

Criteria for selecting specified infrastructure projects – Ofwat guidance

About this document

This document sets out guidance that Ofwat will take into account in determining whether to select an infrastructure project as a 'specified infrastructure project', which is required to be put out to competitive tender under the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013¹ (the Regulations). The Regulations are available on the legislation.gov.uk website. This document also sets out the factors that Ofwat will take into account in deciding whether to designate a company as an infrastructure provider under the Regulations.

In this guidance, we set out:

- an overview of the regulatory framework for specified infrastructure projects in England;
 - the factors we will take into account before specifying an infrastructure project;
 - the factors we will take into account before varying or revoking a notice specifying an infrastructure project;
 - the factors we will take into account before designating a company as an infrastructure provider; and
 - the factors we will take into account before varying or revoking a notice designating a company as an infrastructure provider.
-

¹ The Regulations were made pursuant to the powers conferred on the Secretary of State by Part 2A of the Water Industry Act 1991. These provisions were inserted into the Act by section 35 of the Flood and Water Management Act, 2010. The SI number for the Regulations is 2013 No. 1582 and they can be found along with the Explanatory Memorandum and Impact Assessment on the [legislation.gov.uk](http://www.legislation.gov.uk) website at <http://www.legislation.gov.uk/2013/1582>. The Regulations were amended on 9 January 2015, the amendment coming into effect on 10 January 2015. The amendments can also be found on the [legislation.gov.uk](http://www.legislation.gov.uk) website.

Contents

1. Introduction	3
2. Overview of the specified infrastructure projects regulatory framework	3
3. Status of this guidance	5
4. Guidance on specification	6
5. Guidance on designation	11
Annex 1: Relevant regulatory provisions	14

1. Introduction

The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 ('the Regulations') were made on 27 June 2013 and came into force on 28 June 2013.

The Regulations give the Secretary of State for Environment, Food and Rural Affairs or Ofwat the power, in certain circumstances, to specify an infrastructure project in the water sector in England and Wales. Specification means that the infrastructure project must be put out to competitive tender under the Water Industry Act 1991 ('the Act') and the Regulations, rather than being delivered by the relevant incumbent water or sewerage undertaker in the course of its statutory duties. Such specification is by notice in writing.

The Regulations require Ofwat to publish guidance to be followed by it in determining whether or not to exercise its power to specify an infrastructure project; or in determining whether to revoke or vary such a specification notice.

This document sets out guidance which gives effect to this requirement.

A draft of this document was published for consultation [insert link]. We also amended this guidance, following consultation [insert link]. This second consultation response [insert link] is also available on our website.

2. Overview of the specified infrastructure projects regulatory framework

The Regulations introduce a new regulatory framework to sit alongside the existing framework for water and sewerage undertakers. It enables the financing and delivery of large and complex water and sewerage infrastructure projects to be delivered by specific 'infrastructure providers' that are competitively tendered by the incumbent water or sewerage undertaker.

In particular, the Regulations provide that:

- the Secretary of State or Ofwat may specify certain infrastructure projects, which must be put out to competitive tender by the incumbent water or sewerage undertaker;

- where an infrastructure project has been specified, the incumbent water or sewerage undertaker will be prohibited from carrying out the project itself, other than certain preparatory work;
- the Secretary of State or Ofwat may specify an infrastructure project to be put out to tender only if the Secretary of State or Ofwat is of the opinion that:
 - the infrastructure project is of a size or complexity that threatens the incumbent undertaker's ability to provide services for its customers; and
 - specifying the infrastructure project is likely to result in better value for money than would otherwise be the case; and
- the successful company that is awarded the tender may be designated by the Secretary of State or Ofwat as an 'infrastructure provider' for the purposes of the Regulations and the Act, and may be directly regulated by Ofwat under the terms of a newly established 'project licence'.

It is considered that requiring water and sewerage companies to put certain large and complex projects out to competitive tender will help to deliver necessary infrastructure projects in a way that provides better value for money for customers. By separating the associated risks and costs of financing and delivering such projects within a distinct infrastructure provider, the new regulatory framework will provide overall better value for money for the financing and delivery of such infrastructure projects while keeping water or sewerage bills for customers as low as possible. It will also safeguard the ability of water or sewerage undertakers to continue delivering the required level of existing water or sewerage services to their customers.

