

DPC Licence Changes Consultation
Direct Procurement
Ofwat
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By email to: DPC@ofwat.gov.uk

Response to the Consultation on proposed amendments to licence conditions for Direct Procurement for Customers

21 April 2020

Amber Infrastructure Group (“Amber”) welcomes the opportunity to provide a response to the Ofwat consultation published in February 2020. The key messages which emerge throughout our response, and which we would be pleased to discuss further with you, can be summarised as follows:

- We believe that the proposed DPC regime is a positive development for the sector
- We believe that the proposed licences changes taken in aggregate provide clarity for companies, potential CAPs and therefore protect and provide value for money to consumers
- While we are supportive of the proposed role for Ofwat in the DPC regime, we do believe that companies (and Ofwat) should retain the discretion necessary to decide certain matters on a case by case basis
- We are in favour of incentives (both positive and negative) that encourage Appointees in the appropriate manner.

About Amber

Amber is a leading UK-based infrastructure investor employing ~130 infrastructure professionals, headquartered in London and with offices in mainland Europe, Australia and North America.

Amber manages c. £4.5bn of capital across six different funds on behalf of public and private sector investors. Amber has extensive experience of developing and investing in UK infrastructure assets. Amber’s listed fund, International Public Partnerships (“INPP”), manages ~£2.5bn of capital, of which 73% is invested into UK public infrastructure projects. INPP has brought private sector finance to deliver market leading transactions in recent years, including the Thames Tideway Tunnel, Offshore Transmission links connecting the grid to the offshore wind farms, and Cadent gas distribution network.

Amber has a long history of working closely with the public sector, the regulators and the UK Government. We are also a key player in the delivery of the nascent infrastructure sectors related to energy transition and digital fibre. Amber has an established track record for driving innovation together with Government to design bespoke investment vehicles that deliver policy objectives. This includes the London Energy Efficiency Fund (“LEEF”), the UK’s first dedicated energy efficiency fund, which the EIB invested on behalf of Government in energy efficiency schemes in London, as well as the follow-on fund, the Mayor of London’s Energy Efficiency Fund (“MEEF”), backed by the Greater London Authority and European Regional Development Fund. Amber is also the manager for a similar fund in Scotland, the Scottish Partnership for Regeneration Centres (“SPRUCE”), backed by Scottish Government and the EIB.

In 2017 Amber was appointed by HMT to manage the National Digital Infrastructure Fund (“NDIF”), a co-investment fund set up with public sector seed capital from the Digital Infrastructure Investment Fund (“DIIF”). This fund has made four investments to date and is working to expand the provision

of full fibre broadband infrastructure in the UK and crowd in new private sector investments to the sector.

Please do let us know any comments or queries¹ on our responses, which we would be pleased to discuss further with your team as part of our ongoing commitment to strengthening the market for infrastructure finance in the UK.

Kind regards

Gavin Tait
CEO

¹ Please note that certain information contained in this document may be commercially sensitive, therefore to the extent Ofwat wishes to publish any of the below material we would be grateful if you could seek consent from Amber beforehand

1. Do you agree with the key aspects of the proposed licence amendments outlined above?

The proposed licence amendments require companies to prioritise outcomes that deliver best value for money for customers, formalise Ofwat's assurance process at various stages of the process, allow for the pass through of the CAP charge to customers and provide further clarity on the levels of information that Ofwat expects to receive at each stage of the process.

On that basis we broadly agree with these proposed amendments, but would draw attention to the following points:

- **Permission to enter into a CAP Agreement**

We understand Ofwat's desire for assurance around the CAP award but believe this is a potential area of risk for the DPC process. If bidders believe there is any risk that the appointee will not be given permission to enter into a CAP Agreement, they will be materially discouraged from entering into the process and incurring potential bid costs.

At this late stage of the process, having signed off the proposed structure pre-tender and been informed of any amendments, we don't believe there should be a material risk of Ofwat refusing to provide this consent and we believe Ofwat should make this clear. We believe that Ofwat choosing to exercise its right to refuse permission post-tender would endanger future DPC processes.

Given companies are obligated to act in the interests of their customers, we see limited incentive for companies to compromise key clauses or insert additional clauses to the detriment of customers in the manner envisaged. If Ofwat believes there is a material risk in this respect, we believe it should clearly set out its 'red lines' in advance of the procurement to all parties to avoid the highly detrimental step of not approving the CAP Agreement post tender and post-bidders incurring bid costs.

