

# New cost adjustment: Diversions special factor

Cost assessment representations: Appendix

## Document Reference: D003d

This document contains the new cost adjustment claim for diversions gross expenditure within the Water and Wastewater network plus price controls that is not adequately reflected within Ofwat's botex baselines, causing issues within the derivation of net totex for AMP7.

**United Utilities Water Limited**



## Cost adjustment claim summary form

Name of claim	Diversions		
Claim identifier			
Price control(s) the claim relates to.	Water network plus Wastewater network plus		
Total opex of claim for 2020-2025	£111.6m gross (infrastructure renewals expenditure) est. £90.11m net		
Total capex of claim for 2020-2025	£0m		
Depreciation on capex in 2020-2025 (retail controls only)	n/a		
Remaining capex required after 31 March 2025 to complete construction	£0m		
Whole life totex of claim	n/a		
Expected materiality of claim impacting on 2020-2025 as percentage of business plan (5 year) totex for the relevant control(s) (please tick)	1-6%	6-10%	>10%
	✓		
Is the claim likely to feature as a Direct Procurement for Customers (DPC) scheme? (please tick)	Yes		No
			✓

Test	Brief summary of evidence to support claim	Page
<b>Need for cost adjustment</b>	Base costs models only account for historic gross diversion expenditure and do not include any variables that can predict a company's diversion activities. This results in there only being a small 'implicit allowance' for diversion expenditure within the botex baseline which, given the atypical size of United Utilities AMP7 expenditure requirements, is not sufficient to deliver the programme.	6
<b>Management control</b>	We have no control over the third parties that seek to construct developments or new infrastructure within the proximity of our assets or the approval that they obtain from planning authorities.	8
<b>Need for investment</b>	The request for developer driven diversions falls under section 185 of the Water Industry Act (WIA) whereas larger diversions will typically fall under the New Roads and Street Works Act 1991 (NRSWA). Both of these different pieces of legislation give the developers the right to request the company to move our infrastructure.	9
<b>Best option for customers</b>	We work alongside the developer/third party to assess all options before agreeing on the best solution for both parties which, as a last resort, would be a diversion. The alternative would be to amend the developer/third party's scheme to accommodate the	9

	existing water main or sewer, e.g. put public open space over the easement strip. When a Developer Driven diversion is required, we work alongside the developer to agree the costs and timescales for the scheme.	
<b>Robustness and efficiency of costs</b>	We undertake a competitive tender for all of our diversions projects and the selection of the final contractor is agreed with the developer/third party, confirming the estimated cost and availability to carry out the work in the agreed timescales. This approach ensures that all parties are comfortable that the costs incurred (that will be recharged) are efficient.	10
<b>Customer protection</b>	<p>Our assumption is that:</p> <ul style="list-style-type: none"> <li>• gross expenditure incurred in the delivery of HS2 (and NRSWA activities) will be 100% recoverable and that</li> <li>• the revenues will sit outside of the price control (i.e. they are non-price control grants and contributions) in line with Severn Trent and Thames' categorisation in AMP6.</li> </ul> <p>This means that should the requirements of HS2 change, there will be no impact on customer bills as it would not be subject to the WRFIM and therefore any under/over-recovery would not be balanced from the revenues recovered from customers, removing this potential bill volatility.</p>	13
<b>Affordability</b>	Customer research to date indicates that application of the proposed cost adjustment is capable of being incorporated within a plan that is affordable, financeable and acceptable. Affordability of the plan in the round was evidenced in the September business plan.	13
<b>Board assurance</b>	The evidence used within this document has been based upon information developed for and used within our PR19 business plan, which was subject to explicit board assurance processes. The UUW Board Statement within our PR19 business plan confirms that the plan included well evidenced, efficient and challenging cost forecasts, including cost adjustment proposals which are conditional on the nature and basis of Ofwat's final cost models. A robust 'three lines of defence' assurance framework as documented within section 10.3 of our business plan supported this board statement.	13

## Introduction

In deriving the net totex baseline for each company, Ofwat has made assumptions on the appropriate recovery rates and grants and contributions resulting from activities related to diversions (both mains and sewer). These assumptions do not reflect the predictions made within botex models used in setting gross expenditure for cost assessment with the resulting disconnect causing issues for the legitimacy of the modelled view of net totex.