Ofwat's general duties with respect to the water sector (as set out in section 2 of the Act) apply to the exercise of Ofwat's power to specify a project². This means that in exercising its power to specify a project Ofwat must act in a manner which it considers best calculated:

- to protect the interests of consumers, wherever appropriate by promoting effective competition;
- to secure that the functions of undertakers and licensed infrastructure providers are properly carried out; and
- to secure that undertakers and licensed infrastructure providers are able to finance the proper carrying out of those functions (in particular by securing a reasonable return on their capital).

² See Regulation 3(3) of the Regulations.

Ofwat also has secondary duties which include promoting economy and efficiency on the part of companies and contributing to the achievement of sustainable development.

3. Status of this guidance

The Regulations require Ofwat to issue guidance that it will follow in determining whether to exercise its power to specify a project as an infrastructure project that must be put out to tender or to vary or revoke a specification notice. Paragraph 4 of this guidance gives effect to this requirement and, accordingly, we will follow this statutory guidance before specifying any project and before varying or revoking a specification notice.

Either the Secretary of State or Ofwat may specify a project as an infrastructure project that must be put out to tender and either the Secretary of State or Ofwat may vary or revoke a specification notice.

However, only Ofwat is required to issue statutory guidance as to how it will exercise these powers. Although the Regulations do not require the Secretary of State to follow the statutory guidance issued by Ofwat, it is expected that if the Secretary of State specifies a project, or varies or revokes a specification notice, this statutory guidance will be one of the factors that the Secretary of State will have regard to in making that decision.

Ofwat takes the view that if the Secretary of State specifies a project, it is for the Secretary of State, not Ofwat, to vary or revoke the specification notice. Similarly, we expect that if Ofwat issues a specification notice, the Secretary of State will leave the decision to vary or revoke that notice to Ofwat.

Before specifying a project as an infrastructure project, or before varying or revoking a notice specifying a project as an infrastructure project, the Secretary of State or Ofwat will:

- prepare draft reasons for exercising the power;
- consult interested parties; and
- consider the impact such a specification, variation or revocation may have on customers, the water or sewerage undertaker, and the infrastructure provider.

Similarly, either the Secretary of State or Ofwat may designate as an infrastructure provider a company which appears to the Secretary of State or Ofwat respectively to

be wholly or partly responsible for a specified infrastructure project that was put out to tender in accordance with the Regulations, and either the Secretary of State or Ofwat may vary or revoke a designation notice.

However, Ofwat is only required to issue statutory guidance as to how it will exercise the power to specify, not the power to designate. As such, paragraph 5 of this guidance is not a requirement of the Regulations but is being issued by Ofwat as a matter of good governance. We will have regard to this part of the guidance before revoking or varying a designation notice issued by us. Although as noted above the Regulations do not require the Secretary of State to follow the statutory guidance issued by Ofwat, it is expected that if the Secretary of State designates an infrastructure provider, or varies or revokes a designation notice, this guidance will be one of the factors that the Secretary of State will have regard to in making that decision.

Ofwat takes the view that if the Secretary of State designates an infrastructure provider, it is for the Secretary of State, not Ofwat, to vary or revoke the designation notice. Similarly, we expect that if Ofwat issues a designation notice, the Secretary of State will leave the decision to vary or revoke that notice to Ofwat.

Before varying or revoking a notice designating a company as an infrastructure provider, the Secretary of State or Ofwat will:

- prepare draft reasons for exercising the power;
- consult interested parties; and
- consider the impact such a variation or revocation may have on customers, the water or sewerage undertaker, and the infrastructure provider.

Ofwat may amend both the statutory and non-statutory parts of this guidance at any stage but will only do so after consulting on its intention to amend the guidance.

4. Guidance on specification of a project as a specified infrastructure project

4.1 Issuing a notice specifying a project as an infrastructure project

Ofwat is committed to ensuring that customers receive safe, reliable, efficient and affordable water and wastewater services. The Act makes provision for delivery of infrastructure by undertakers or, in certain circumstances, by separate and

independent infrastructure providers. It sets a two-part test for determining whether a separate infrastructure provider should deliver a project. This test makes the interests of customers paramount. Where a company's ability to provide its other core services may be threatened if it had to carry out a large or complex project itself, it is likely to be in customers' interests to specify the project. But even in these circumstances, we must still be satisfied that specifying the project is likely to result in better value for money than not specifying the project.

