MI/d.
- **Severn Thames Transfer SRO funding request increased from £1.25m to £2.5m:** Following engagement with RAPID, we have responded to its request by increasing our AMP8 scope to further develop the STT scheme to ensure it is capable of being quickly mobilised if a WRSE adaptive pathway is triggered.
- **Kielder SRO funding request reduced from £5.23m to £1.7m:** In collaboration with partner companies we have revised our funding request based upon the proposed methodology for new SROs outlined in the 'Major projects development and delivery' document¹.

2. North West Transfer SRO

UW's PR24 Proposal

Our October 2023 business plan document *UW62R - Water (Markets) Enhancement Case*² proposed to address the requirements of two Water Resource Management Plan (WRMP) pathways³.

- Firstly, deliver a preferred plan outcome of a 25 MI/d trade with Severn Trent from 2030. This included progression of the NWT SRO through the RAPID gated process and delivery of associated infrastructure, namely three new 'backfill' boreholes – Aughton Park (WR107a2), Tytherington (WR113) and Woodford (WR111) – and enabling works at Lake Vyrnwy (STT A4) to enable water to be released for abstraction in the River Severn.
- Secondly, prepare for an adaptive pathway scenario of a trade up to 180 MI/d with the South East (WRSE) via the STT SRO. This included 'trickle' funding to undertake limited feasibility work on further source options to 'backfill' the 180 MI/d trade volume.

The total funding request for the NWT SRO was £77.42m.

Draft determination position

The Draft Determination allowance is £75.48m. Funding has been split into baseline (£14.13m) and contingent (£61.36m) allowances, with contingent funding being triggered post consents (planning, abstraction licencing etc).

This is referenced in Ofwat's DD⁴.

¹ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>

² https://www.unitedutilities.com/globalassets/z_corporate-site/pr24/supplementary-documents/uw62r.pdf

³ https://www.unitedutilities.com/globalassets/z_corporate-site/about-us-pdfs/wrmp24-drafts/revised-draft-wrmp24-main-report.pdf

⁴ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>, page number 18, Table 5 & page number 24, Table 8

Issues and implications

As stated in our October 2023 business plan document *UW62R - Water (Markets) Enhancement Case*⁵, the three proposed borehole options to achieve the WRMP preferred plan trade of 25 MI/d – namely Aughton Park (WR107a2), Tytherington (WR113) and Woodford (WR111) – were subject to change due to ongoing feasibility assessment through the RAPID gated process. Subsequently, groundwater modelling delivered in collaboration with the EA has established that all three options are no longer viable due to unsustainable abstraction.

As stated in our WRMP, the preferred water trading options were part of a portfolio of options designed to meet water trading needs. Each of these options have progressed to the same level of maturity throughout the Rapid process. In accordance with this approach we are now progressing feasibility on alternative source options to deliver the 25 MI/d. This includes a range of options encompassing both ground water and surface water sources.

Separately, RAPID has indicated through engagement post draft determination that they are seeking further work in AMP8 to further develop the STT SRO and associated support schemes so that they are able to be quickly mobilised if a WRSE adaptive pathway is triggered. As a support scheme, the NWT SRO will therefore require additional scope and pace of delivery than was originally included in our business plan in order to prepare for a 180 MI/d trade scenario.

In summary, there have been material changes to the business plan assumptions for both the preferred and adaptive pathway scenarios and the funding requirement needs to be revised to reflect the latest position.

Approach for final determination

As the Aughton Park (WR107a2), Tytherington (WR113) and Woodford (WR111) sources are no longer viable we propose to remove the contingent costs associated with construction of the assets.

In order to fully assess alternative options to achieve a 25 MI/d trade – which are less mature with respect to feasibility – we are proposing that RAPID Gate 3 is moved to December 2026 and Gate 4 to December 2028, to ensure we can achieve the full requirements of the gated assessment and have confidence in the deliverability of the scheme.

The proposed adjustment of gates to facilitate further feasibility work also impacts the delivery programme of the solution, with an anticipated earliest project completion date of 2032 (dependent upon the source option(s) progressed). This is beyond the 2030 date included in the WRMP preferred plan and we have engaged with Severn Trent to make them aware of the uncertainty regarding which solution will ultimately be delivered and the impact this may have on both programme and cost. They have confirmed that they want us to continue with feasibility work in AMP8 to achieve a 25 MI/d trade.

