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Trust in water

Delivering Water 2020: consultation on PR19 methodology Appendix 9: Company bid assessment frameworks - the principles

**Appendix to chapter 6:
Targeted controls,
markets and innovation:
wholesale controls**

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1. Summary

The purpose of company bid assessment frameworks is to support the bidding market for water resources, demand management and leakage services. In a bidding market, third parties (who can be independent or out of area incumbents) submit bids to an incumbent water company (incumbent) to provide solutions to help the incumbent meet its future water needs.

Our Water 2020 work has shown that this market is not working as well as it could be, as potential third parties are deterred due to a lack of information, search/bidding costs and incumbents' bias towards their own in-house solutions. To address this, we are implementing a package of policies, one part of this is company bid assessment frameworks. This will reduce bidding costs for third parties in the bidding market and promote third party bids and innovation across the sector.

Our proposed principles for incumbents to follow for their bid assessment frameworks build on existing processes and obligations such as water resources planning requirements, procurement principles, and competition obligations, but with a focus on ensuring consistency and transparency across the sector. We propose that each incumbent produces a bid assessment framework which shows a clear commitment to the key procurement principles of transparency, equal treatment, non-discrimination and proportionality. Company frameworks will provide confidence and clarity to third parties about the integrity of the procurement process and mitigate against the risk of actual or perceived incumbent bias towards its own in-house solutions.

Incumbents will submit their bid assessment framework, which should be prepared by reference to this document, with their business plans which are due in September 2018. The quality, ambition and innovation of each incumbent's bid assessment frameworks will be considered as part of the initial assessment of business plans. This is our process for assessing the quality, ambition and innovation of incumbents' business plans.

The appendix is structured as follows:

- Section 2 discusses the background to our proposal;
- Section 3 sets out the existing obligations and rules which incumbents must have regard to, setting the context for the bid assessment framework;
- Section 4 provides an overview of the key principles incumbents should follow in preparing their bid assessment frameworks;
- Section 5 sets out the best practice recommendations for incumbents to consider; and

- Section 6 sets the review and implementation process for the bid assessment frameworks

We welcome stakeholder views on these proposals and the principles we expect incumbents to follow. Please see consultation question 4, which is set out in Chapter 6 Targeted controls, markets and innovation: wholesale controls.

2. Background

We set out our decision to require each incumbent to publish a bid assessment framework which sets out its policies and processes for assessing bids from third party providers of water resources and leakage/demand management services in 'Our regulatory approach for water and wastewater services in England and Wales', Ofwat, May 2016 ('the May 2016 decision document').

In that document we said we would adopt a principles-based approach, where incumbents would take ownership of their bid assessment frameworks to help ensure a level playing field for third party providers. We stated that a principles-based approach will protect customers' interests through promoting markets and efficiency, while allowing incumbents the flexibility to develop their own bid assessment framework.

Since the May 2016 decision document was published, we have continued to develop our approach through continued engagement with incumbents, potential third party market entrants and wider stakeholders. We have engaged through discussions in the water resources working group meetings. Slides and minutes of the working group discussions are published on [our website](#).

The purpose of the bid assessment framework is to support the bidding market for water resources, demand management, and leakage services by promoting bids and innovation.

Our Water 2020 work has shown that the bidding market for these services was not working as well as it could be. The evidence suggests that third parties interested in identifying trading opportunities are deterred by lack of information, search costs and incumbent bias towards its own in-house solutions. While the five yearly water resources management plan (WRMP) process provides some transparency leading up to the preparation of the plans, it does not reveal in-period changes to the supply-demand balance and new opportunities for third parties. This means that trading is below its optimal level.

In the May 2016 decision document, we estimated that the increased use of markets in water resources would provide net benefits of our £802 million over 30 years (2015/16 prices). Taking steps to reduce identified barriers (such as creating greater transparency) could lead to significant benefits to customers, companies, investors and the environment.

