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Trust in water

Delivering Water 2020: Our final methodology for the 2019 price review Appendix 8: Company bid assessment frameworks – the principles

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

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1. Summary

Applicability to England and Wales

Our final methodology for company bid assessment frameworks **applies to both** companies whose areas are wholly or mainly in England and companies whose areas are wholly or mainly in Wales.



This appendix confirms the principles for the company bid assessment frameworks and how they will be assessed as part of the initial assessment of business plans. This methodology has been determined after fully considering the views expressed by respondents to our [draft methodology proposals](#), published in July of this year.

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 submit bids to an incumbent water company¹ to provide solutions to help the incumbent meet its future water needs. Third parties can be independent entities or other incumbents from outside the area.

Our Water 2020 work has shown that this market is not working as well as it could. Potential third parties are being deterred by 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, including company bid assessment frameworks. These policies will reduce bidding costs for third parties in the bidding market and promote third party bids and innovation across the sector.

Our principles for incumbents to follow when preparing 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. Each incumbent should produce a bid assessment framework that shows a clear commitment to the key procurement principles of transparency, equal treatment, non-discrimination and proportionality. Company bid assessment frameworks will

¹ A company holding an appointment as a water undertaker under the Water industry Act 1991 for whom we will be setting full price controls at PR19.

provide third parties with confidence and clarity about the integrity of the procurement process and mitigate the risk of incumbents' actual or perceived bias towards their own in-house solutions.

Incumbents will submit their bid assessment frameworks, which should be prepared with reference to this document, with their business plans, which are due in September 2018. In light of this timetable third party bids cannot be assessed under the company bid assessment frameworks for WRMP19, where draft plans are due to be submitted in December 2017. However we would expect incumbents to adhere to the principles of transparency, equal treatment/non-discrimination and proportionality when assessing third party bids as part of WRMP19. If incumbents are unable to do so, we would expect them to provide reasons why.

The quality, ambition and innovation of each incumbent's bid assessment framework will be considered as part of the initial assessment of business plans, which is our process for assessing the quality, ambition and innovation of incumbents' business plans.

2. Background

We set out our decision to require each incumbent to publish a bid assessment framework – setting 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 would protect customers’ interests by promoting markets and efficiency, while allowing incumbents the flexibility to develop their own bid assessment frameworks.

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 other stakeholders. We have engaged through discussions in the water resources working group meetings. Slides and minutes from the working group discussions are published on [our website](#).

The purpose of the bid assessment frameworks is to support the bidding market for water resources, demand management, and leakage services by promoting bids and innovation. The bid assessment frameworks will enable incumbents to identify more efficient providers of water resources, demand management and leakage services. They are therefore a means of reducing costs to customers.

Our Water 2020 work has shown that the bidding market for these services was not working as well as it could. The evidence suggests that third parties interested in identifying trading opportunities are being deterred by a lack of information, search costs and incumbents’ bias towards their 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 or 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 more than £802 million over 30 years (2015-16 prices). Taking steps to reduce known barriers (such as by promoting greater transparency) could lead to significant benefits for customers, companies, investors and the environment.

To address these barriers and stimulate a market in services which until now has been dominated by incumbents, we proposed a requirement that incumbents publish market information, making the existing information that forms part of their published WRMPs more visible and accessible. This information includes key assumptions and economic data that underpin incumbents' water resources planning and investment processes. Publishing it will help potential third parties to identify opportunities to provide innovative new solutions to meet future challenges. We published the market information guidance on 11 October 2017².

To stimulate potential third parties to submit bids once they have identified the opportunity, they need to be given 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 that sets out clearly each of its policies and processes for assessing 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 an 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
- a cost breakdown and details of the scheme options included in the incumbents' WRMPs to solve a planning period deficit.

Company X views incumbent Y's published bid assessment framework, which gives clarity and confidence about the bid X needs to put together and how the

² ['Water resources market information guidance'](#), ['Bioresources market information guidance'](#), and ['Bioresources and water resources market information response document'](#)

bidding process will be run. Company X successfully engages with incumbent Y. The bid is assessed against incumbent Y's in-house solution and other third party bids in accordance with Y's published bid assessment framework.

