

**Consultation on award of a project licence and  
issue of a waiver notice to the infrastructure  
provider that will deliver the Thames Tideway  
Tunnel Project**

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## 1. Purpose of this document

On 14 July 2015 Thames Water announced **Bazalgette Tunnel Limited** as the preferred bidder to be appointed as an infrastructure provider (IP) to deliver the Thames Tideway Tunnel Project (the Project).

The purpose of this document is to seek comments before:

- granting a project licence to the preferred bidder; and
- issuing a notice to the IP, once appointed, selectively dis-applying in specified circumstances the obligation on the IP to comply with the procurement regime set out in the relevant regulations (a Waiver Notice).

The closing date for this consultation is 14 August 2015.

## 2. Responding to this consultation

We welcome your responses to this consultation by close of business on 14 August 2015. You can email your responses to [TTTLicensing@ofwat.gsi.gov.uk](mailto:TTTLicensing@ofwat.gsi.gov.uk)

or post them to:

The Thames Tideway Tunnel Project  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA.

We will publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory 'Code of Practice' which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

### **3. Proposed designation of preferred bidder and proposed award of project licence to preferred bidder**

#### **3.1 Overview of the regulatory framework for specified infrastructure projects**

The Thames Tideway Tunnel Project ('the Project') is of unprecedented scale, size and complexity in the water sector in England and Wales, and will be the first project to be delivered under a new regulatory framework. That framework allows for certain large and complex infrastructure projects to be delivered by infrastructure providers that:

- are selected by the incumbent undertaker following a competitive procurement; and
- are regulated by Ofwat under a project licence.

This new framework was introduced by the Flood and Water Management Act 2010 which, among other things, amended the Water Industry Act 1991 ('the Act') by inserting a new part ('Part 2A – Regulation of Provision of Infrastructure'). The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 ('the Regulations') were made under Part 2A of the Act on 27 June 2013 and came into force on 28 June 2013.

The Regulations apply a modified version of the general duty imposed on Ofwat under section 2 of the Act. This modified duty provides that in exercising its powers conferred by virtue of the Regulations (which includes the power to designate an infrastructure provider, grant a project licence or a waiver notice) Ofwat will do so in the manner which it considers is best calculated to:

- further the consumer objective;
- secure that the functions of a water undertaker and of a sewerage undertaker are properly carried out;
- secure that companies holding appointments under Chapter 1 of Part 2 of this Act as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions;
- secure that the functions of a licensed infrastructure provider are properly carried out; and

- secure that relevant licensed infrastructure providers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions.

For the purpose of regulating specified infrastructure projects, the Regulations introduce new provisions into the Act and also apply particular provisions of the Act with or without modification (referred to below as ‘the modified Act’).

So, for example:

- new provisions enable Ofwat to issue a project licence to a designated IP, subject to any conditions that Ofwat considers to be requisite or expedient (sections 17FA and 17HA of the modified Act);
- the special administration regime is made to apply to a licensed infrastructure provider (modified sections 23–26 of the modified Act); and
- Ofwat is required to take enforcement action against a licensed infrastructure provider if that infrastructure provider breaches its licence conditions or the modified Act (modified section 18 of the modified Act).

The Regulations allow the Secretary of State or Ofwat to specify an infrastructure project as a project that must be put out to competitive tender. On 4 June 2014, following a public consultation, the Secretary of State specified the Project under the Regulations. The [Project Specification Notice](#), which sets out the scope of the Project, and the [Preparatory Work Notice](#), which sets out what Thames Water is required or permitted to do in relation to the Project, came into effect on 5 June 2014.

At a high level, the Project Specification Notice describes the Project as including:

- the design, construction, testing and commissioning of the Thames Tideway Tunnel and associated infrastructure; and
- once constructed and accepted by Thames Water, the operation and maintenance of certain IP-owned structures.

Under the Regulations, either Ofwat or the Secretary of State may by notice designate as an infrastructure provider a company which appears to Ofwat or the Secretary of State to be wholly or partly responsible for a specified infrastructure project that was put out to tender in accordance with the Regulations. A designation notice may be subject to such conditions as Ofwat or the Secretary of State considers appropriate.