To address these barriers and stimulate a market in services which until now has been dominated by incumbent companies, we proposed a requirement that

incumbents publish market information to provide greater visibility and accessibility to existing information which forms part of their published WRMP – this includes key assumptions and economic data that underpin incumbents’ water resources planning and investment processes. This will help potential third parties to identify opportunities to provide innovative new solutions to meet future challenges. Our consultation on this market information was published on 18 April and closed on 6 July.

For potential third parties to be stimulated to submit bids once they have identified the opportunity, they need to have clarity and confidence that their bids will be assessed fairly and transparently. To achieve this, we also decided in our May 2016 decision document that each incumbent should publish a bid assessment framework which sets out clearly each of their policies and processes for the assessment of third party bids. This should include each incumbent’s approach to ensuring that it does not unduly favour its in-house solutions at the expense of third party solutions that may be more efficient or offer other benefits for example, improving resilience or reducing environmental impact.

Working together, these two policies should stimulate the bidding market, as illustrated in the case study below.

Box 1: Case study

Company X, an owner of water resources (or abstraction licence), identifies an opportunity to provide a scheme to incumbent Y, following Y’s publication of its water resources market information (which Y keeps regularly updated). The water resources information includes - forecasts of supply and demand; whether a water resource zone is in surplus or deficit; and cost breakdown and details of the scheme options included in the incumbents’ WRMPs to solve a planning period deficit.

Company X, views the incumbent’s published bid assessment framework, which gives clarity and confidence about the bid it needs to put together and how the bidding process will be run. Company X successfully engages with the incumbent. The bid is assessed against incumbent’s in-house solution and other third party bids in accordance with the incumbent’s published bid assessment framework.

3. Existing obligations and rules

Our proposed principles for company bid assessment frameworks draw on and reinforce the key principles derived from procurement law and competition law. It also takes account of the requirement for companies to follow the existing requirements of water resources planning. As key elements of any future framework already exist, we want to ensure our proposals are consistent with these and do not create undue regulatory burden. Our principles-based approach means that incumbents will retain the flexibility to adopt alternative procurement methods. The obligations and rules are

- the WRMP process;
- competition law compliance;
- procurement rules;
- current and future regulatory framework; and
- trading and procurement codes.

3.1 The WRMP process

All incumbents have a statutory obligation to prepare WRMPs every 5 years to cover a planning period of at least 25 years. The WRMP shows:

- how the incumbent plans to maintain the supply-demand balance for water over the planning period; and
- highlights any options (both supply and demand) necessary to meet changes in the balance and provide sufficient resilience.

Through WRMPs, water resources are managed and new investment planned by the incumbents. For WRMP19, the water resources planning guidance makes it clear that incumbents should engage with third parties who could provide solutions at a lower cost or that offer better value than their own in-house solutions.

Incumbents have identified third party options in the following ways:

- advertising through the Official Journal of the European Union (OJEU);
- publishing a Statement of Need and Availability of Water;
- contact with neighbouring water companies either directly or as part of the work of the Water Resources in the South East (“WRSE”) and Water Resources East (“WRE”) regional groups;
- through options that have been identified in previous WRMPs; and

- through a review of water abstraction licences within the region and direct approaches from/to other third parties.

Water resources planning guidance sets out a process for appraisal of all options (including incumbent's own in-house solution). The procedure involves the development of an unconstrained list of options, and from that list, the identification of feasible options and finally a decision as to the preferred option(s). Incumbents are required to provide evidence in their plan that:

- third parties have been able to propose options for appraisal;
- third party options have been appraised;
- consistent screening/evaluation criteria has been applied at each stage of the process; and
- a preferred option (if appropriate) has been identified or a clear explanation why third party options are not feasible options.

Our proposal for the bid assessment framework aims to complement the WRMP process by providing greater transparency on how third party bids/options are appraised by making clear at the outset the specification of the need and evaluation criteria which will be used. Moreover, it intends to reinforce the aim that third party options are appraised fairly and transparently at each stage of the WRMP process against in-house solutions.