The efficient costs associated with infrastructure projects are paid for by an undertaker's customers, subject to price review control by Ofwat. Where undertakers do not have adequate resources or capacity, they are able to buy in additional capacity or resources or to outsource certain functions (but not outsource responsibility under the Act or their licence).

It may sometimes be better value for money to deliver some infrastructure projects via a third party infrastructure provider – for example, where customers could benefit up front from a market tested cost of finance; or where the size or complexity of some infrastructure projects in practice may impact on the incumbent undertaker's ability to provide services for its customers, taking into consideration the commercial and economic context, and the undertaker's management skills, resources and ability to deliver complex projects. Also, section 154B of the Act³ gives the Secretary of State the power to make financial assistance available for large and complex infrastructure projects.

In assessing whether the project is of a size or complexity such that it may threaten the incumbent undertaker's ability to provide services for its customers and whether specifying the project is likely to result in better value for money than would otherwise be the case, we will take into account our general statutory duties, including our duty to promote competition where this is in the interests of consumers.

We will also have regard to the factors listed below. Not all of these factors will be relevant in every case, and there may be additional factors not listed below that we may take into account. We will also take the undertaker's views into account in making this assessment.

³ Inserted into the Act by the Water Industry (Financial Assistance) Act 2012.

4.1.1 Value for money

Evidence we may take into account when considering whether specifying the infrastructure project is likely to result in better value for money than would otherwise be the case may include:

- whether delivering the infrastructure project through a specification is likely to be more efficient than delivery by the undertaker, taking into account the likely relative costs of those alternatives;
- whether it is comparatively difficult to assess accurately the cost and risks of the infrastructure project without testing those costs and risks in competitive markets (that is, by going out to tender under the Regulations), and if so, whether going out to tender is likely to result in better value for money for customers;
- whether it is desirable to have competitively tendered finance for the infrastructure project;
- whether the undertaker is likely to be able to raise the financing for the infrastructure project and if so, the likely impact of financing the project on:
 - the undertaker’s ability to finance its other functions;
 - its credit rating, existing finance facilities, the cost of debt and equity; and
 - the level of other financial support required to deliver the infrastructure project;
- if cost overruns occur, the likely consequences (financial or otherwise) of such overruns for either the undertaker or the infrastructure provider; and
- the likelihood of the infrastructure project being delivered on time if it is specified under the Regulations and if it is not, and the consequences, financial or otherwise, of any such delay.

4.1.2 The size of the project

Evidence that we may take into account in assessing the size of the project relative to the rest of the undertaker’s regulated business, may include:

- the likely cost of the infrastructure project as compared with historic or future costs of other projects carried out, or to be carried out, by the undertaker;
- the likely finance requirement of the infrastructure project as compared with the finance requirement of historic or future projects carried out, or to be carried out, by the undertaker;
- the period of time over which delivery of the infrastructure project is likely to occur as compared with the periods for delivery of historic or future projects carried out, or to be carried out, by the undertaker; and

- the likely level of resource required to deliver the project as compared with the level of resource required for delivery of historic or future projects carried out, or to be carried out, by the undertaker – in particular, considering the organisational impact of delivery by the undertaker as opposed to delivery by an infrastructure provider.

4.1.3 The complexity of the project

Evidence that we may take into account in assessing the complexity of the infrastructure project and the inherent risks associated with such complexity, may include:

