

Consultation on proposal to issue a further waiver notice to the infrastructure provider that will deliver the Thames Tideway Tunnel Project

About this document

This document seeks comments on Ofwat's proposal to issue a further waiver notice to Bazalgette Tunnel Limited (referred to as BTL), the infrastructure provider (IP) appointed by Thames Water to deliver the Thames Tideway Tunnel Project (the Project).

On 24 August 2015, after [consultation](#), we issued a [notice](#) under regulation 6(8) of the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (the Regulations) dis-applying to a limited extent BTL's obligations to apply the procurement provisions set out in the Regulations.

BTL has now requested a further waiver which we have considered and, subject to any consultation responses we receive, we propose granting the waiver requested.

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1. Responding to this consultation

We welcome your responses to this consultation by close of business on **25 February 2016**.

You can email your responses to 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this consultation on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished.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.

2. Consultation question

We invite comment on our intention to issue a further waiver notice to BTL in respect of:

- certain specified professional services related to BTL's financing arrangements;
and
- a number of specified legal services contracts.

3. Overview of the regulatory framework for specified infrastructure projects

The Project is of unprecedented scale, size and complexity in the water sector in England and Wales, and is 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
- 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 or WIA91') by inserting a new part ('Part 2A – Regulation of Provision of Infrastructure'). 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 Act¹. This modified duty provides that in exercising its powers conferred by virtue of the Regulations (which includes the power grant a project licence or a waiver notice), Ofwat will do so in a manner which it considers is best calculated to:

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

¹ The Water Act 2014 adds a new duty to our primary duties: to 'further' the resilience objective which can be summarised as securing the resilience of both water systems and services, in the long term, making clear that this not only includes issues of supply but also embraces demand. However, as the Regulations came into effect before the Water Act 2014 was passed, this new duty does not apply to our regulation of infrastructure providers. Any amendments to the WIA91, which are introduced after the Regulations came into effect, will require a consequential amendment to the Regulations if those WIA91 amendments are to apply to the regulation of infrastructure providers.

- 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').

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, the operation and maintenance of certain IP-owned structures.

In line with its obligation to put the specified project out to tender, Thames Water conducted a competitive procurement for an IP to deliver the project. On 14 July 2015 Thames Water announced BTL as the preferred bidder to be appointed as an IP to deliver the Project. Ofwat then consulted on its intention to award BTL a project licence and on 24 August it granted BTL [a project licence](#).

4. Proposal to issue a further waiver notice under the Regulations

4.1 The legal framework

The Regulations apply a procurement regime to specified projects which the incumbent water or sewerage undertaker (in this case Thames Water) and the licensed IP must follow in circumstances where the Utilities Contracts Regulations 2006 (the UCR) or the Public Contracts Regulations 2015 do not impose a requirement to conduct a competitive tender process. However, the Regulations permit Ofwat to issue a notice to disapply this requirement in relation to the licensed IP. We refer to this modified procurement regime below, as the “modified UCR regime”. 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.

4.2 Issue of Waiver Notice in August 2015

In July-August 2015 we [consulted](#) on our intention to issue a waiver notice to the IP under the Regulations, and on 24 August 2015, we issued BTL with a [waiver notice](#) dis-applying the procurement regime in the Regulations in respect of specified construction related contracts and the Project Management Contract. In addition, Ofwat dis-applied the procurement regime in the Regulations in respect of some general categories of contracts – in particular, all contracts below a specified threshold value. In granting that waiver the principle was accepted by Ofwat that BTL should, in some circumstances, be treated in an equivalent way to a medium sized water company, which would be subject to the UCR and would therefore benefit from exemptions under the UCR. While the modified UCR regime applies some provisions of the UCR to the IP, it does not include the various exemptions.

4.3 Application for further waiver

BTL has now requested a further waiver which we have considered.

There are two limbs to BTL's waiver application – 1) an exemption in respect of the procurement of services that will be paid for by shareholders, rather than by customers, and that relate to professional services related to the IP's financing and corporate arrangements and 2) an exemption in respect of three specified legal services contracts (some of which will be paid for by customers). We deal with each of these below.

4.3.1 Exemption in respect of the IP's financing and corporate arrangements

BTL asked for a broad exemption ("professional and ancillary services" relating to its "financing and corporate arrangements" to the extent that those services will be paid for by shareholders and not customers). We are, however, minded to grant a narrower exemption (only in respect of certain specified professional services in relation to its financing and only to the extent that those services will be paid for by shareholders and not customers). BTL argues that it will place an unnecessary administrative (and cost) burden on it to comply with the modified UCR regime in respect of these services, as the modified UCR regime is a relatively complex and time consuming process compared to the simpler and more direct procurement processes run by most corporates. It does not consider that complying with this more onerous procurement process offers any benefit or additional value for money to customers. The services that it identifies as falling into this category include certain kinds of tax, legal or other professional advice.