As the earliest delivery date for backfill sources is assumed to be 2032, we also propose to remove the contingent funding associated with delivery of enabling works at Lake Vyrnwy (STT A4). The forecast construction programme associated with this project is less than 3 years, and therefore could be delivered in AMP9 to align with availability of the source option(s).

A further consequence of our preferred ground water source options being discounted is that our ValueStream option selection model is now considering a number of surface water options within our portfolio to achieve the 25 MI/d trade. The forecast solution costs of these river abstraction options are above the £200m whole life totex threshold for DPC and likely to be suitable for delivery through a competitive delivery model. We are therefore proposing to include costs associated with undertaking DPC related activities ahead of construction, including running the procurement process for the CAP. The costs associated with this activity are in alignment with the methodology outlined on p17 of the Major projects development and delivery document⁶.

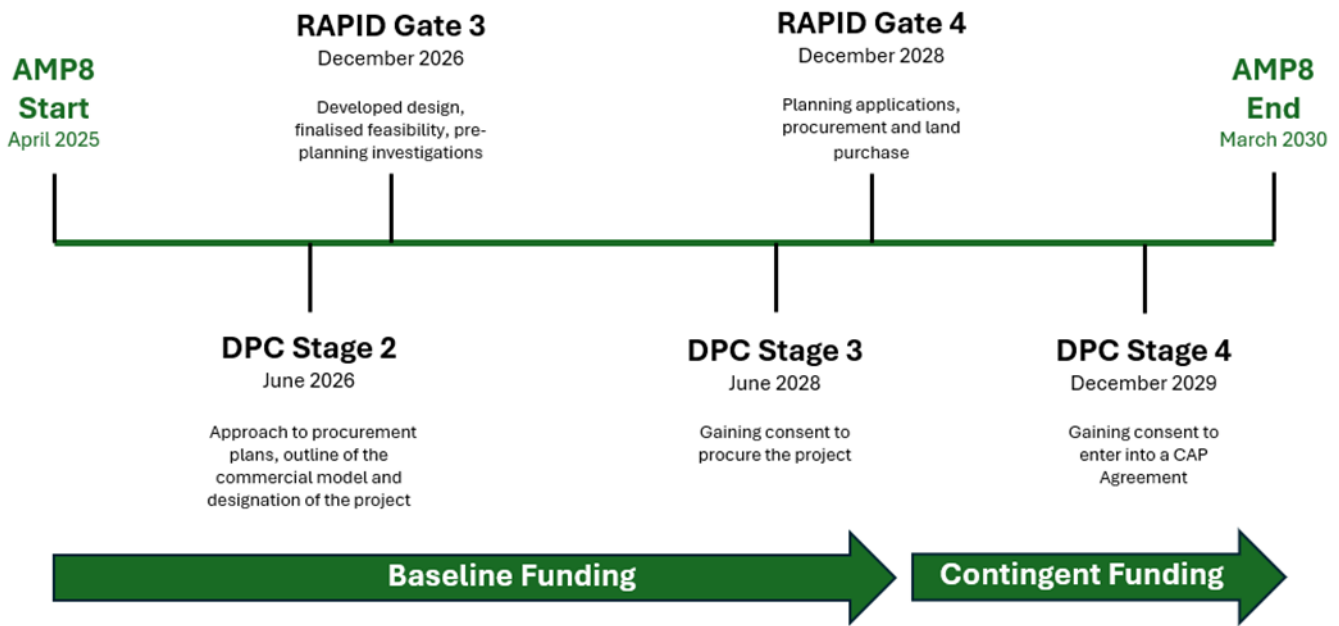
Although we are assuming a direct procurement delivery route, this is subject to change depending on the outcome of feasibility assessment and the solution proposed at RAPID Gate 3. For example, the recommended

⁵ https://www.unitedutilities.com/globalassets/z_corporate-site/pr24/supplementary-documents/uw62r.pdf, Table 1, p6

⁶ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>

solution may fall below the £200m totex threshold or fail to achieve the technical discreteness criteria following detailed design. Figure 1 illustrates how the DPC stage process interfaces with the RAPID gate process.. Given the timing of the change in source options, UUW has not at this stage prepared a DPC stage 1 submission. We propose that, subject to Ofwat confirmation, we prepare a stage 1 submission immediately post final determination in order to establish whether the project is suitable for DPC, and ahead of any further substantial expenditure on a DPC procurement. Subject to the outcome of this assessment, we would then develop a Stage 2 submission prior to Gate 3. This would be a key decision point as it would determine the subsequent procurement strategy.

