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## Reasons for Issuing a Fifth Waiver Notice

### Introduction

On 21 August 2015 Ofwat granted a [Project Licence](#) to Bazalgette Tunnel Limited (trading as Tideway) to deliver the Thames Tideway Tunnel project (the Project). Tideway must carry out all activities described in the [Project Specification Notice](#) issued by the Secretary of State in respect of the Thames Tideway Tunnel, apart from those activities that Thames Water Utilities Limited (Thames Water) is to carry out under the [Preparatory Works Notice](#), also issued by the Secretary of State.

The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (the [SIP Regulations](#)) apply a procurement regime to the Project which the incumbent water or sewerage undertaker (in this case Thames Water) or the designated licensed infrastructure provider (IP) (in this case Tideway), must follow in circumstances where the Utilities Contracts Regulations 2016 (the UCR) or the Public Contracts Regulations 2015 (the PCR) do not impose a requirement to conduct a competitive tender process. However, regulation 6(8) of the SIP Regulations permits Ofwat to issue a notice to dis-apply this regime (or aspects of the regime) in relation to the licensed IP. The procurement regime that applies to the Project under the SIP Regulations is a modified form of the procurement regime in the UCR (the modified procurement regime).

At the same time that we issued a project licence to Tideway, we also issued a [notice](#) under regulation 6(8) of the SIP Regulations dis-applying to a limited extent Tideway's obligation to apply the procurement provisions set out in the SIP Regulations (referred to below as a 'Waiver Notice'). In particular, this first Waiver Notice provided that Tideway should benefit from some of the exemptions that apply to all utilities under the UCR. It also provided that Tideway did not have to follow the modified procurement regime for contracts with a monetary value under a specified

threshold. This threshold is the same threshold that applies to all utilities under the UCR (the UCR financial threshold).<sup>1</sup>

We have now issued Tideway with five Waiver Notices. Some of these have been in respect of specific named contracts and some have been general in nature – ie applying to a defined category of contracts.

In Oct 2017 Tideway applied for a waiver requesting that the higher threshold that applies to contracts for “social and other specific services” should be extended to it. Currently Tideway must put out to tender contracts for these services if the services fall above the threshold of £363,424. For other utilities, to whom the UCR apply, there is a higher threshold of £820,370 and above that higher threshold a “light touch” procurement regime applies. We agreed to grant Tideway this further [waiver](#) on 27 February 2018, coming into effect on 28 February 2018.

In accordance with section 195A of the Water Industry Act 1991 (as applied by the SIP Regulations), this document sets out the reasons for granting this fifth Waiver Notice.

Granting Tideway’s request under this heading means 1) excluding the application of the modified UCR regime for contracts for social and other specific services listed in Schedule 2 of the UCR that fall below the higher threshold for these services (£820,370); and 2) extending the light-touch regime set out in the UCR to Tideway for all contracts for social and other specific services above that threshold. The Waiver Notice achieves this by importing (with some modification) the processes in Regulations 91 and 92 of UCR 2016 for above threshold contracts.

## **Reasons for issue of Waiver Notice**

The first waiver notice that was issued to Tideway extended a number of the general exemptions to Tideway. However, when granting the first waiver we did not extend the general exemption in relation to the award of social and other specific services as we considered that to do so would have resulted, due to relevant legislation applicable at the time, in Tideway effectively being placed in a better position than regulated utilities. This was because the legislation at the time did not exempt utilities entirely but rather required them to carry out at least a basic tender process

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<sup>1</sup> The current thresholds are £363,424 for a supply or a services contract, and £4,551,413 for a works contract

in respect of the award of these contracts. The legislation has now changed and we now consider that extending this exemption to Tideway will put it in an equivalent position to other undertakers (rather than a better position).

In line with the principle that, where appropriate, Tideway should have the same procurement obligations as water and sewerage undertakers, we have granted this request.

## Conclusion

From 9<sup>th</sup> January 2018 to 30<sup>th</sup> January 2018, we [consulted](#) on our proposal to issue Tideway with a fifth Waiver Notice. We received [one response](#) to the consultation which argues Ofwat should not grant any further waivers to Tideway on the basis that Tideway is in breach of its licence in two respects and should therefore not benefit from any further concessions by Ofwat.

We have set out below why the respondent considers Tideway to be in breach of its licence and why we disagree with the respondent's conclusions in this regard.

### First Breach of Licence

The respondent quotes from Thames Water's audited accounts for 2017 the statement that 'substantially all the risks and rewards of ownership (of TTT) will lay with the company (TWUL) [Thames Water]. The company will therefore account for the transaction arrangement with BTL [Tideway] post construction as a finance lease.'

The respondent sees this as being contrary to the Specification Notice, issued under the SIP Regulations, and in particular the statement in the Specification Notice that the TTT includes 'from the Acceptance Date: the operation and maintenance of the IP owned structures.' The respondent concludes that operational and maintenance responsibility is being passed to Thames Water Services Regulation Authority in conflict with Tideway's licence obligations.

### Second Breach of Licence

The respondent argues that under condition G of its licence Tideway is obliged to provide customers with information as to tariffs, complaints and a Code of Practice. As a customer of Thames Water the respondent says that he has received no such

information from Tideway and therefore Tideway is in breach of its condition G obligations.

## **Ofwat's Response**

With regard to the first alleged breach, a similar question on this statement in Thames Water's audited accounts was raised as a Parliamentary question by Lord Berkeley (PQ HL 288717/19). Lord Gardiner of Kimble provided the following written response (on 17 November 2017):

“Once the Thames Tideway Tunnel construction and system acceptance is completed, the above-ground assets, structures and equipment constructed by Tideway on land acquired by Thames Water for purposes of the project will transfer to Thames Water's ownership. The deep tunnels, shafts and other related non-mechanical assets will remain in Tideway's ownership, along with responsibility for inspections and any necessary maintenance arising to ensure the tunnel continues to operate effectively. Thames Water's statutory obligation for ensuring effective drainage of its area remains, and as part of this it will have the right to exclusive use of the Tideway Tunnel to discharge sewage into it and remove it for treatment. This arrangement is a finance lease as defined under international accounting standards, from which the terminology in Thames Water's published accounts relating to risks and rewards of ownership lying with the company derives.”

This statement reflects our understanding, namely that once the tunnel is completed, Tideway will continue to retain ownership of the asset, with Thames Water having exclusive use of it after hand-over as an integral part of its London sewerage network. This arrangement is a finance lease governed by the International Financial Reporting Standards, which drives the way in which both Tideway and Thames Water have to report the TTT project in their respective statutory annual company accounts. Thames Water has taken the phrase “On completion of construction of the Thames Tideway Tunnel, substantially all the risks and rewards of ownership will lay with the Company” directly from the international accounting standards that classify a finance lease as relating to the right to use an asset (owned by someone else) on an exclusive basis. This goes on to describe the lease term as being for the major part of the economic life of the asset, even if title is not transferred. This precisely describes the lease arrangements between Thames Water and Tideway once the tunnel is operational. We do not consider that entering into this finance lease puts Tideway in breach of its licence.

With regard to the second alleged breach, condition G is not in effect and will only come into effect in the unlikely event that Tideway charges customers directly.

There is therefore no expectation that Tideway will communicate with customers and no licence breach.

We consider that the request by Tideway to extend the general exemption in relation to the award of social and other specific services will put Tideway in an equivalent position to other undertakers under the current regulations.

We issued Tideway with a Waiver Notice on 27 February 2018, effective on 28 February 2018 and consider that nothing in this Notice shall prevent any further exercise by Ofwat of its powers under regulation 6(8) of the SIP Regulations.