The result of this is that Ofwat's net totex baseline is approximately £105m lower than it should be (*ceteris paribus*) of which approximately £99m<sup>1</sup> is due to Ofwat's assessment of diversions grants & contributions.

We raised the potential for this issue to occur within our IAP response '*1001 - Response to Actions*', however, Ofwat has not corrected for this within their process and therefore it is necessary that we submit a new cost adjustment claim to correct for this issue.

Whilst specific enhancement models cover new connection and new development activities, diversions (gross) expenditure is included within base expenditure models. These costs and activities are therefore not explicit within the baseline but an appropriate calculation of diversions grants and contributions within net totex must account for the fact that **there is only an implicit allowance within the gross botex modelled 'allowance'**. Simply using the company forecast for grants and contributions will over/under remunerate companies if their forecast activities differ from the historic average. This is a particular issue for diversions, for two reasons:

- It is an activity demanded by a third party, and hence is not predictable or particularly within management control; and
- It is predominantly rechargeable to the third party, so the risk of ex post variation to the company, or to customers (in general) should be negligible.

We sub-divide our diversions activities into three distinct categories:

1. **Developer driven diversions under s185 of the Water Industry Act** – Moving our existing water/wastewater infrastructure at the request of developers.
2. **New Roads and Street Works Act 1991 (NRSWA) diversion schemes** - Moving our existing water/wastewater infrastructure at the request of a third party under NRSWA, due to the construction of new road or rail infrastructure authority in accordance with NRSWA 1991.
3. **One off significant infrastructure diversions, not related to connection activity** (e.g. HS2) – Moving our existing water/wastewater infrastructure to enable the new road/rail infrastructure to be installed outside of NRSWA arrangements at the requested of HS2 Limited.

Each of these categories of diversion activity require different types of intervention that vary by their complexity and value. Developer driven diversions will tend to involve low complexity and low value interventions whereas diversion schemes under NRSWA can require significantly more complex and expensive interventions and as a result, typically comprise the majority of our expenditure requirements.

It is important to distinguish between the different types of diversion as each have different recovery rates (of grants & contributions) associated with them and therefore the amount of expenditure that is required to be paid for by customers can vary. We currently expect there to be an atypically high number of large diversion activities in AMP7 due to the construction of HS2 and

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<sup>1</sup> £90.11m of gross cost underestimation as set out in this claim plus £8.91m of recovery assumptions associated with NRSWA schemes as set out in section 2.2 of '*D003 - Cost Assessment*'.

large NRSWA diversion schemes that will cause our gross expenditure requirements to be significantly higher than the historic averages of both United Utilities and the industry.

For each of the categories of diversion above, our totex business plan submission included the gross expenditures shown within Table 1 within the Water and Wastewater network plus price controls.

*Table 1 UUU gross expenditure and associated grants and contributions for AMP7 diversion activities*

	Water network plus	Wastewater network plus	Wholesale
Developer driven expenditure	£7.32m	£1.84m	£9.16m
NRSWA expenditure	£20.44m	£21.80m	£42.24m
HS2 expenditure	£40.44m	£19.76m	£60.20m
<b>Gross totex for all diversions</b>	<b>£68.20m</b>	<b>£43.40m</b>	<b>£111.60m</b>

**This claim covers both the Water and Wastewater network plus price controls and is for the full value (less the implicit allowance) of expected gross expenditure for diversion activities of £111.6m.**

We estimate that the implicit allowance with Ofwat’s botex models for diversions expenditure to be £21.49m and therefore **the net value of the claim, which needs to be added to the baseline, is £90.11m.** This implicit allowance is based on our approximation of industry diversions expenditure, Ofwat may be required to collect additional information from companies in order to undertake a more accurate valuation.

We submit this claim as an aid to adjusting for the inconsistency within the draft determination between gross expenditure and grants and contributions. As such, while we have provided as much information as we reasonably can in the time available. However, we do not believe that this detracts from the legitimacy or appropriateness of the claim.

We have also provided a version of Ofwat’s business plan special cost factor data tables Wn6 and WWn8, within document “*Cost assessment data tables – WS2, Wn6 and WWn8*”<sup>2</sup>.

<sup>2</sup> The data tables are consistent with our business plan for AMP7. For FY05 to FY20, costs represent our estimated level of cost relative to our reported contributions for diversions.