3.2 Competition law compliance

Companies are obliged to comply with competition law. Nothing in this document should be read as requiring companies to act in a way that is inconsistent with their competition law obligations. In particular, companies should ensure during the tender process that they do not:

- artificially narrow competition (where the design of the procurement is made with the intention of unduly favouring or disadvantaging certain or all parties);
- distort competition in the market by abusing their dominant buyer position (for example by awarding unreasonably long exclusivity contracts to a third party, hence foreclosing the water resource market to other potential suppliers); or
- facilitate collusion between third parties by disclosing confidential bid information.

This type of conduct may raise competition law concerns.

3.3 Procurement rules

The legal framework which governs the procurement process is dependent on the nature and value of the contract. The procurement of certain goods and services by water companies is regulated by the Utilities Contracts Regulations 2016 (UCR16), but it is unclear whether this applies to the procurement of all water resources (for example, water resources which may be at various different stages of treatment) by an incumbent from a third party. Consequently, it is uncertain whether third parties bidding to provide water resources may have a right of action under this legislation if they consider they have been treated unfairly during the procurement process. In any event, the application of the UCR16 will be a matter for the incumbents to assess.

For many other types of contract procurement, companies are obliged to adhere to the key principles set out in procurement rules (such as UCR16) which include obligations to ensure transparency, equal treatment/non-discrimination for all potential bidders and proportionality. These are discussed further in section 4.1 below.

We propose these principles are formally integrated into each companies' bid assessment frameworks for water resources, demand management and leakage services. This will ensure a standardised approach and some consistency amongst incumbents' procurement processes, while not creating further regulatory burden.

We recognise that procurement law will, where relevant, take precedence over incumbents' bid assessment frameworks. We expect incumbents to update their bid assessment frameworks when necessary to reflect developments in the law.

3.4 Current and future regulatory framework

At present, there is no regulatory framework for the direct regulation of water supply agreements made between incumbents and unregulated third parties. In due course, section 12 of the Water Act 2014 will change the legal framework and enable the UK and Welsh Governments to make provision about the regulation of such agreements. If regulation was required, Ofwat could potentially be given powers to determine disputes about such supplies of water (including the power to require a water undertaker to take a supply), to make enforceable codes about procedures in connection with making, varying or terminating such supply agreements and/or to make rules about charges.

3.5 Trading and procurement codes

At PR14 we introduced water trading incentives. An incumbent is able to obtain these incentives for new water trades agreed during 2015-20 subject to a cap on the size of the incentive, and a requirement for trades to comply with an Ofwat-approved trading and procurement code. Our requirements for the code are set out in [Appendix 3 of our final PR14 methodology statement](#). Incumbents that do not wish to claim water trading incentives do not have to prepare a code.

The trading and procurement code is not aimed at creating greater clarity and confidence in the bidding process for third party bidders. Instead it provides assurance that any incentive payment delivers net benefits to customers and the environment. As set out in appendix 7. 'Wholesale revenue incentives' we are proposing that the water trading incentives will be maintained for 2020-25 and that we will be maintaining the trading and procurement codes for this period.

4. Overview of our proposals for the principles of the bid assessment framework

In this section we set out:

- the principles in the bid assessment framework; and
- a summary of approach.

4.1 The principles

We propose that incumbents should produce a bid assessment framework which shows a clear commitment to the three key principles of:

- transparency;
- equal treatment/ non-discrimination; and
- proportionality.

The principle of transparency requires the process for the selection of third parties and award criteria to be transparent to all bidders. Transparent rules-based decision making is important to show that the incumbent is following the principle of equal treatment and non-discrimination in each step of the procurement process.

More transparency in the process ensures confidence that incumbents will not favour their own in-house solutions, or allow unfair advantage to other bidders. Confidence in the procurement process will help to stimulate third parties to make bids.

Equal treatment requires that all potential suppliers must have: (i) an equal opportunity to compete for the contract (unless a difference in treatment can be objectively justified); and (ii) there is an objective comparison of all tenders. This also applies to the consideration of bids against an incumbent's own in-house solution. This helps to avoid discrimination.