Figure 1: Illustration of interface between DPC and RAPID processes in relation to the NWT SRO



If the outcome of the DPC assessment is that the solution is not suitable for DPC this will create a financeability risk as there will be no contingent funding in the PR24 business plan to deliver the scheme through an ‘in-house’ model. Ofwat’s proposed approach of companies financing the contingent allowance in AMP8 and recovering the costs in AMP9⁷ presents a significant risk to United Utilities, especially given that the delivery of assets is not for the benefit of customers in our operating area and there may be no contractually binding commitment from the importer to fund those costs prior to construction.

We note in the Major projects development and delivery document⁸ that Ofwat ‘welcome views from stakeholders on the approach for addressing the uncertainty associated with post consent costs’ (p25). To address the financeability risk our preference would be to apply a regulatory mechanism to adjust revenues within period or the application of a risk pot which could be drawn down with Ofwat’s consent, both of which are options considered in the draft determination document (p25). An alternative approach in the context of the NWT SRO would be to re-allocate the funding identified for managing a DPC process to enable an in-house delivery approach, given that construction costs would only be incurred at the end of AMP8 (i.e. post Gate 4 in December 2028).

Finally, with respect to addressing RAPID’s request to further develop the STT SRO and supporting schemes, we propose to undertake further feasibility assessment of source options in the NWT SRO to achieve a potential 180 Ml/d trade. This will include development of source options in preparation for a planning submission and will support rapid mobilisation of the STT solution in the event of a WRSE adaptive pathway being triggered in AMP8.

⁷ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>, p24

⁸ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>

The impact of these proposed scope changes leads to a revised funding request for the NWT SRO of £37.11m (previously £77.42m).

3. Severn Thames Transfer SRO

UUW's PR24 Proposal

As the STT SRO was not selected in a preferred WRMP pathway, our October 2023 business plan document *UUW62R - Water (Markets) Enhancement Case*⁹ proposed limited progression of the project to keep it on 'standby' should a WRSE adaptive pathway be triggered in AMP8. This included funding to undertake limited feasibility work – primarily around commercial / system operation and environmental assessments.

The United Utilities funding request for the STT SRO was £1.25m.

Draft determination position

The United Utilities funding allowance is £1.31m, noting that the funding is allocated 100% to baseline activity (i.e. pre-construction).

This is set out in Ofwat's DD¹⁰.

Issues and implications

Although we have been fully funded for our involvement in the STT SRO, engagement with RAPID post draft determination has indicated that RAPID is seeking an increase in both pace and scope of work beyond that proposed in the business plan to further develop the project and ensure it could be quickly mobilised if a WRSE adaptive pathway is triggered in AMP8. RAPID referenced p16 of the Major projects development and delivery document¹¹ which states that Ofwat is 'challenging companies to identify mitigating actions and enabling works that would increase confidence that the project will deliver in an efficient and timely manner'.

This will require additional activities to be undertaken which were not reflected in the funding request of the original business plan submission.

Approach for final determination

The three STT partner companies are jointly proposing an increase in scope of the project to (i) resolve uncertainty of option viability issues (focused on HRA, permitting, commercial and system design) and (ii) maintain project readiness and minimise schedule risk by providing agility to ramp-up the option in AMP8 if required.

Activities identified to achieve these outcomes include: further HRA assessment including a limited programme of environmental monitoring and targeted expert and legal advice; permitting; interconnector design development; commercial model development; system design and modelling; supply chain technical partner procurement and mobilisation.

These activities would progress the Gate 3 design development but would not include: reactivation of the option to meet either RAPID full Gate 3 or Gate 4 submission milestones, or DCO and DPC activities to meet a pre-2040 water into use target; inquiry or judicial review inputs; or development of new source support options (e.g. Welsh Water).

The impact of this proposed change in scope leads to a revised United Utilities funding request of £2.5m (previously £1.25m).