## 1. Need for cost adjustment

Whilst specific enhancement models cover new connection and new development activities, diversions (gross) expenditure is included within base expenditure (botex) models. These costs and activities are therefore not explicitly reported within the baseline, but an appropriate calculation of diversions grants and contributions within net totex must account for the fact that **there is only an implicit allowance within the gross botex modelled ‘allowance’ and not necessarily the same prediction.** Ofwat’s application of using company forecast diversions grants and contributions<sup>3</sup> within their baseline implicitly assumes that their botex models account for the same level of gross expenditure that is present within the company plan. This is incorrect.

For both Water and Wastewater, Ofwat develops their botex models using the reported expenditure from 2011-12 to 2017-18 for all companies. Whilst we do not have access to the historic gross expenditure for diversions within the industry<sup>4</sup>, we can infer the amount that each company has spent by utilising the grants and contributions reported within APR table 2E (lines 5 and 12) and table A11 (line 1 and 10) for grants and contributions prior to the Annual Performance Review. We are able to utilise reported information for 2012-13 to 2017-18 but due to the cessation of the June Return process, we do not have the same industry information for 2011-12.

Table 2 Historic reported Water grants and contributions for diversions (nominal prices) [2011-12 estimated]

Company	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total
ANH	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£3.1m	£3.1m
NES	£1.7m	£1.1m	£2.9m	£1.0m	£1.4m	£2.0m	£1.5m	£9.9m
NWT	£1.5m	£3.2m	£2.3m	£6.5m	£6.2m	£9.4m	£7.9m	£35.6m
SRN	£0.3m	£0.5m	£0.5m	£0.6m	£1.6m	£0.5m	£1.3m	£5.0m
SVT	£7.4m	£7.5m	£8.9m	£6.6m	£7.0m	£11.5m	£7.4m	£48.9m
SWB	£0.0m	£0.0m	£0.0m	£0.0m	£0.9m	£1.1m	£0.6m	£2.5m
TMS	£14.1m	£14.7m	£9.1m	£9.4m	£3.5m	£8.6m	£4.7m	£50.1m
WSH	£2.1m	£1.5m	£3.1m	£3.2m	£2.9m	£2.3m	£3.3m	£16.3m
WSX	£0.0m	£0.0m	£0.0m	£0.0m	£0.4m	£0.0m	£0.3m	£0.7m
YKY	£4.3m	£3.4m	£2.9m	£4.4m	£2.9m	£0.1m	£2.0m	£15.6m
AFW	£0.0m	£0.0m	£0.0m	£0.0m	£0.9m	£2.8m	£8.3m	£12.0m
BRL	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m
DVW	£0.0m	£0.0m	£0.0m	£0.2m	£0.1m	£0.1m	£0.0m	£0.4m
PRT	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m
SES	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m	£0.0m
SEW	£0.0m	£0.0m	£0.0m	£0.0m	£0.5m	£0.5m	£1.1m	£2.1m
SSC	£0.0m	£0.4m	£0.4m	£0.8m	£0.5m	£1.5m	£5.6m	£9.1m
<b>Total</b>	<b>£31.32m</b>	<b>£32.26m</b>	<b>£30.05m</b>	<b>£32.64m</b>	<b>£28.96m</b>	<b>£40.36m</b>	<b>£47.07m</b>	<b>£211.34m</b>

Table 3 Historic reported Wastewater grants and contributions for diversions (nominal prices) [2011-12 estimated]

Company	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2011-18
ANH	£0.0m	£0.2m	£0.3m	£0.3m	£0.3m	£0.3m	£3.6m	£4.8m
NES	£2.4m	£1.6m	£1.0m	£2.1m	£7.3m	£0.7m	£0.3m	£13.0m
NWT	£2.6m	£4.5m	£1.6m	£3.7m	£8.7m	£7.7m	£5.1m	£31.3m
SRN	£2.7m	£2.1m	£2.2m	£3.2m	£2.9m	£1.4m	£1.8m	£13.7m
SVT	£2.0m	£1.3m	£3.2m	£2.2m	£2.4m	£2.6m	£2.1m	£13.8m
SWB	£0.0m	£0.0m	£0.0m	£0.0m	£2.1m	£1.4m	£2.2m	£5.7m

<sup>3</sup> [Grants and Contributions model – United Utilities Water](#), Ofwat draft determinations.