3. Existing obligations and rules

Our principles for company bid assessment frameworks draw on and reinforce the key principles derived from procurement law and competition law. They also take into account the requirement for companies to follow the existing requirements of water resources planning.

We want to make sure our principles are consistent with these and minimise the burden of regulation. Our principles-based approach means that incumbents will retain the flexibility to adopt alternative procurement methods. Relevant obligations and rules include:

- the WRMP process;
- competition law;
- procurement rules;
- the 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 five 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 who 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;
- contacting 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 appraising all the options (including incumbent's own in-house solution). The procedure involves developing an unconstrained list of options; identifying the feasible options from that list; and making a decision as to the preferred option(s). Incumbents are required to provide evidence in their plans that:

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

The bid assessment framework aims to complement the WRMP process by clearly specifying, from the outset, the need and evaluation criteria that will be used to appraise third party bids/options, increasing the transparency of the appraisal process. Moreover, it intends to reinforce the aim of appraising third party options fairly and transparently against in-house solutions at each stage of the WRMP process.

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, during the tender process, companies should ensure 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 a dominant buyer position (for example, through an unfairly low purchase price); 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 that governs the procurement process is dependent on the nature and value of the contract. The Utilities Contracts Regulations 2016 (UCR16) set rules about the procurement of goods and services by water companies, but the rules do not apply in all cases. The application of the UCR16 will be a matter for the relevant parties to assess, but we note that third parties will not always have a right of action under this legislation, if they consider they have been treated unfairly during the procurement process.

Where procurement rules (such as the UCR16) apply, companies are obliged to adhere to the key principles, which include obligations to ensure transparency, equal treatment/non-discrimination for all potential bidders and proportionality. These are discussed further in section 4.1.

These principles should be formally integrated into each company's bid assessment frameworks for water resources, demand management and leakage services. This will ensure there is a standardised approach and some consistency among incumbents' procurement processes, while minimising the 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 provisions about the regulation of such agreements. If regulation were required, we could potentially be given powers to:

- determine disputes about supplies of water (including the power to require a water company to take a supply);
- make enforceable codes about procedures in connection with making, varying or terminating such supply agreements; and/or
- make rules about charges.

3.5 Trading and procurement codes

At PR14, we introduced water trading incentives. An incumbent can 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 provides assurance that any incentive payment delivers net benefits to customers and the environment and is not intended to give third party bidders more clarity and confidence in the bidding process. As set out in appendix 5, 'Water resources control', we will maintain both the water trading incentives and the trading and procurement codes for the 2020-25 period.

4. Overview of the principles of the bid assessment framework

In this section we set out:

- the principles of the bid assessment framework;
- a summary of approach; and
- responses to our proposals in the draft methodology.

4.1 The principles

Incumbents should produce a bid assessment framework that 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 selecting 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.

The principle of equal treatment requires that:

- all potential suppliers have an equal opportunity to compete for the contract (unless a difference in treatment can be objectively justified); and
- 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 overspecify the requirements; this could increase bidding costs, which may result in the withdrawal of some or all of the potential bidders.

4.1.1 Avoiding conflicts of interest

We 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 associated company (as defined in condition A (interpretation and construction) of the incumbent's licence), if any, 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 in-house solutions or schemes as part of the WRMP process. We require incumbents to publish and update these as part of the market information guidance. 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.

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

When an incumbent is assessing third party bids against its own in-house solution, we expect it 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 this to be a proportionate approach that strikes an appropriate balance between needing to stimulate third party bids and not creating an undue regulatory burden.

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

- pre-qualification requirements, to avoid submitting bids which will be automatically rejected;
- the specifications required (though incumbents should take a proportionate approach, and avoid overspecifying 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 the same as the 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 misuse or the perception of misuse by the incumbent to gain an unfair advantage;
- the decision making process will be expedient, fair, 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 appraised in accordance with the bid assessment framework.