⁹ https://www.unitedutilities.com/globalassets/z_corporate-site/pr24/supplementary-documents/uuw62r.pdf

¹⁰ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>, page number 18, Table 5 & page number 24, Table 8. 'Do more' reference on page number 16, final paragraph

¹¹ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>, p16

4. Kielder SRO

UUW's PR24 Proposal

Subsequent to Ofwat PR24 queries, in December 2023 we submitted a proposal for a new SRO in conjunction with Northumbrian Water and Yorkshire Water to optimise utilisation of Kielder reservoir. This included exploration of two potential transfers – Kielder to UU and Tees Transfer. On the basis that the Kielder to UU transfer was not contained in current WRMP preferred or adaptive pathways, it was assumed that UU would exit at Gate 2, with the scheme progressing to deliver the Tees Transfer element only.

The United Utilities funding request for the Kielder SRO was £5.23m.

Draft determination position

The SRO has gained approval, but the United Utilities funding allowance is only £0.24m.

This is primarily due to Ofwat proposing that Gate 1 and Gate 2 funding should be from base (as per Final Methodology, p114¹²) on the basis that these early gates are commensurate with WRMP optioneering phases. A small enhancement allowance has been applied to Gate 2 to accommodate potential activities not covered in base (e.g. site based investigations).

In addition, Ofwat has reduced the development cost benchmark (i.e. gated funding allowance) from 6% to 5.5% of forecast solution costs for all new SROs.

Ofwat has agreed with the assumption that United Utilities will exit at RAPID Gate 2 and that the SRO will proceed with Northumbrian Water and Yorkshire Water delivering the Tees Transfer element.

This is referenced in Ofwat's DD¹³.

Issues and implications

There is a shortfall in funding for United Utilities of £4.99m compared to the business plan submission.

Our proposed participation in Gates 1 and 2 is on the basis that we want to work collaboratively to support the exploration of the long term strategic benefits of Kielder, modelling potential utilisation to maximise the benefits not only in the North of England but also the opportunities created to provide additional support to other regions (for example Kielder could enable the NWT SRO to increase support for the STT SRO to meet the future needs of the Midlands and South East).

Given that a Kielder-UU transfer is not included in our current WRMP we cannot justify utilising base funding to explore these national strategic opportunities or participate in a RAPID gated process. This would reduce the scope of the Kielder SRO to only considering the Tees Transfer element and lead to a sub-optimal outcome from a national resilience perspective.

Approach for final determination

We understand from engagement with RAPID post draft determination, that Gates 1 and 2 will be 'lighter touch' in AMP8 with respect to regulatory oversight and that penalty mechanisms will not be applied. A confirmation is expected to be published by RAPID on this topic.

While this pragmatic approach is welcomed and mitigates some of the financial exposure associated with Gates 1 and 2, we do not believe the £0.24m funding for Gate 2 reflects the wide-ranging scope associated with the Kielder SRO, given that it is exploring two inter-regional transfers and the onward national benefits which may accrue from these. Additionally, the requirements of a regulated gated process, funding of the National Appraisal

¹² https://www.ofwat.gov.uk/wp-content/uploads/2022/12/PR24_final_methodology_Appendix_9_Setting_Expenditure_Allowances.pdf, p114

¹³ <https://www.ofwat.gov.uk/wp-content/uploads/2024/07/PR24-draft-determinations-Major-projects-development-and-delivery-1.pdf>, page number 20, Table 6 & page number 24, Table 8

Unit, and mobilisation costs associated with development of a collaborative project (such as common governance processes, legal arrangements and procurement agreements) will not be reflected in WRMP base allowance.

We therefore propose that additional enhancement funding is allowed for Gate 2 based upon Ofwat's revised SRO funding methodology for PR24. This includes a 5.5% of total capex development allowance (previously 6%) and a 10% allocation to Gates 1 and 2 (previously 25%). We have also assumed a relaxation of the regulatory assessment of early gate submissions and a reduced project scope.

The impact of these proposed changes leads to a revised United Utilities funding request for the Kielder SRO of £1.70m (previously £5.23m).

5. Revised Funding Request

The financial impact of the scope adjustments outlined in this representation are summarised in Table 1 below.

Table 1: Summary of revised funding request (FY 2023 Price Base, Pre Frontier Shift)

SRO Project	AMP8 (£m)					Total (£m)	AMP9
	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030		
North West Transfer SRO	£8.51	£7.25	£6.69	£6.59	£8.07	£37.11	£9.21
Severn Thames Transfer SRO	£0.50	£0.50	£0.50	£0.50	£0.50	£2.50	
Kielder SRO	£0.57	£0.75	£0.38	£0.00	£0.00	£1.70	
CAPEX			£41.31			£41.31	£9.21