<sup>4</sup> Ofwat would be able to request the actual expenditure information for all companies rather than inferring this information through the assessment of grants and contributions.

TMS	£18.7m	£18.6m	£9.5m	£10.4m	£1.2m	£3.4m	£1.6m	£44.7m
WSH	£2.8m	£1.9m	£2.7m	£3.4m	£1.8m	£3.5m	£0.9m	£14.2m
WSX	£0.0m	£0.0m	£0.0m	£0.0m	£0.2m	£0.2m	£0.2m	£0.6m
YKY	£1.2m	£1.3m	£1.2m	£1.3m	£1.7m	£1.6m	£1.4m	£8.5m
<b>Total</b>	<b>£32.4m</b>	<b>£31.5m</b>	<b>£21.7m</b>	<b>£26.6m</b>	<b>£28.6m</b>	<b>£22.8m</b>	<b>£19.2m</b>	<b>£150.3m</b>

Whilst we recognise that the type of diversion dictates how much of the expenditure is recoverable from the third party (e.g. NRSWA), we do not have the knowledge of other company activities of the allocation between the three categories highlighted above. We therefore can only make an assumption in line with the approach that Ofwat have taken within the draft determinations and assume that 100% of expenditures are recovered, or to put this another way, expenditure is exactly equal to the reported grants and contributions stated by each company.

For the purposes of assessing how much expenditure is covered by the models, we have taken the simple approach to trend the missing data for 2011-12 for all companies (even United Utilities for consistency<sup>5</sup>). This is not preferable but including a trended value rather than no value prevents understating the implicit allowance, and given the relatively constant nature of diversions expenditure was deemed to be more appropriate in the interest of balance. After removing the expenditure values shown in Table 2 and Table 3 from each company within the full dataset, we have generated new econometric models<sup>6</sup> with new AMP7 expenditure predictions for each company as supplied previously within '1014 Cost assessment approach data'. The difference between this predicted expenditure and the expenditure within Ofwat's IAP models could therefore be attributed to the implicit allowance for diversions expenditure within the models. The revised predictions and the variance of these to the predictions within Ofwat's IAP assessment are within Table 4 and Table 5.

Table 4 Revised gross totex prediction and variance to the IAP for Water price controls £m (2017-18 CPIH FYA).

Company	Water resources	Network +	Wholesale water	Water resources variance	Network + variance	Wholesale water variance
ANH	267	1,930	2,197	(0.71)	(4.27)	(4.98)
HDD	17	104	122	(0.05)	(0.39)	(0.44)
NES	240	1,319	1,558	(0.42)	(4.20)	(4.62)
NWT	379	2,064	2,443	(0.84)	(6.91)	(7.75)
SRN	105	958	1,063	(0.25)	(2.37)	(2.62)
SVE	336	2,488	2,824	(0.98)	(8.08)	(9.05)
SWB	78	821	900	(0.17)	(2.44)	(2.61)
TMS	459	3,738	4,198	(1.23)	(11.48)	(12.71)
WSH	250	1,055	1,305	(0.63)	(3.72)	(4.36)
WSX	80	520	600	(0.21)	(1.74)	(1.95)
YKY	240	1,466	1,706	(0.54)	(5.10)	(5.64)
AFW	224	1,066	1,290	(0.31)	(3.60)	(3.91)
BRL	69	333	402	(0.20)	(1.25)	(1.46)
PRT	86	146	231	(0.08)	(0.52)	(0.60)
SES	21	196	217	(0.07)	(0.61)	(0.68)
SEW	115	702	817	(0.28)	(2.14)	(2.43)
SSC	50	446	496	(0.12)	(1.34)	(1.46)
<b>Total</b>	<b>3,017</b>	<b>19,351</b>	<b>22,368</b>	<b>(7.09)</b>	<b>(60.16)</b>	<b>(67.25)</b>

<sup>5</sup> Although we know that the actual values are higher for this year, we have opted to maintain a consistent approach to all companies for simplicity.

<sup>6</sup> Including revised efficiency estimates (WWN2/WWWN2) in line with the new model coefficients.