For the principle of proportionality to be met, the measure taken must be appropriate for attaining the objective pursued and must not go beyond what is necessary to achieve it. For example, when designing a specification for a contract, incumbents should not over specify the requirements, as this could increase bidding costs which may result in the withdrawal of some or all of the potential bidders.

Avoiding conflict of interests

We would expect incumbents to take appropriate measures to prevent, identify and remedy any conflicts of interest arising from the procurement process to avoid distortion of competition and ensure equal treatment of all bidders. One important aspect of this, is that an incumbent's subsidiary or affiliate should not participate in the bidding process. To do so, would create a conflict of interest which would be perceived as unfair by third party bidders and undermine confidence in the procurement process.

This does not preclude incumbents developing their in-house solutions/schemes (as part of the WRMP process) which we are currently proposing incumbents publish and update as part of the market information guidance proposals. Bids should be assessed against the developed in-house scheme using the same criteria. This will enable more cost efficient bids which meet the same criteria to be identified.

Assessment of third party bids against an incumbent's in-house solution

When assessing third party bids against an incumbent's own in-house solution, we would expect incumbents to do so in accordance with the same principles of transparency, equal treatment/non-discrimination and proportionality.

4.2 Summary of approach

Company bid assessment frameworks should provide a standardised process for inviting and considering all third party bids. We consider our proposal to be a proportionate approach which strikes an appropriate balance between needing to stimulate third party bids and not creating undue regulatory burden.

We would expect a high quality bid assessment framework to give bidders a clear understanding of the following:

- pre-qualification requirements to avoid submitting bids which will be automatically rejected and
- the specifications required (incumbents should take a proportionate approach and avoid over specifying requirements and/or increasing bidding costs so as to narrow competition) and
- the evaluation criteria.

It should also give third party bidders confidence that:

- the bid will be assessed fairly and according to the same evaluation criteria as the incumbent's own in-house solution
- the bid will be treated equally to other bids submitted
- commercially sensitive information will be subject to a confidentiality ring to which only the procurement team will have access to safeguard against the misuse or perception of misuse by the incumbent to gain unfair advantage
- the decision making process will be expedient, fair and transparent, and subject to oversight by a project board and
- there is a robust and accessible complaints/challenge process in place, should they consider their bid has not been considered in accordance with the bid assessment framework.

5. Best practice recommendations

We propose a separate procurement team (i.e. not one that has been involved in any pre-tender engagement or is involved in other incumbent operations) oversees the bidding process to

- protect against conflicts of interest;
- ensure no actual or perceived bias; and
- safeguard against the misuse of commercially sensitive information disclosed by third parties as part of their bids.

As well as applying the principles of transparency, equal treatment/non-discrimination and proportionality when assessing third party bids against each other, we would also expect the separate procurement team to also ensure the bids are assessed against the incumbent's in-house solution in accordance with these principles.

We would also expect the procurement process to be documented and an audit of compliance be retained and made available to Ofwat, should we require it. Incumbents should consider whether a separate compliance role is justified.

We consider that incumbents should publish a clear and transparent complaints and appeals process which is accessible to third parties. Third parties who have grounds for complaint or wish to challenge the award of a contract may as a first step have recourse to the incumbent's internal complaints procedure. However, we consider that third parties should be able to challenge a complaint if they are dissatisfied with the incumbent's handling of it.

As part of the bid assessment framework, where procurement projects are not regulated by the UCR16, we propose that each incumbent voluntarily offers a written agreement between itself and the bidders which sets out that

- (i) if bidders consider that the incumbent has not complied with the principles of transparency, equal treatment/non-discrimination and proportionality, then an independent third party will be appointed to resolve the dispute and
- (ii) the incumbent will agree to be bound by the decision of the independent third party that the incumbent had breached the procurement principles by which it had agreed to be bound.