We are empowered to issue a project licence to a designated infrastructure provider under section 17FA of the modified Act, and a project licence may be made subject to conditions under section 17HA of the modified Act. We must consult before issuing a project licence under section 17FA (2) of the modified Act.

Once granted, the project licence will require the infrastructure provider to carry out all activities described in the Project Specification Notice apart from those activities that Thames Water is to carry out under the Preparatory Work Notice.

### **3.2 Proposed designation of the preferred bidder**

The purpose of designation is to bring the preferred bidder within the scope of the modified Act and the Regulations and then to enable us to issue the designated IP with a project licence.

We have issued guidance setting out the factors we will take into account before designating an infrastructure provider. The guidance is set out at paragraph 5 of the document entitled 'Criteria for selecting specified infrastructure projects – Ofwat guidance' and is available on our [website](#).

As set out in that guidance, there is no obligation on us or the Secretary of State to consult before designating a company as an infrastructure provider.

Before designating, we must be satisfied that the Project was:

- specified under the Regulations and
- put out to tender in accordance with the Regulations.

We must also be satisfied that the company that we designate as an IP:

- appears to be wholly or partly responsible for the specified infrastructure project;
- is not an associated company of the incumbent undertaker save where it has been given consent by us or the Secretary of State to bid in the tender process; and
- is registered in England and Wales or Scotland and is limited by shares of guarantee.

We consider that the Project should be carried out by a regulated entity, and we are satisfied that the above factual considerations have been satisfied in relation to the

Project and in relation to Bazalgette Tunnel Limited. Accordingly, we intend to designate Bazalgette Tunnel Limited as an IP. The designation notice will be subject to a condition that if the project licence is not granted to the designated IP within 12 months after the date of the designation notice, the designation notice will cease to have effect.

### **3.3 Proposed award of project licence to the designated IP**

#### **3.3.1 Content of draft IP project licence**

We [consulted](#) on a draft project licence in October 2014 and received four responses to this consultation. We have responded individually to each respondent and we attach as **appendix A**, a table summarising our responses to these respondents. **Appendix B** sets out a revised track change draft of the project licence highlighting all changes made to the draft project licence since the consultation held in October 2014. **Appendix C** includes a table of the main changes made to the draft project licence following the consultation and following input from bidders. It includes a column setting out why changes have been made.

**We invite comment on any of the changes made to the draft project licence.**

#### **3.3.2 Whether the preferred bidder is fit and proper to hold a project licence**

The purpose of this part of the consultation is to set out why Ofwat considers Bazalgette Tunnel Limited to be competent to hold a project licence.

#### **Our process**

Thames Water was required to put the Project out to tender by the Specification Notice. It did this on 10 June 2014 by way of a contract notice in the Official Journal of the European Union (an OJEU notice). 12 bidders were pre-qualified and invited to tender during the first round of bidding, with two final bids being submitted on 3 July 2015 following a final revise and confirm round. Having evaluated those bids, on 14 July 2015 Thames Water announced that Bazalgette Tunnel Limited had been selected as the preferred bidder for the Project. Ofwat and the Secretary of State were consulted on the terms on which the Project was put out to tender, including on the terms of the final revise and confirm bidding round.



In a parallel but separate process, both shortlisted bidders applied to Ofwat for a project licence and Ofwat conducted an assessment of both shortlisted bidders in order to determine if both bidders were fit and proper bodies to hold a project licence. The reason this assessment was carried out before the IP procurement was finalised was so that bidders would be given sufficient notice if there was anything in their applications for a project licence that caused Ofwat concern. We wanted to avoid a situation where a bidder was successful in the IP procurement but was considered by us at a later stage not to be an appropriate body to be awarded a project licence.

Following that assessment we concluded that, subject to various caveats, both bidders were competent bodies to hold a project licence.