Table 5 Revised gross totex prediction and variance to the IAP for Wastewater price controls £m (2017-18 CPIH FYA)

Company	Bioresources	Network +	Wholesale wastewater	Bioresources variance	Network + variance	Wholesale wastewater variance
ANH	309	2,568	2,877	(2.17)	(10.21)	(12.38)
HDD	5	21	26	(0.03)	(0.13)	(0.17)
NES	122	882	1,004	(0.85)	(4.19)	(5.04)
NWT	366	2,455	2,821	(2.50)	(11.25)	(13.74)
SRN	200	1,891	2,091	(1.43)	(8.25)	(9.69)
SVE	424	2,629	3,053	(2.99)	(13.38)	(16.37)
SWB	91	844	935	(0.62)	(4.12)	(4.74)
TMS	703	3,793	4,496	(4.87)	(20.49)	(25.36)
WSH	157	1,189	1,346	(1.14)	(6.29)	(7.43)
WSX	136	1,231	1,368	(0.92)	(5.28)	(6.20)
YKY	287	2,086	2,373	(2.08)	(8.84)	(10.93)
<b>Total</b>	<b>2,800</b>	<b>19,589</b>	<b>22,389</b>	<b>(19.61)</b>	<b>(92.43)</b>	<b>(112.04)</b>

Although these are activities (you would expect to be) confined to the network plus price controls, because of the utilisation of aggregated modelling, both the Water Resources and Bioresources expenditure forecasts will include some of this implicit allowance. We have not chosen to exclude this from our assessment as it would not be appropriate to simply cherry pick the parts that we wish to use to accentuate the issue. **This indicates that the total modelled expenditure (the implicit allowance) for United Utilities is £21.49m between the two price controls**, significantly less than the gross expenditure that we included within our plan and that which Ofwat uses to develop their view of diversions grants and contributions.

As we have shown above, there is only £21.49m of gross expenditure included within the baseline that can be associated with diversions activities for United Utilities (the implicit allowance). This is significantly less than the £62.67m and £40.03m of operating expenditure grants and contributions (for diversions<sup>7</sup>) that Ofwat includes within their views of efficient Water and Wastewater net expenditure respectively. This results in an additional stretch of £54.92m and £26.29m within the Water and Wastewater price controls without accounting for the impact of NRSWA diversions (i.e. assuming 100% recovery). Given our position at the IAP, these additional challenges are clearly too large to manage within the draft determination 'allowances'. Furthermore, it would not be appropriate for Ofwat assess whether these additional challenges could be accommodated within the draft determination totex 'allowances' as firstly, they place an additional challenge on the totex programme, above that which we accepted at the IAP (which only assessed gross expenditure) and secondly, are due to issues with Ofwat's assumptions and therefore methodological in nature.

## 2. Management control

The requirement to relocate our infrastructure through undertaking diversions is at the request of third parties and can occur at any time. We have little effective control over the extent to which

<sup>7</sup> To calculate this, we have removed the £10.5m of operating expenditure that Ofwat has incorrectly included within the grants and contributions assessment as stated within our response document *D003 - Cost Assessment*. All operating grants and contributions are associated with diversions for United Utilities.



third parties seek to construct developments or new infrastructure within the proximity of our assets or the approval that they obtain from planning authorities. Whilst we could (in some circumstances) choose to leave our infrastructure in situ, the risk of damage to the assets and resulting service issues for customers does not warrant such a risky approach, particularly for an activity for which the costs are recovered from the third party themselves rather than from customer bills.

Although there is no impact (or negligible) to customer bills due to the costs of the diversion being recovered from the requestor/third party, we still seek to achieve the lowest cost option for any intervention. We discuss the approach to optioneering within *Best option for customers*.

### 3. Need for investment

The expenditure for diversion activities does not result in any change to the service received by customers as it only entails the relocation of an existing asset and therefore is primarily concerned with maintaining the current service and risk levels. On occasion, we may undertake additional work in order to enhance the service provided to customers while we relocate the infrastructure, however we account for this activity separately within the network reinforcement programme (enhancement) and do not seek to recover the additional expenditure from the requestor/third party that required the diversion. There may be an improvement to customers in that we are replacing an older asset and therefore reducing the short-term risk of failure for that section, however diversions do not tend to cover significant distances and therefore any reduction in risk of service failure will only be marginal.

