

# INSIGHT ON TOTEX OPPORTUNITIES AND CHALLENGES IN WATER SECTOR

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# CONTENT

- Water Price Control Period 2015-2020 – Customer Outcomes and incentives
- What is Totex?
- Role of Totex in delivering customer outcomes – How important is it to implement Totex?
- Totex Best Practice – Strategies for implementing Totex
- Summary and conclusions

# EXECUTIVE SUMMARY

- The AMP6 price control period has a different set of objectives: “Delivering Customer Outcomes” - which has necessitated a new perspective for the sector.
- Introduction of Totex, both as a new cost assessment and as an efficiency incentive, has created an opportunity to help deliver the customer outcomes.
- There are a number of barriers to overcome in order to benefit from Totex incentives, including accounting treatments, legacy capex-bias culture, misalignment of “design and Build” contracts with Totex incentives and shortfalls in operational cost data.
- To benefit fully from the opportunity that Totex presents, substantial changes are needed in the way water companies work, internally and externally. This is evidenced by the progressive changes within utilities, and outside utilities, already taking place.

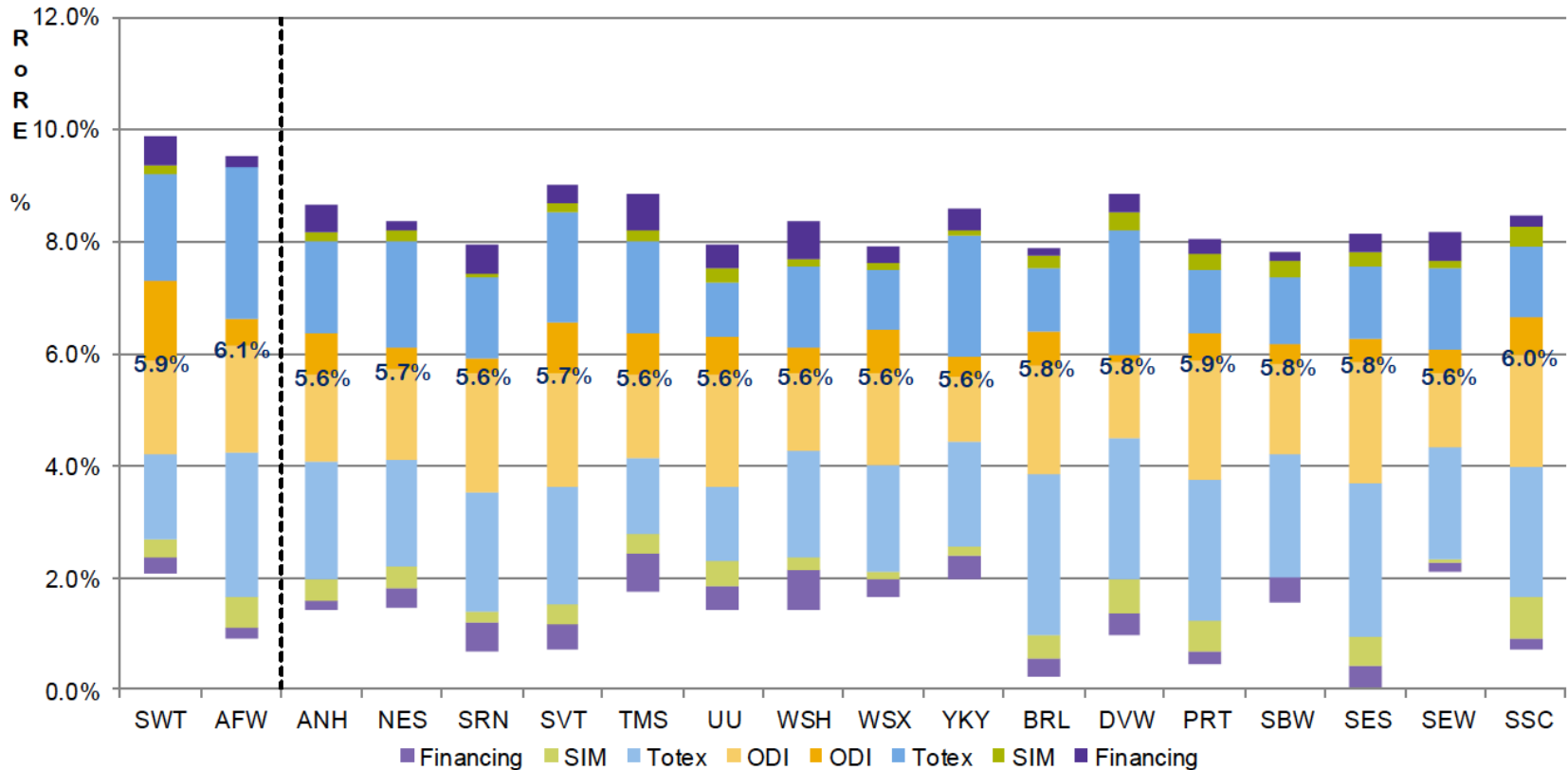
# CUSTOMER PERFORMANCE COMMITMENTS AND OUTCOME DELIVERY INCENTIVES (ODIS)