The caveats included:

- receipt and review of the preferred bidder's final shareholder agreements and financing and associated documentation;
- receipt of undertakings from the preferred bidder's ultimate controllers and, where required, UK Holding Companies under condition K of the draft project licence; and,
- consideration of any responses to this consultation.

## **Management of the IP**

In order to ensure that Bazalgette Tunnel Limited is a competent body to hold a project licence and that the Board of Directors, who will play a key role in managing the delivery of the Project, consists of an appropriate mix of experienced individuals, we have reviewed the management structure proposed by it for the Project.

The board of Bazalgette Tunnel Limited will comprise a total of twelve directors, five of whom are independent non-executive directors (including the Chairman), with four shareholder non-executive directors and three executive directors. The proposed composition of the board is in accordance with Ofwat's published [board leadership, transparency and governance principles](#) and the company has committed to comply with these principles in the future and with the [holding company governance principles](#). The proposed individuals comprise an appropriate mix of experienced individuals. It should be noted that the first four independent non-executive directors and the executive directors have been involved with the Project for over a year and have overseen the procurement of three construction consortia who will be responsible for the construction of the tunnel. The non-executive directors

representing shareholders and the fifth independent non-executive director have significant experience in holding similar roles in infrastructure companies.

The persons proposed to be on the Board of Directors of Bazalgette Tunnel Limited are:

#### Independent Non-Executive Directors

- Sir Neville Simms, Chairman
- Richard Morse
- Anne Baldock
- Mark Fairbairn OBE
- Michael Queen

#### Non-Executive Directors representing shareholders

- Jaroslava Korpancová
- Gavin Tait
- Alistair Ray
- Andrew Freeman

#### Executive Directors

- Andrew Mitchell, CEO
- Mark Corben, CFO
- Mark Sneesby, COO

### **Financing and ownership structure**

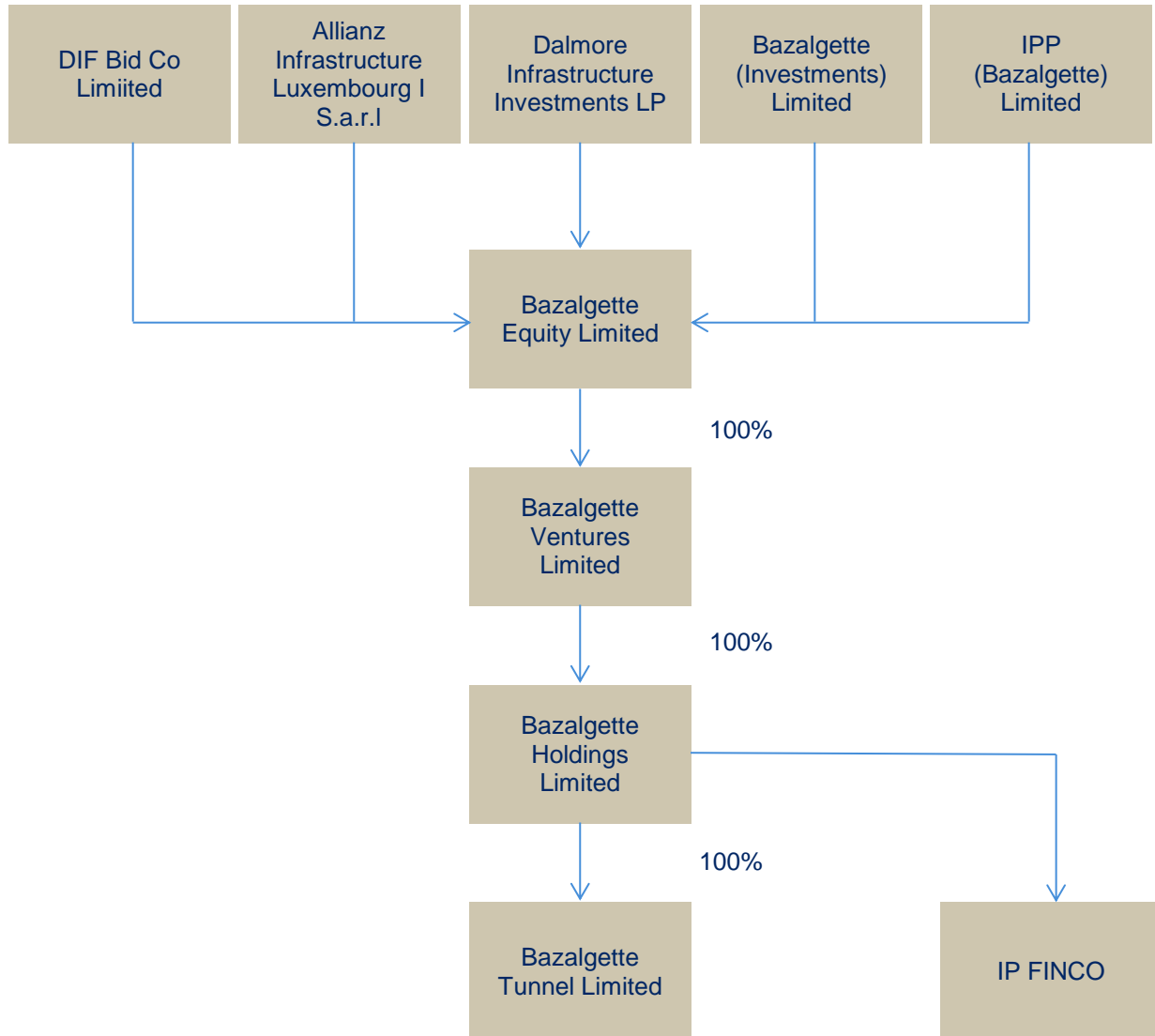
We have a duty to act in a way best calculated to secure that the functions of an infrastructure provider are properly carried out and that an infrastructure provider will be able to finance its functions. Therefore we must be satisfied that the prospective owners have the probity and operational and financial capacity to assume that role.