- **Ultimate controller of the CAP**

We have concerns around Ofwat's desire to approve any change of Ultimate Controller of the CAP. The CAP Agreement as envisaged will place clear contractual obligations on the CAP, irrespective of the identity of the Ultimate Controller and irrespective of whether that party changes or is replaced. As such we question the requirement for this approval process.

We believe such an approval process may prove to be unattractive for potential bidders, large or small, for whom commercial reorganisations or M&A will suddenly require the consent of the UK Water regulator. Particularly for larger companies where a potential CAP Agreement may represent a small part of its overall business, we believe this will be particularly unattractive. Should Ofwat be firmly committed to such an approval process, we believe it should provide clear guidance on the type of transfer it would not consent to. In practice we believe such circumstances may be limited and would therefore question the utility of the process.

2. Do you think that a water company is sufficiently incentivised to manage the CAP Agreement? Do you think Ofwat should consider applying specific Outcome Delivery Incentives to provide the right incentives for the water company to act in customers best interests?

In the agreements as drafted we see limited 'upside' incentive for water companies to manage the CAP agreements, but plenty of negative consequences for not doing so in a proper manner, particularly given Ofwat's close oversight of the process.

We do believe that upside incentives have a role to play, particularly in the following areas where otherwise, *inter alia*, the Appointee may have very limited incentive:

- Providing a detailed and workable design that can withstand scrutiny beyond the due diligence phase
- The interface between the project and the existing network
- General co-operation and alignment between CAP and Appointee
- Outperformance above the minimum level, which results in the best overall outcome for the customer.

We believe the monitoring of these areas (and others) would be extremely challenging for any regulator, even with the level of information sharing proposed.

Such outcome delivery incentives are perhaps best adapted to the specifics of each project but we believe they should be designed to materially incentivise at least: (i) the appointment of a CAP at an overall cost that delivers value for money vs the cost of the Appointee doing the work themselves; (ii) the completion of the project on time; and (iii) the completion of the project on budget.

3. Should a materiality threshold be applied to consent to vary the CAP Agreement? If so what should level of materiality applied and how should this be worded for the new licence condition?

We believe companies should be given a high level of discretion to vary the CAP Agreement without consent and would propose a high threshold. This is because: (i) if properly incentivised, companies should be best placed to judge these matters for themselves; and (ii) a decision to vary a CAP Agreement would be highly visible to both customers and regulator and not something any Appointee would be likely to embark upon without due consideration.

4. Please tell us your views on the appropriate balance of risk the water company is undertaking? What level of risk do you think the water company should be taking in this process?

We believe the water company is undertaking a broadly appropriate level of risk. We see it as particularly critical that the Appointees are incentivised to make the DPC process work post-tender: even with the requirement to act in the best interest of customers, an efficiently managed company may look to limit the resources devoted to the DPC project post-tender as at that point risks have been materially transferred to the CAP. The addition of incentives as outlined above may help this.

One innovation could be to nominate Appointees as the construction provider of next/last resort should the CAP or the project fail, with the fair costs that would be allowable to be determined by Ofwat? Given the tender is the most recent indication of these fair costs, and given this tender if successful is likely to be below the allowed return, this may provide further incentive to ensure the success of the CAP.

5. Please provide your comments on the processes outlined in the DPC Briefing Note?

Subject to the comments provided above we are supportive of the process as outlined. We would add only that the Briefing Note anticipates few circumstances where a project would be permitted to leave DPC and would in preference be retendered or redesigned.

If a project has failed and needs to be redesigned / retendered, we believe that it could be in the best interests of consumers for the project to be completed by the Appointee as the likely delays of such a process are likely to be detrimental or the issue potentially insurmountable. That said, clearly Ofwat need to avoid creating a perverse incentive for Appointees to see a DPC process fail and bidders require confidence that competition is encouraged and bid costs

are being incurred in a procurement that all parties are committed to – the timing of the ability to exit a DPC is therefore important.

6. If a CAP terminates the CAP Agreement with the water company should we consider further provisions in the new licence condition and what should these be?

We believe such circumstances are best dealt with at the time.

7. Please provide your comments on the proposed licence amendments set out in Appendix 1 and their wording?

We have provided comments on the key principles throughout this response, but don't intend to provide a supplementary markup of the proposed licence amendments.