

**Criteria for selecting specified
infrastructure projects
– a consultation on draft guidance**

About this document

This consultation sets out proposed 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.

In this draft guidance, we provide:

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

We also ask for stakeholders' views on the questions on page 2.

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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>

Consultation questions

Q1 Do you agree that the factors listed in section 3.1 are the correct ones for us to take into account before specifying an infrastructure project?

Q2 Are there other factors we should take into account?

Q3 Do you agree that the need for varying a specification notice is likely to arise for the reasons set out in section 3.2?

Q4 Are there other reasons that may give rise to a notice to vary?

Q5 Do you agree that the need for revoking a specification notice is likely to arise for the reasons set out in section 3.3?

Q6 Are there other reasons that may give rise to a notice to revoke? Are there other factors we should take into account before revoking a notice?

Q7 Do you want to comment on any other aspect of this draft guidance?

Responding to this consultation

We welcome your responses to this consultation by close of business on **28 November 2013**.

You can email your responses to kate.haycock@ofwat.gsi.gov.uk or post them to:

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If you wish to discuss any aspect of this consultation, please contact Kate Haycock on 0121 644 7762 or by email at kate.haycock@ofwat.gsi.gov.uk.

We will publish responses to this consultation on our website at 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.

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 or sewerage sectors. 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 draft guidance which will give effect to this requirement.

The relevant provisions of the Regulations are set out in appendix 1 to this document.

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 will enable 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.

3. Guidance

3.1 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 project should be delivered by a separate infrastructure provider. 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, Ofwat 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). Also, section 154B of the Act³ gives the Secretary of State the power to make financial assistance available for large and complex infrastructure projects.

Despite this, 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.

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 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

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

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.

3.1.1 Value for money

Evidence we may consider 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;
- the likely impact of financing the infrastructure project on the undertaker's 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.

3.1.2 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.

3.1.3 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;
- 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 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 they should be delivered by an infrastructure provider;

- 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.

3.2 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.

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 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 such that the infrastructure project can no longer be delivered by the infrastructure provider in the manner envisaged (following conclusion of the competitive tender carried out pursuant to the Regulations).

⁴ See appendix 1.

Before varying 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 variation may have on customers, the water or sewerage undertaker, and the infrastructure provider.

3.3 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 will be able to revoke the specification of an infrastructure project under regulation 4(7)(b)⁵.

In practice, it is envisaged that the need to revoke a specification notice will only arise if:

- (i) 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) the designated infrastructure provider can no longer carry out its duties because it is put into special administration and no suitable alternative infrastructure provider can be found; or
- (iii) the project is discontinued for any other reason.

Before revoking a notice specifying a project as an infrastructure project, the Secretary of State or Ofwat will prepare draft reasons for exercising the power and consult interested parties and consider the impact such a revocation may have on the undertaker's customers, the water or sewerage company, and the infrastructure provider.

⁵ See appendix 1.

Appendix 1: Relevant regulatory provisions

The Regulations allowing the Secretary of State or Ofwat 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.”



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