The owners of Bazalgette Tunnel Limited and their respective participations are as set out below.

Allianz Infrastructure Luxembourg I S.a.r.l.	34.26%
Dalmore Infrastructure Investments LP	33.76%
IPP (Bazalgette) Limited	15.99%

DIF Bid Co Limited	10.66%
Bazalgette (Investments) Limited	<u>5.33%</u>
	100%

### Ownership Structure



Bazalgette Tunnel Limited, Bazalgette Holdings Limited, and Bazalgette Equity Limited are UK registered and resident in the UK for tax purposes. The IP FinCo, when formed, will also be UK registered and a UK tax resident.

## About the prospective owners

**Allianz Infrastructure Luxembourg I S.a.r.l.** is an in-house investment company formed by nine of the listed Allianz Group's insurance companies and managed by Allianz Capital Partners, Allianz's captive asset manager for alternative investments. With €1,801 billion total assets under management (including those of the Allianz Group), Allianz is one of the largest asset managers in the world actively managing assets. Allianz Capital Partners manages around €12 billion of alternative assets, focusing on direct investments in infrastructure and renewable energy as well as private equity fund investments.

**Dalmore** is an independent UK fund manager with over £1.5bn of funds under management. Dalmore has made over 90 investments in UK greenfield and brownfield infrastructure assets. Dalmore's main investment vehicle is a £500m fund established for long-term investment in operational UK infrastructure assets. For the purpose of its investment in the Thames Tideway Tunnel, Dalmore has established a single purpose fund which has secured £440m of commitments, primarily from leading UK pension funds as well as a small number of European investors.

**DIF** is a Netherlands based and registered independent fund management company managing funds of approximately €2 billion. DIF invests in infrastructure assets that generate long term stable cash flows, including in public private partnerships (PPP) and private finance initiatives (PFI) and renewable energy assets in Europe, North America and Australia.

**Bazalgette (Investments) Limited** has been established by Swiss Life Asset Managers for the sole purpose of its investment in the Thames Tideway Tunnel project. Swiss Life Asset Managers manages the assets of the Swiss Life Group and at December 2014 managed over 183 billion Swiss francs of assets for the Swiss Life Group.