Each category of diversion has different legislation underpinning the requirement. The requirement for developer driven diversions falls under section 185 of the Water Industry Act (WIA) whereas larger diversions will typically fall under the New Roads and Street Works Act 1991 (NRSWA) or a special infrastructure agreement such as HS2 legislations. Both of these different pieces of legislation require the developers to *request* the company to move our infrastructure rather than construct around it. We expect that HS2 diversions will be carried out under (yet to be enacted) high-speed rail legislation, as was the case within HS1 phase 1, which was subject to High Speed Rail (London – West Midlands) Act 2017. This Bill is currently in the House of Commons for West Midlands – Crewe section and refers to the Town and Country Planning Act 1990, specifically:

*“11 Extinction of rights of statutory undertakers (1) Sections 271 to 273 of TCPA 1990 (extinguishment of rights of statutory undertakers etc) apply in relation to land held by the Secretary of State as being land which is required for or in connection with the works authorised by this Act as they apply in relation to land acquired or appropriated as mentioned in section 271(1) of that Act.”*

Although we have reviewed our investment proposals in detail with our CCG “YourVoice”, we have not specifically sought assurance from YourVoice around the AMP7 diversions programme as we recover the majority of expenditure incurred from the third party that requests the diversion.

### 4. Best option for customers

In AMP7, any developer who requests a diversion as part of a new development scheme would be surveyed for D-MeX which will ensure that we are incentivised to offer the best possible service to

our customer (in this case the developer). However, the D-MeX survey does not account for requests relating solely to diversions (e.g. NRSWA and HS2).

We work in conjunction with the developer/third party to assess all options before agreeing on the best solution for both parties which, as a last resort, would be a diversion. The options that we consider are to:

- Do nothing (where we are not bound by legislation) and bear the risk of disruptions to service,
- Amend the developer/third party's scheme to accommodate the existing water main or sewer, e.g. put public open space over the easement strip,
- Relocate our existing infrastructure to accommodate the developer/third party's scheme.

We select the most appropriate option in agreement with the third party/developer taking into account the expected costs (using initial estimates from our framework delivery partners) and timescales involved for each option. If a diversion is required, we work alongside the developer to agree the costs and timescales for the scheme. For a NRSWA diversion, we work with the Highways Authority through the following NRSWA gateways:

- **Scheme identification and preliminary enquires** - investigation stage into Developer Services.
- **Budget estimates** – we inform the cost to divert assets that usually includes follow up meetings with the Highways Authority. The estimate is made up of the construction price (by the engineers/UU estimating), cost of design management and supervision, and risk. This is sent back to the developer and they instruct a detailed estimate.
- **Detailed estimates** - more detailed specific quote that is agreed with the Highways Authority.

If the resulting estimate of expenditure and time is acceptable to the developer then we set out the required payments from the developer (i.e. the total rechargeable and the initial upfront payment) and commence relocation of the asset.

**Diversions are generally carried out as the lowest risk solution after considering all other options, in respect of customer impact (supply interruption).**

## 5. Robustness and efficiency of costs

We are committed to improving our engagement with markets in procuring services. This includes comprehensive market testing of our costs via our Market Engagement Methodology (MEM) and Direct Procurement where appropriate, as detailed in Chapter 6 of the price review submission. Through the adoption of our industry leading Market Engagement Methodology (MEM), we are able to strive for a better supply chain and procurement strategy to leverage maximum value from the market to ensure best value for customers.

We undertake a competitive tender for all of our diversions projects (within the non-core/specialist programme of our Network Maintenance Service) and the selection of the final contractor is agreed with the developer/third party, confirming the estimated cost and availability to carry out the work in the agreed timescales. This approach ensures that all parties are comfortable that the costs incurred (that will be recharged) are efficient.

The expected gross costs for AMP7 are set out in detail Table 1 but comprise:

- *Developer Driven* - £9m based on run rate of historic volumes of smaller value schemes

- NRSWA - £42m based on bottom up build of named schemes, the costs of which have come from the latest engineering project estimates (Table 7 below).
- HS2 - £60m based on estimates of scheme costs at the point of our PR19 submission. The value of scheme costs have since changed as further discussions between United Utilities and HS2 Ltd have taken place.