4.3 Responses to the proposal in the draft methodology

We received 16 responses in total from water and wastewater companies, water only companies and another stakeholder. There was strong support for our approach but there were comments from a small number of respondents about aspects of the proposal. Section 5 of appendix 16 outlines respondents' answers to our question about whether they agreed with the proposals for the company bid assessment frameworks. In appendix 16, we provide our response to the issues raised by respondents.

Most of the substantive comments were related to the best practice recommendations. In response to these comments, we have

- clarified our recommendation for a separate procurement team, to make clear our intention to exclude the participation of individuals who could potentially give rise to a conflict of interest. This includes individuals who have been involved in the development of the incumbent's own in-house solution or pre-tender preparation, rather than experts in the incumbent business generally.
- amended two of the best practice recommendations to allow companies to exercise greater ownership over their frameworks. This will also allow companies

more flexibility in their approaches. As a result of these amendments to the best practice recommendations:

- we are no longer advocating leaving the bidding process completely open. Instead, we recommend that incumbents make it clear when bids should be submitted and provide an underlying rationale for their approach. This gives incumbents the flexibility to adopt an open or time limited approach, depending on business need; and
- we are replacing the recommendation that the incumbent and all third party bidders agree to appoint an independent third party arbitrator to resolve disputes. In any event, incumbents will be expected to implement a robust, accessible, proportionate and appropriate complaints/challenge process in case third parties consider their bid has not been appraised in accordance with the bid assessment framework (as set out in section 4.2).

These revisions are reflected in this final methodology.

5. Best practice recommendations

We recommend that a separate procurement team – one that does not include individuals who have been involved in any pre-tender engagement, or in the development of the incumbent’s own in-house solutions – oversees the bidding process to:

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

We would expect the separate procurement team to apply the principles of transparency, equal treatment/non-discrimination and proportionality both when assessing third party bids against each other and when assessing the bids against the incumbent’s in-house solution.

We would also expect the procurement process to be documented and an audit of compliance to 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.

As part of the bid assessment framework, where procurement projects are not regulated by the UCR16, we propose that each incumbent voluntarily states in writing that it will comply with the principles of transparency, equal treatment/non-discrimination and proportionality.

This written agreement would provide increased confidence in the framework, which could increase the likelihood of it achieving its aim: to stimulate the bidding market. This would have a positive impact on efficiency and affordability without being unduly costly or difficult for incumbents.

To ensure the effectiveness of the company bid assessment framework, we consider incumbents should take ownership of decisions about when bids should be submitted, and so retain the flexibility to decide whether a particular bidding process should be ‘open’ or time limited. We expect incumbents to provide a rationale for these decisions. This is because we are mindful that while most bidding activity will

occur when WRMPs are being prepared every five years, we want to encourage more bidding activity in-period, and an open bidding process will allow bids from new entrants who are able to submit a bid for a one-off trade.

Figure 1 sets out an example of the process we would expect the incumbent's bid assessment framework to cover, to maximise transparency about the bidding process while making sure the approach is proportionate. Proportionality is important when considering specifications because, 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	
Specification 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 evaluation's 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

Incumbents should submit their bid assessment frameworks as part of their business plans in September 2018. They will be reviewed as part of the initial assessment of business 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 its bid assessment framework falls short of our principles (set out in section 4) and best practice recommendations (outlined in the section 5), an incumbent 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 make sure 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 insufficient assurance about the information they are providing, this may affect their rating 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 for incumbents to be efficient. The approach will have a positive impact on customers while allowing sufficient flexibility for companies. It also fosters innovation and encourages incumbents to take ownership and ensure accountability of their compliance strategies.

6.2 Implementation

We do not expect third party bids to be assessed under the company bid assessment frameworks for WRMP19, because the draft plans are due to be submitted in December 2017 and we expect to receive company frameworks in September 2018. However, in the interim 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 why.

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 links to these publications from our website.