**International Public Partnerships Limited (IPP)** is a FTSE 250 UK listed infrastructure investment company investing globally in PPP and PFI public or social infrastructure projects. Listed in 2006, IPP is a long-term investor in social and transport infrastructure projects, including schools, hospitals, courts, police headquarters, transport and renewable energy projects in the U.K., Europe, Australia and Canada.

The **Amber Infrastructure Group** is an international infrastructure specialist, providing asset management and investment advisory services in respect of over £5 billion of assets in the UK, Europe, Australia and North America. While Amber

Infrastructure Group Holdings Limited (AIGHL) is not an investor it provides investment advisory and management services to International Public Partnerships (see above) as well as private investment funds, specialising in urban regeneration, and will due to its material influence be required to enter into an Ultimate Controller undertaking as described below. Additionally as AIGHL is 50% owned by the Hunt Companies of the USA, with associated negative control rights, it is proposed that Hunt ELP, Ltd. (a Texas USA limited partnership) as the primary operating entity holding the interest in AIGHL should, in addition, provide an ultimate controller undertaking pursuant to Condition K of the Project Licence.

### **Funding commitments and structure**

We have reviewed the financing plan prepared by the prospective owners of the IP and consider that it provides a robust funding package to enable the successful delivery of the Project in compliance with the project licence.

The prospective owners have stated that the financing plan has also been designed to ensure the IP will be a strong counterparty to Thames Water, the Secretary of State as provider of the Government's support package and to all other counterparties throughout the Project.

The financing plan provides for shareholder funds to be fully invested either as equity or shareholder loans in advance of any debt drawdowns. Funding from each prospective owner would be provided in the form of equity (40%) and shareholder loans (60%). The shareholders' commitments will be secured by letters of credit issued at licence award, and are supported by commitment letters from the issuing banks which have been provided to us and which we have reviewed. In addition to shareholder commitments it is proposed that Bazalgette Tunnel Limited will at licence award enter into a circa £1 billion 10-year committed revolving capex facility with a syndicate of banks which will provide liquidity during the construction period.

Based on the structure of the shareholder loans we consider that they are in line with precedent transactions. However the terms of the shareholder loans, where such loans are made to the proposed infrastructure provider by an associated entity, will need to be ring-fenced to ensure that the terms of such loans, or any other transactions between the infrastructure provider and associated entities, are undertaken on an arms' length basis and subject to consent from us. As such these arrangements will be subject to condition K of the project licence and any consent to be granted, pursuant to condition K, will be carefully considered on a case-by-case basis to ensure the relationship between the infrastructure provider and an associated company is appropriate.

The special purpose IP finance company (“IP FinCo”) will be established as a sister company rather than a subsidiary of Bazalgette Tunnel Limited. For this reason, condition K will specifically include IP FinCo in the ring-fence so that transactions between IP FinCo and the IP will need to be arms’ length transactions. While the proposed funding plan does not envisage debt issuance for a number of years the operation of condition K and the consents required under condition K are being carefully considered by us ahead of proposed licence award.

A full list of required consents has been submitted by the prospective owners. A full review of loan documentation and shareholder agreements will be undertaken ahead of providing any consent letters pursuant to the project licence.

**We invite views on whether Bazalgette Tunnel Limited is a fit and proper entity to be licensed as infrastructure provider.**

### **Undertakings**

In carrying out its functions, the IP will need the active co-operation of its owners. The draft project licence, in line with the conditions of appointment of undertakers, includes a condition that requires it to obtain legally enforceable undertakings from its owners. The companies giving the undertakings are required to:

- give the IP any information it needs to comply with its project licence;
- refrain from any action that could cause the IP to breach its project licence; and
- maintain a minimum of three independent non-executive directors on the IP’s board.

These undertakings will strengthen the ability of the IP to comply with its licence conditions and to maintain its independence from the rest of the group to which it belongs.

The relevant condition in the draft project licence is condition K which requires the IP to secure legally enforceable undertakings from its Ultimate Controller and if the Ultimate Controller is not a UK holding company, an undertaking must also be obtained from the UK holding company.