When assessing the cost estimates for any diversion activity it is important that we do not disassociate the grants and contributions received and therefore we should assess the net cost of the diversion. As we are able to recover all of the incurred expenditure for Developer driven and HS2 related diversions, the net expenditure (and therefore the impact on customer bills) is nil and therefore the assessment of efficient expenditure is not applicable. However, for NRSWA diversions we are bound by the legislation set out in The Street Works (Sharing of Costs of Works) (England) Regulations 2000, which states that (emphasis added)<sup>8</sup>:

**“Diversions works executed by an undertaker because of an authority’s major works**

**3.—(1) Where, because of major works initiated by an authority, an undertaker executes diversionary works, the authority shall pay to the undertaker—**

- where the major works are major transport works (other than major bridge works or section 86(3) (a) to (g) works) and payment is made in accordance with regulation 8(1), a sum equal to **92.5 per cent.** of the allowable costs of the diversionary works;*
- in other cases where payment is made in accordance with regulation 8(1), **a sum equal to 82 per cent.** of the allowable costs of the diversionary works;*
- in all other cases, the allowable costs of the diversionary works.*

*(2) This regulation is subject to regulation 6.”*

This legislation results in a small amount of the costs incurred being passed on to customers. Table 6 sets out the expenditure and associated grants and contributions (G&C) for each of the three categories of diversions activity across both Water and Wastewater. This illustrates the full recovery of costs incurred for two out of the three categories, as well as the residual expenditure that is required to be recovered from customers for NRSWA activities (due to legislation).

Table 6 UUU gross expenditure and associated grants and contributions for AMP7 diversion activities

	Water network plus	Wastewater network plus	Wholesale
Developer driven expenditure	£7.32m	£1.84m	£9.16m
Developer driven G&C	(£7.32m)	(£1.84m)	(£9.16m)
NRSWA expenditure	£20.44m	£21.80m	£42.24m
NRSWA G&C	(14.91)	(18.43)	(£33.34m)
HS2 expenditure	£40.44m	£19.76m	£60.20m
HS2 G&C	(£40.44m)	(£19.76m)	(£60.20m)
<b>Net totex for all diversions</b>	<b>£5.54m</b>	<b>£3.37m</b>	<b>£8.91m</b>

Ofwat’s assumption that all diversion activities for United Utilities are 100% recoverable is not possible to achieve due to NRSWA legislation; although the amount of net diversions expenditure will differ between companies depending upon their mix of the three categories outlined above (indeed some companies may only undertake developer driven in a period). Given the tendering process outlined above, the third party (and UUU) must be confident that the gross expenditure

<sup>8</sup> [http://www.legislation.gov.uk/ukxi/2000/3314/pdfs/ukxi\\_20003314\\_en.pdf](http://www.legislation.gov.uk/ukxi/2000/3314/pdfs/ukxi_20003314_en.pdf), page 2

incurred (and therefore the residual net expenditure) is efficient in order to agree to paying for the diversion.

It is important to note that we have not included any additional net expenditure in our business plan to cover future/unplanned diversions and therefore the ‘final’ amount of diversion activities may actually increase from this position. We are therefore not attempting to recover any additional expenditures over and above what we already know, which given the future uncertainties, we think is a reasonable position to take. The alternative would be to include an assessment of future requirements with a resulting increase to net totex to accommodate. For the expenditure included within the plan, we have a full project list to support the planned large-scale diversions activities associated with NRSWA and HS2. All projects are at different stages of maturity, with some being more advanced in their development, therefore having different estimating accuracy. As schemes advance, providing greater certainty of the expected cost, the grants and contributions is updated using the specified recovery rate. This means that the exposure to customer bills is limited to the residual net expenditure rather than solely any gross cost variations.

Table 7 AMP7 bottom up plan for large-scale diversion expenditure and recovery rates (NRSWA/HS2)