- the likely complexity and the inherent risks associated with the design, procurement, financing, construction, maintenance or operation of the infrastructure project relative to other activities associated with other historic or future projects carried out, or to be carried out, by the undertaker;
- whether the undertaker's competencies and existing resources are sufficient to enable it to deliver an infrastructure project of this likely level of complexity and inherent risk without threatening its ability to provide services to its customers;
- whether the risks involved in the project are different from the risks normally associated with the undertaker's capital investment programme and whether the management and mitigation of those risks involve competencies, resources, assets or specialist skills that the undertaker may not have;
- if the undertaker does not have the necessary competencies, resources, assets or specialist skills, whether it is preferable for the undertaker to acquire those competencies, resources, assets or specialist skills or whether an infrastructure provider should deliver them;
- whether the inclusion of the project in an undertaker's capital investment programme would concentrate too much risk in a single company;
- the managerial capacity of the undertaker and, in particular, whether carrying out the infrastructure project may divert management time and resources in a way that may put at undue risk the rest of the undertaker's regulated business;
- where the infrastructure project is likely to span multiple price review periods, the likely complexity and the inherent risks associated with it doing so; and
- where the infrastructure project is being constructed for the benefit of customers of two or more undertakers or water supply licensees, the likely complexity and the inherent risks associated with the interface between those customers and undertakers.

4.2 Varying a notice specifying a project as an infrastructure project

If the conditions in regulation 4(3) continue to be met, the Secretary of State or Ofwat may in accordance with regulation 4(7)(a)⁴, vary a notice specifying a project as an infrastructure project to be put out to competitive tender. In determining whether the conditions in regulation 4(3) continue to be met, Ofwat will have regard to paragraph 4.1 of this guidance.

A need to vary a specification notice is likely to arise if, for example:

- the nature or scope of the project changes – either because it is extended or diminished, or because planning or technical issues cause the scope of the project to change;
- there was an error in describing the nature or scale of the project (possibly because of inadequate information available at the time of specification);
- the project was specified in a way that created overlap with the preparatory work being carried out by the water or sewerage company, or a case is made for a different allocation between preparatory work and project work (possibly because of practical interface issues); and
- there is a change in circumstances (including a change in law) such that the infrastructure project can no longer be delivered by the infrastructure provider in the manner envisaged, or if it is delivered in the manner envisaged will not be compliant with the law.

4.3 Revoking a notice specifying a project as an infrastructure project

Alternatively, if in the Secretary of State's or Ofwat's opinion, the conditions in regulation 4(3) are no longer satisfied, the Secretary of State or Ofwat may revoke the specification of an infrastructure project under regulation 4(7)(b)⁵. In determining whether the conditions in regulation 4(3) are no longer satisfied, Ofwat will have regard to paragraph 4.1 of this guidance.

We expect that the need to revoke a specification notice will only arise in very limited circumstances in that the primary purpose of a specification notice is to require a company to put a specified project out to tender. Once a project has been put out to tender and the tender has been successful, that purpose is spent. If a project is

⁴ See appendix 1.

⁵ See appendix 1.

subsequently discontinued, that discontinuation will, in most instances be regulated by the terms of the project licence which may be issued to the infrastructure provider.

Therefore, we envisage that the need to revoke a specification notice is likely to only arise:

- (i) if the competitive tender pursuant to the Act and the Regulations does not result in the appointment of an infrastructure provider either because:
 - (a) no compliant bids are received; or
 - (b) the competitive tender process is abandoned;
- (ii) where Ofwat issues the infrastructure provider with a project licence and that project licence terminates under its own terms; or
- (iii) where Ofwat does not issue a project licence to the infrastructure provider and the project is discontinued.

5. Guidance on designation of a company as an infrastructure provider

5.1 Status of this paragraph 5

As noted above, under Regulation 8, 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. Either Ofwat or the Secretary of State may also vary or revoke a designation notice. There is, however, no regulation requiring Ofwat to issue guidance to be followed by it in determining whether to exercise its power to designate or its power to vary or revoke a designation notice.

Although the Regulations do not give Ofwat a statutory obligation to issue guidance on designation, Ofwat considers that guidance on this issue will provide additional assurance to potential bidders in projects that are put out to tender under the Regulations. As noted above, Ofwat will have regard to paragraph 5 of this guidance before designating a company as an infrastructure provider and before varying or revoking a designation notice. We also expect that if the Secretary of State designates an infrastructure provider, or varies or revokes a designation notice, this guidance will be one of the factors that the Secretary of State will have regard to in making that decision.

5.2 Notice of designation as an infrastructure provider

The power to designate a company as an infrastructure provider is discretionary in nature. However, we can only issue a project licence to a designated infrastructure provider. It is therefore a necessary step if we consider that the project should be carried out by a regulated entity. The main consideration in deciding to designate will therefore be whether we or the Secretary of State considers that the project would benefit from being carried out by a regulated rather than an unregulated entity.