Appendix 4 to the draft project licence (definitions), defines ‘Ultimate Controller’ as “any person which, whether alone or jointly and whether directly or indirectly is, in the reasonable determination of the Authority, in a position to control or in a position to

materially influence the policy or affairs of the Infrastructure provider or any Holding Company of the Infrastructure Provider.”

The proposed owners of the IP have proposed that Ultimate Controller letters be provided by the following with, where required, additional undertakings from a UK holding company:

- Allianz Infrastructure Luxembourg I S.a.r.l.
- Amber Infrastructure Group Holdings Limited
- International Public Partnerships Limited
- Hunt ELP, Ltd
- Dalmore Capital Limited (acting in its capacity as manager of Dalmore Infrastructure Investments LP)
- Dalmore Capital 14 GP Limited (acting in its capacity as general partner to Dalmore Infrastructure Investments LLP)

After review and consideration of the named Ultimate Controllers, and shareholder agreements between the proposed owners we see no reason to challenge the view that these are the appropriate entities to provide the condition K undertakings.

**We invite views on whether Allianz Infrastructure Luxembourg I S.a.r.l., Amber Infrastructure Group Holdings Limited, International Public Partnerships Limited, Hunt ELP Ltd, Dalmore Capital Limited and Dalmore Capital 14 GP Limited are the appropriate entities to provide the condition K undertakings.**

## 4. Proposal to issue a Waiver Notice under the Regulations

### 4.1 The legal framework

The Regulations apply a procurement regime to the project which the incumbent water or sewerage undertaker (in this case Thames Water) or the designated licensed IP must follow in circumstances where the Utilities Contracts Regulations 2006 (the UCR) or the Public Contracts Regulations 2006 (the PCR) do not apply. However, the Regulations permit Ofwat to issue a notice to disapply this requirement in relation to the licensed IP. When we refer to a Waiver Notice we are referring to a notice disapplying the requirement on the IP to comply with the procurement regime set out in the Regulations.

The Preparatory Work Notice issued by Government permits Thames Water to organise and manage the procurement process on behalf of the IP for various works and services, including in respect of the main construction contracts. It also provides that Thames Water's role may include:

- determining the procurement strategy;
- developing the procurement documentation; and
- managing the procurement process including accepting and evaluating tenders and the selection of preferred bidders.

The Preparatory Work Notice also provides that Thames Water may “build the capabilities of the workforce, including finance, project delivery, operational, engineering, asset management, stakeholder engagement, commercial and legal, business services, health, safety and environment, such that on tender award to the Infrastructure Provider there are such personnel when supplemented by those of the selected Infrastructure Provider to manage a seamless transition from development to implementation of the Thames Tideway Tunnel Project.”

### 4.2 The procurement strategy

Consistent with the Preparatory Work Notice, Thames Water, in consultation with Government and Ofwat, developed a procurement strategy for the project which:

- provides for a parallel procurement process whereby Thames Water procures, on behalf of the IP, various contracts necessary for the construction of the



Project (the construction contracts) and at the same time procures an IP responsible for financing and delivering the Project. The proposed approach is timed so that the award of the IP and the construction contracts take place sequentially – with Thames Water first awarding the contract for the IP and the IP then concluding the construction contracts with the preferred bidders identified by Thames Water in the procurement for the construction contracts; and

- mandates the IP to enter into a contract for project management services with a company appointed by Thames Water and on terms negotiated between Thames Water and the appointed company. The appointed company is CH2M Hill Inc.

Ofwat agreed to support the adoption of the procurement strategy by Thames Water for the following reasons:

- the parallel procurement of the construction contracts and the IP was necessary for timing reasons. Had Thames Water first procured the IP on the basis that the IP would then procure the construction contracts, it would not have been possible to award the construction contracts in 2015 to enable construction to begin in 2016. Any delays in commencing construction will increase the likelihood and size of any fines that may be imposed on the UK Government for non-compliance with the Urban Waste Water Treatment Directive;
- bidders were asked to bid a weighted average cost of capital (WACC) and that would have been difficult (and would not have maximised value for money for customers) without cost information gathered from the construction procurement; and
- requiring the IP to take over a pre-agreed Project Management Contract (PMC) was considered important to provide the IP with the necessary level of knowledge and expertise on the Project to enable the IP to start delivering on its obligations immediately after appointment.