Scheme name	Gross cost £m	Grants & contributions £m	Net expenditure £m	Recovery percentage
<i>HS2 Phase 2b - Water</i>	30.6	(30.6)	0.0	100.0%
<i>HS2 Phase 2b - Wastewater</i>	16.0	(16.0)	0.0	100.0%
<i>HS2 Phase 2a - Water</i>	9.8	(9.8)	0.0	100.0%
<i>HS2 Phase 2a - Wastewater</i>	3.8	(3.8)	0.0	100.0%
<b>HS2 Subtotal</b>	<b>60.2</b>	<b>(60.2)</b>	<b>0.0</b>	<b>100.0%</b>
<i>Port of Liverpool</i>	8.5	(6.9)	1.5	82.0%
<i>M56 New Junction 11A (Vyrnwy Aqueduct)</i>	7.0	(5.8)	1.3	82.0%
<i>Windy Harb To Skippool</i>	6.7	(5.5)	1.2	82.0%
<i>Trans Pennine upgrade programme</i>	6.4	(5.2)	1.1	82.0%
<i>Preston Western/Hodder Aqueduct</i>	3.6	(3.0)	0.7	82.0%
<i>Poynton Relief Road</i>	2.7	(2.2)	0.5	82.0%
<i>T2 Western Loop Metrolink Extension</i>	2.6	(2.4)	0.2	92.5%
<i>St Annes Road Bridge Denton</i>	1.0	(0.9)	0.1	92.5%
<i>Middlewich Eastern Bypass</i>	0.8	(0.6)	0.1	82.0%
<i>Kearsley Roundabout</i>	0.6	(0.5)	0.1	82.0%
<i>Liverpool Connectivity Lime St Scheme</i>	0.3	(0.2)	0.1	82.0%
<i>Congleton Relief Road</i>	0.2	(0.2)	0.0	82.0%
<i>Diversions Management Costs</i>	2.1	0.0	2.1	0.0%
<b>NRSWA Subtotal</b>	<b>42.2</b>	<b>(33.3)</b>	<b>8.9</b>	<b>78.9%</b>
<b>HS2 and NRSWA Total</b>	<b>102.4</b>	<b>(93.5)</b>	<b>8.9</b>	<b>91.3%</b>

## 6. Customer protection

There are clearly significant uncertainties outside of our control concerning the future scale of our diversions programmes due to the ongoing issues with HS2 and wider economic growth within the region. However, under our current assumptions **this will not cause any impact for customers** providing Ofwat make consistent assessments in determining allowed costs and revenues in PR19. Our assumption (as discussed within Section 2.3 of 'D003 - Cost Assessment') is that:

- **gross expenditure incurred in the delivery of HS2 (and NRSWA activities) will be 100% recoverable and that**
- **the revenues will sit outside of the price control (i.e. they are non-price control grants and contributions) in line with Severn Trent and Thames' categorisation in AMP6.**

This means that should the requirements of HS2 change, there will be no impact on customer bills as it would not be subject to the WRFIM and therefore any under/over-recovery would not be balanced from the revenues recovered from customers, removing this potential bill volatility.

## 7. Affordability

We have not conducted specific tests for the net expenditure required to deliver the diversions programme given the legislative requirements combined with the risk of inaction. Our PR19 customer research showed that providing a reliable, continuous supply of water ranks second only to safe drinking water in terms of customer priorities. As a result we do not believe that it would be appropriate to reject the request to divert our infrastructure. It also indicates that application of the proposed cost adjustment is capable of being incorporated within a plan that is affordable, financeable and acceptable. We provided evidence of the affordability of the plan in the round within the September business plan.

## 8. Board assurance

The evidence used within this document has been based upon information developed for and used within our PR19 business plan, which was subject to detailed and explicit board review and assurance processes.

The development of our overall PR19 cost proposals and the proposed cost adjustment claims have been subject to detailed independent review and have been reviewed throughout the business including with the United Utilities Water Limited Board. The conclusions from and summary of this Board review process are set out within the following document.

- [PR19 Board assurance statement](#)

To provide confidence to the Board, the development of the cost proposals within our business plan, including the cost adjustment claims, was subject to a robust 'three lines of defence' assurance framework. This framework included a number of broad and deep reviews, which were undertaken by independent specialist assurance partners. These reviews covered both the process and the governance that was applied to the development of the cost and efficiency proposals set out within the plan. In addition to these targeted reviews, Deloitte undertook an overarching review of the submission supported by a number of deep dives onto areas such as the enhancement expenditure proposals.

The framework that was applied to build the required confidence and assurance in our business plan is set out Chapter ten of the plan, with details of the specific assurance undertaken within each section of the plan being set out within supplementary document S9001. Both of these documents are published on our web site and are available via the links below.

- [Chapter 10 Confidence and assurance](#)
- [S9001 Confidence and assurance: Process, controls and assurance of our business plan](#)