This written agreement would provide increased confidence in the framework which could lead to a greater likelihood of it achieving its aim - to stimulate the bidding

market. This would have a positive impact on efficiency and affordability without being too costly or difficult for incumbents in the long term.

To ensure the effectiveness of the company bid assessment framework, we consider incumbents should maintain an open process rather than introduce time limited bidding windows. This is because while we recognise that most bidding activity will occur when WRMPs are being prepared every five years, we want to encourage more bidding activity in-period. An open bidding process, should minimise the potential for inefficiency and will allow bids from new entrants who are able to submit a bid for a one off trade.

The figure overleaf sets out an example of the process that we would expect to be covered by the incumbent's bid assessment framework to maximise transparency about the bidding process while ensuring the approach is proportionate. Proportionality is important when considering specifications, as for example, the higher the specification, the higher the bidding costs for third parties, which may deter them.

Figure 1 Overview of an example bid assessment framework

Prequalification	
Gateway criteria – mandatory requirements eg financial viability of the company	Ensures third party does not commit resources to a bid if it will automatically be rejected
Need specification	
Need made clear at the outset, including the environmental aspects, water source and quality, costs and reliability	Bidders must understand needs, assumptions and capital requirements of fulfilling the contract
Time limits and bid clarification	
Bids considered within a reasonable time of being submitted. Ambiguities clarified before evaluation and communicated to all bidders, through authorised channels	Equal treatment of bids and non-discrimination in relation to in-house solutions
Evaluation	
Evaluation criteria aligned to specifications and made clear upfront. For each criteria, make clear the relative weighting in the bid request to reflect importance to process	Ensures a transparent, rule-based decision-making process that limits discretion and ensures equal treatment and non-discrimination
Governance	
Develop process to ensure objective and independent analysis of evaluation of bids. Document process with reasons for rejecting/accepting bids	Ensures fairness, transparency and equal treatment
Contract award	
Audit report of compliance with the bid assessment principles and company's own framework to be prepared and be made available to Ofwat	Embedded process ensures validity of evaluations conclusion. Independent oversight will encourage equal treatment and limit discrimination
Communication of decision	
Decisions communicated to all bidders including reasons for acceptance/rejection of bid and bid scores	Encourages improvements in the quality of bids by ensuring future potential bidders can see the quality of successful bids

6. Review and implementation of company bid assessment frameworks

6.1 Review process

We propose incumbents submit their bid assessment framework as part of their business plans in September 2018. It will be reviewed as part of the initial assessment of plans under our markets and innovation tests. We want incumbents to produce high-quality, ambitious bid assessment frameworks, which stretch the boundaries for delivery and efficiency. This will ultimately lead to benefits for customers, the environment and wider society.

If the bid assessment framework falls short of our minimum expectations, (as outlined in the section 5 above), incumbents may have to resubmit the bid assessment framework or we may need to consider additional regulatory measures.

We expect incumbents to provide information which has been subject to good assurance processes to ensure it is consistent and accurate. It is for the incumbents and their Boards to determine how best to provide this assurance, including the role of external assurance. If incumbents provide a lack of assurance about the information they are providing this may attract monitoring under the company monitoring framework which may impact on the assessment of their business plans at PR19 or subsequent price reviews.

We consider that our review approach provides effective incentives to incumbents to be efficient, which will have a positive impact on customers while allowing sufficient flexibility for companies. It also encourages ownership and accountability of their compliance strategy and fosters innovation.

6.2 Implementation

We do not expect third party bids to be assessed under the company bid assessment frameworks for WRMP19 – as draft plans are due to be submitted in December 2017 and we expect to receive company frameworks in September 2018. However, in the interim period we would expect incumbents to adhere to the principles of transparency, equal treatment/ non-discrimination and proportionality when assessing third party bids. If incumbents are unable to do so, we would expect them to provide reasons for not adhering to them.

After the incumbents' final determinations are published we would expect each incumbent to publish its bid assessment framework alongside the water resources market information on its website. To ensure they are both easily accessible to third parties, we will provide a link to these publications from our website.