It also argues that the highly specialised nature of advice in this area means that there is a limited pool of suppliers in the market. As these costs will not be borne by customers they do not believe that issuing an OJEU notice², as required by the modified UCR regime, will be cost effective or efficient and in particular do not believe that this will result in any alternative suppliers that they do not already know about and whom they would invite to tender in any event, coming forward. They point out that as these costs will be entirely met by their shareholders, they are already incentivized to seek value for money from these services and propose to hold a less

² This is a procurement notice placed in the Official Journal of the European Union.

formal tender process, with the ability to negotiate the scope of the advice and benchmark the rates.

4.3.2 Specific waiver for listed legal services contracts

BTL has asked for a waiver from having to re-procure the services currently provided to it by three specified firms of solicitors. It sets out its rationale as follows

“The Tideway project has been using a small group of law firms to support the project's development and we believe there is justification to retain their services without a further competitive process given the intrinsic value they deliver in terms of background knowledge of the project, the legal documentation and how those legal agreements were developed with our various stakeholders.”

BTL's motivation for retaining the services offered by these firms is as follows:

- The first firm advised Thames Water in its application for a development consent order (DCO) under the Planning Act 2008. It therefore has a comprehensive overview of the consents and property process and how the various consents work together. Now that the project is in its implementation phase, advice on these agreements is frequently required. It also drafted the relevant employment and related staff contracts for staff engaged by Thames Tideway Tunnel Co.³ It is expected that Thames Tideway Tunnel Co will be wound up and the staff migrated to BTL,⁴ and BTL considers it will be most efficient to continue to rely on this firm for advice in this area.
- The second firm advised the BTL consortium during its bid for the Project and it developed all the equity and shareholder arrangements and negotiated BTL's senior debt facility and the government support package. As all this work preceded licence award, BTL management was not part of these negotiations and therefore consider the retention of this firm for a specified period to be an important resource to the management team which has inherited this framework.

³ This was set up by Thames Water as subsidiary company to facilitate the transfer of skills and functions to the IP. It transferred to BTL on appointment of BTL as IP.

⁴ Under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE).

BTL also considers that it is important to retain this firm for any future re-negotiation of the financing arrangements.

- The third firm advised Thames Water on the procurement of the main works contracts and BTL therefore considers that it is in a unique position to advise on any complex issues arising under the main works contracts as it understands the development of the risk allocation and how the contractors approached the tender and negotiation process.

In respect of each of these contracts, BTL has negotiated discounted rates from the companies' standard rates. It envisages each of these contracts being in place for four years from 1 April 2016.

4.4 Proposal to grant a further Waiver Notice

BTL stressed in its application that it has “a strong commitment to running transparent and competitive procurement processes for corporate governance reasons and that any request for a waiver from the modified UCR regime is not intended to undermine or dilute that commitment.”

We consider that BTL is incentivised to keep costs down and therefore, even if a waiver is granted, it is likely to run procurement processes where appropriate, and where a company is offering a unique service, to negotiate favourable rates for that service.

Waiver in respect of certain specified professional services related to BTL's financing arrangements not paid for by customers

We consider that BTL has made a reasonable case for a general waiver for services that will be paid for by shareholders, in relation to professional services related to its financing arrangements. If a waiver is granted, we are satisfied that customers will not be negatively affected (in that only services paid for by shareholders will be covered by this general exemption). We also accept that the nature of these specialist services is such that a simpler and more direct procurement may be more appropriate.

Waiver in respect of a number of specified legal services contracts

The UCR, which generally apply to other water and wastewater companies, do not require a full OJEU tender process for the appointment of legal advisers. In contrast, under the modified UCR regime, BTL would need to carry out a full OJEU process to

procure these services to the extent that the value of the contracts exceed the thresholds referred to in the Waiver Notice of August 2015. We are minded to support the grant of the waiver in respect of the specified legal services contracts for the following reasons:

- We have reviewed the rates which these firms are to charge under the contracts and consider them to be broadly reflective of market rates and therefore the costs associated with carrying out a full OJEU tender process are likely to outweigh any benefit which might accrue to customers.
- Granting this waiver is broadly in line with the accepted principle of treating BTL in an equivalent manner to a medium sized water and wastewater company in some circumstances.
- We consider that BTL has made out a reasonable case that these three companies are best placed to continue advising BTL in the specified areas (including for reasons of efficiency).
- In light of the above, we propose to support the granting of a further waiver to BTL and we are consulting on that proposal.

5. Next steps

This consultation ends on **25 February 2016**.

We will then consider the responses received to this consultation and decide whether to proceed with our proposal to grant the requested waiver.

If we decide to issue the proposed Waiver Notice we will, in accordance with section 195A of the Act, set out the reasons for our decision.

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 trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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