*Example: Bristol Water's Performance Commitments are built on feedback from customers and stakeholders. Some have financial incentives/penalties:*



# RANGE OF RETURN ON REGULATED EQUITY (RORE) FOR WATER COMPANIES

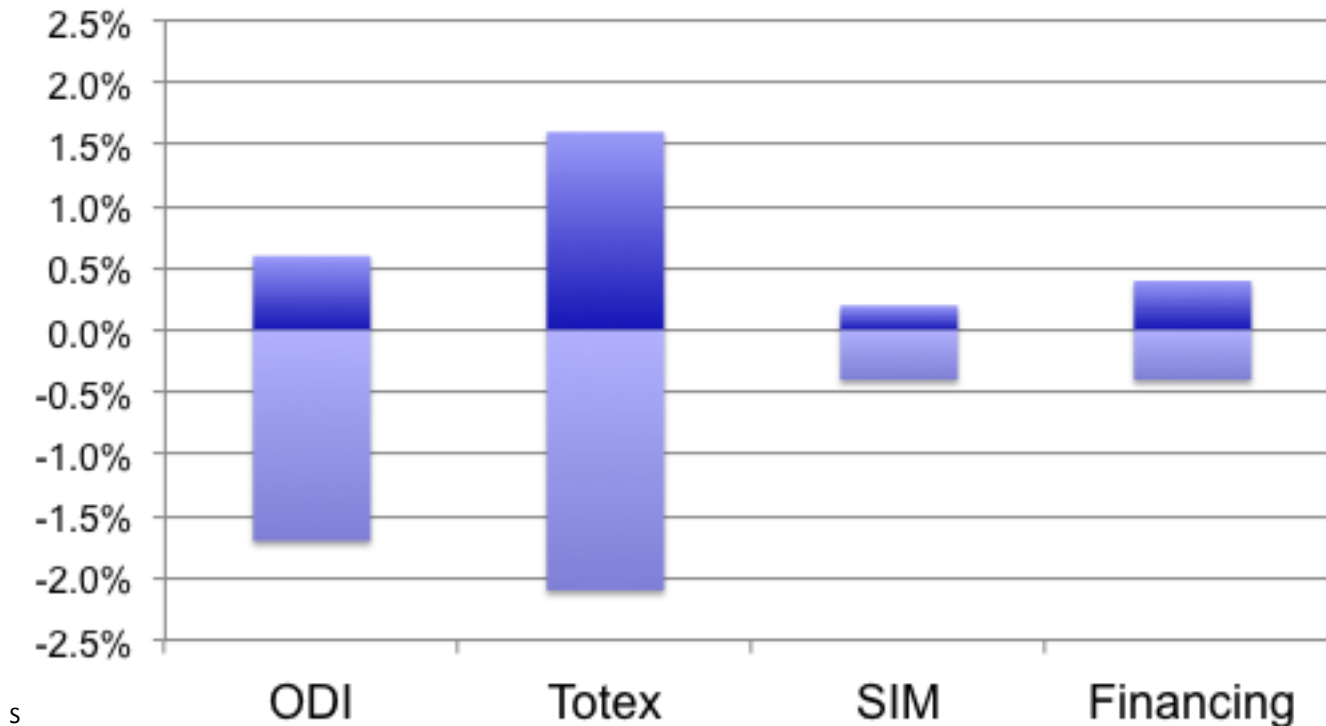
*Incentives in place against ODIs, Totex, SIM and Financing*