Regulation (both economic and functional) of a designated infrastructure provider is likely to be something that is decided by Ofwat or the Secretary of State prior to the start of the tender process. Bidders in any tender will need to know whether or not they can expect to be issued with a project licence at the end of the process. We will therefore make the decision in consultation with the incumbent undertaker and the Secretary of State prior to the launch of the tender process.

There is no obligation on Ofwat or the Secretary of State to consult before designating a company as an infrastructure provider. This is because the hurdle for designation is low. The main factors which need to be satisfied before exercising the power are ones of fact and are as follows:

- the project was specified under the Regulations;
- the project was put out to tender in accordance with the Regulations;
- the company that we may designate as an infrastructure provider appears to the designator to be wholly or partly responsible for the specified infrastructure project;
- the company 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
- the company being designated is registered in England and Wales or Scotland and is limited by shares of guarantee.

5.3 Varying or revoking a notice to designate

The Secretary of State or Ofwat may (depending on which entity designated the infrastructure provider in the first instance), having regard to any subsisting project licence, by notice vary or revoke a designation notice. As noted above, before exercising these powers, the Secretary of State or Ofwat is required to prepare draft reasons and consult the company designated as the infrastructure provider, the Secretary of State or Ofwat (depending of who is exercising the power), the incumbent undertaker and such other persons they consider appropriate.

The main purpose of designation is to enable Ofwat to issue a project licence to the relevant company and a project licence may include conditions for the variation and revocation of the project licence. We therefore consider that the relevant project licence will be the better place to deal with variation and revocation rather than the designation notice. We therefore expect that we will revoke a designation notice only once the relevant project licence has been terminated under its own terms. We also expect that in general we will vary a project licence under its own terms rather than vary a designation notice.

However, there may be a limited set of circumstances where it is appropriate to vary a designation notice – for example, if a designation notice contains an error, if the designated company changes its name, if a designation notice is issued with conditions and those conditions are no longer appropriate, or where the relevant project licence has been transferred to a replacement entity by way of a statutory transfer scheme following a special administration.

Annex 1: Relevant regulatory provisions

The Regulations allowing the Secretary of State or Ofwat (referred to below as ‘the Authority’) to specify certain infrastructure projects as infrastructure projects which are required to be put out to competitive tender, are made under sections 36A to 36G of the Act.

Regulation 4 provides that:

“(1) Subject to the following provisions of this regulation, the Secretary of State or the Authority may by notice specify an infrastructure project.

(2)

(3) The Secretary of State or the Authority may exercise the power under paragraph (1) only if the Secretary of State or the Authority respectively is of the opinion that –

(a) the infrastructure project is of a size or complexity that threatens the incumbent undertaker’s ability to provide services for its customers; and

(b) specifying the infrastructure project is likely to result in better value for money than would be the case if the infrastructure project were not specified, including taking into account –

(i) the charges fixed or likely to be fixed under Chapter 1 of Part 5 of the Act (financial provisions, charges); and

(ii) the powers of the Secretary of State under section 154B of the Act (financial assistance for major works).

(4)

(5)

(6)

(7) Where the Secretary of State or the Authority is of the opinion –

(a) that the conditions in paragraph (3) continue to be satisfied, the Secretary of State or the Authority respectively may by notice vary the notice issued by the Secretary of State or Authority (as the case may be) under paragraph (1); or

(b) that either condition in paragraph (3) is no longer satisfied, the Secretary of State or the Authority respectively may, having regard to any subsisting project licence, by notice revoke the notice issued by the Secretary of State or Authority (as the case may be) under paragraph (1).

(8)

(9) Subject to paragraph (10), the Authority must publish guidance to be followed by it in determining whether to exercise its powers under paragraph (1) or (7).

(10) Paragraph (9) does not apply where the Authority has published such guidance before the Regulations come into force.

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.



Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

Printed on 75% minimum de-inked post-consumer waste paper.
March 2015

ISBN 978-1-908116-93-2

© Crown copyright 2015

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gsi.gov.uk.