### **4.3 Reasons for issue of Waiver Notice**

Ofwat is minded to issue a Waiver Notice dis-applying the procurement regime in the Regulations in respect of specified construction related contracts and the PMC. In addition, Ofwat is considering dis-applying the procurement regime in the Regulations in respect of some general categories of contracts – in particular, all contracts below a specified threshold value.

## **Specified contracts**

In relation to the specified construction related contracts, we are satisfied that customers are protected in that the specified contracts have all been subject to a robust competitive process conducted by Thames Water under the UCR.

With regard to the PMC, we are satisfied that the original appointment of the project manager (CH2MHill Inc.) by Thames Water in 2008, was subject to a competitive process; that only core skills and experience are being transferred; and that the terms of the new contract have been subject to independent bench marking. We also consider that the continued involvement of CH2M Hill Inc. in the management of the project is efficient and likely to result in value for money for customers. If the IP was obliged to procure its own PMC, the competition for an IP may have been distorted if CH2M Hill Inc., as the incumbent service provider, had joined the consortium of one particular bidder, whereas the proposed arrangement means CH2M Hill has been made available to all bidders on an equal footing.

In addition to the PMC, we propose specifying seven contracts in respect of which the IP will not have to comply with the procurement regime set out in the Regulations. Those contracts are: the three main construction contracts; the system integrator contract; two framework agreements (one in respect of occupational health and one in respect of security); and the contract for the services of an Independent Technical Assessor. These contracts will all have been procured by Thames Water under the UCR but will be entered into by the IP after licence award. We consider that the waiver will provide best value for money for customers, as these contracts have already been subject to a rigorous competition and we consider it is not necessary for the IP to have to procure these contracts afresh after licence award. We consider that issuing a Waiver Notice in respect of these contracts will ensure that the project benefits from continuity, technical expertise, bidder certainty and improved commercial terms, resulting in enhanced customer value for money.

## **Extending the general exemptions that apply in the UCR to the IP**

Under the UCR there are a number of exemptions that apply including where the estimated value of a contract is less than a prescribed threshold amount.<sup>1</sup>

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<sup>1</sup> Other exemptions include, for example, employment contracts and contracts for financial services.

There are no equivalent provisions in the Regulations which means that the IP will have to follow an OJEU process for all contracts, irrespective of the type of contract or the value of the contract.

We consider that the IP should be treated in the same way as water and sewerage undertakers (who benefit from the exemptions in the UCR) and we are therefore considering whether some or all of the exemptions in the UCR should apply to the IP.

We intend at least to apply a general exemption that dis-applies the Regulations for all contracts below the same minimum value thresholds that apply in the UCR.<sup>2</sup> It is proposed that this exemption will apply to relevant contracts procured by Thames Water on behalf of the IP prior to award of the project licence, and to relevant contracts procured by the IP following project licence award.

The reasons we propose adopting a minimum value threshold are:

- the IP can be compared to a medium sized water and sewerage company and we see no reason to treat the IP differently from those companies;
- we consider it is disproportionate and inefficient to require that the IP follow an OJEU process for all contracts irrespective of the estimated value of those contracts; and
- the IP is incentivised to bring the project in or under budget so we are satisfied that it will carry out appropriate procurement processes to ensure value for money.

**We invite comment on our intention to issue a Waiver Notice in respect of the specific contracts listed above and in respect of a generic waiver that ensures that the IP is in the same position as undertakers – in particular by exempting all contracts below a specified threshold.**

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<sup>2</sup> The current amounts in sterling are: a) £345,028 for a supply or a services contract; and b) £4,322,012 for a works contract.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a leading economic regulator, trusted and respected, challenging ourselves and others to build trust and confidence in water.



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