**Average RORE of 5.8%, with average variances of -4.6% and +2.7%.**

# IMPACT OF INCENTIVES ON RORE

*Scale of incentives impact on RORE:*



*Totex has the largest potential impact on RORE of +1.6% and -2.1%.*

## WHAT IS TOTEX?

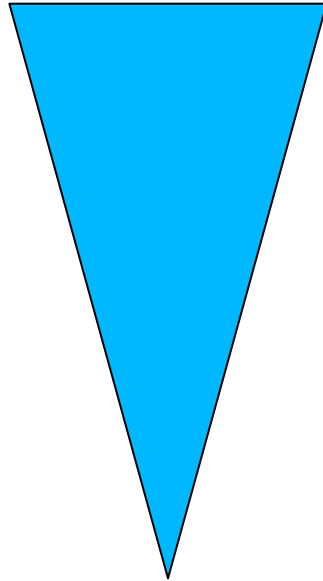
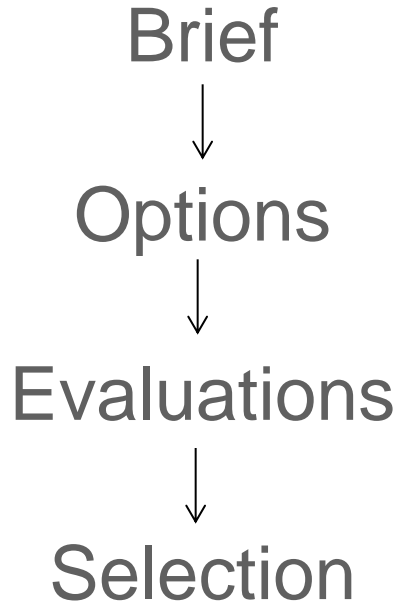
~~Totex = Capex + Opex~~

~~Totex = Design based on Whole Life Cost~~

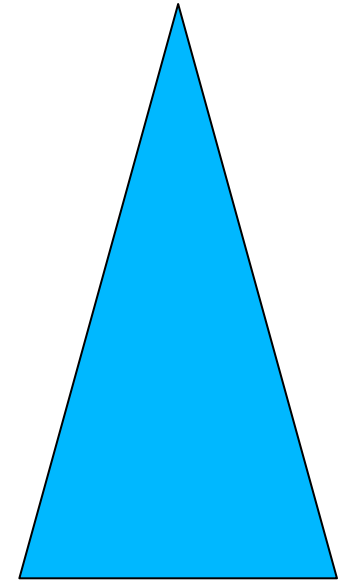
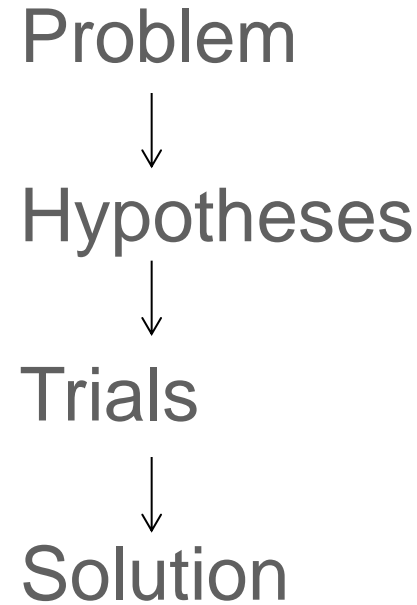
**Totex = Problem Solving without solution  
bias**

# DESIGN V PROBLEM SOLVING PROCESS

## Design Process

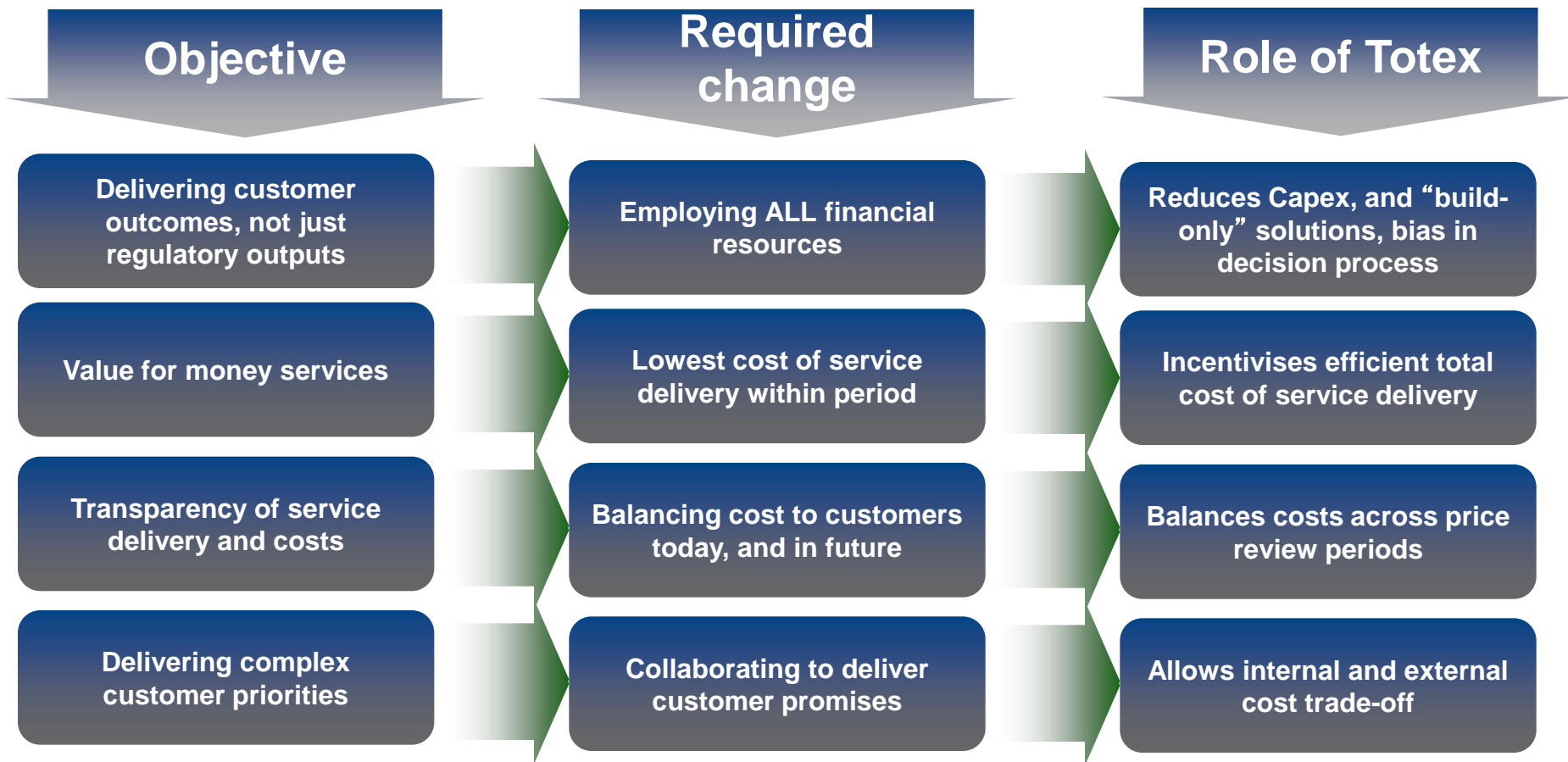


## Problem Solving Process










# TOTEX ROLE IN DELIVERING CUSTOMER OUTCOMES



*Totex-based cost assessment and incentives facilitates stronger service delivery*

# 5 TOTEX STRATEGIES AND EXAMPLES IN WATER SECTOR

Totex Strategy		Customer issue	Solution
	Eliminate root cause	Raw water nitrate and pesticide removal, Bathing water quality	Raw water catchment management, water blending, surface water separation
	Reduce the need for new assets	Asset replacement to maintain availability & reliability, Growth in demand	Enhance Operation and Maintenance to utilise existing assets, extend asset lives
	Engage and educate	Water efficiency, Sewer blockages leading to customer flooding	Educate customers and change behaviour
	Collaborate	Customer flooding, Bathing Waters quality, renewable generation from sludge	Partnership with other stakeholders to leverage synergies
	Fabricate	New Growth	Construct new assets

*Totex strategies work across asset lifecycle, from inception to de-commissioning and replacement*

# 5 MAIN BARRIERS TO GAINING BENEFITS FROM TOTEX INCENTIVES

Barrier/constraint		issue	Solution
1	Accounting rules	Despite regulatory treatment of Totex, accounting rules still treat expenditure as either P&L or Balance Sheet	Modelling of various financial scenarios to set clear boundaries for Totex decisions.
2	Legacy culture	“Capex Bias” culture across the organisation embedded in processes, systems, custom and practice.	Set and communicate clear new strategy, policy, roles and responsibilities on Totex.
3	“Construction” contracts	“Design and Build” contracts favour “build only” solutions.	Create contract incentives for “no-build” solutions.
4	Data shortfalls	Balanced decisions between opex and capex require much richer understanding of operational costs than available.	Start with current data but plan to improve cost models over time.
5	Uncertainty of Totex solutions	By nature, there is more risk and uncertainty of outcome associated with some Totex solutions.	Build additional contingency in delivering outcomes.

***There are strong legacy reasons why adopting Totex is difficult. They are mostly historical constructs and can be overcome.***

# 7 ELEMENTS FOR CREATING A BETTER TOTEX ENVIRONMENT

