

February 2020

Appendix 2: Direct Procurement for Customers

**Briefing Note on the Procurement
Process for 2020-2025**

About this notice

The Briefing Note builds on the policy framework set out in the [PR19 final methodology document](#) and [Appendix 9](#) thereof. This document is intended for Appointees that are engaged in Direct Procurement for Customers (**DPC**) delivered projects.

The **purpose of this document is to explain how we are proposing to monitor and engage with Appointees as part of their DPC procurement process**. This document has been designed to provide an indication of the type of processes Ofwat would expect to see for the procurement of a DPC delivered project.

This document is not, however, a definitive guide to the approach an Appointee should take and we expect that there will be flexibility in approaches to facilitate innovation dependent on the specific features of the DPC delivered projects. DPC has adopted principles from other processes (e.g. HM Treasury Five Case Model). In this document, where helpful we reference these as guidance. Ofwat will retain flexibility as the process develops to ensure best value for customers is achievable.

We will expect Appointees to provide assurances throughout their procurement process that the approach they are taking can provide best value for customers and continuing to manage risk appropriately.

This document should be read alongside the licence¹ amendments which are proposed as part of how the regulatory framework for DPC will be delivered.

This document sets out:

- how we will seek to undertake assurance on the procurement process;
- how Appointees may procure and put in place the contract between an Appointee and a Competitively Appointed Provider (**CAP**) (**CAP Agreement**) (and our role in ensuring that customers are adequately protected);
- our expected role during the asset creation and operation Stages of the CAP Agreement;

¹ References to a licence in this document are to the appointment of a company as a water undertaker and/or as a sewerage undertaker under the Water Industry Act 1991.

- considerations as to what may happen at the end of the term of the CAP Agreement; and
- our expected approach to DPC Exit, allowable costs and termination.

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1. DPC procurement guidance overview

1.1 Background

In Chapter 7 and Appendix 9 of the [PR19 final methodology document](#) we set out our approach and expectations for DPC in relation to Appointees' Business Plans.

At PR19 we expected Appointees to consider the use of DPC for large-scale enhancement projects that were expected to cost over £100 million, based on whole-life Totex. We did not expect Appointees to use DPC for every scheme that met this threshold, rather they should have considered for each relevant scheme which delivery approach had the potential to deliver the greatest possible benefits for customers. We will consider and consult at future price reviews upon our approach to DPC.

By DPC, we mean arrangements where an Appointee competitively tenders for a third party (a competitively appointed provider, or **CAP**) to design, build, operate and/or maintain large scale infrastructure and, critically, finance such activities that would otherwise have been delivered by the Appointee. DPC is different from other tendering and contracting arrangements that Appointees currently use, for example, outsourcing agreements or market testing. DPC involves Appointees tendering to deliver aspects of a service, including, most importantly, the financing for the project. We consider that this makes DPC a different process from Appointees' existing commercial arrangements. We do not intend for DPC to replace the arrangements Appointees currently make for outsourcing services to third party providers. We still expect Appointees to consider the most efficient delivery model for all of their activities.

1.2 Our overall approach to developing DPC

Consistent with our overall approach for PR19, we see Appointees and their customers at the heart of developing arrangements for DPC, not ourselves. We will not, for example, be running procurement processes, instead we expect Appointees to take responsibility for the development of their DPC proposals and to act as buyers on behalf of customers.

Ofwat's role in DPC

Ofwat's role is to ensure that the interests of customers are protected. We will do this by:

- requiring Appointees to follow our [contract and procurement principles](#) when undertaking DPC delivered projects;
- seeking an appropriate level of assurance during the DPC procurement process;
- making any decisions required under an Appointee's licence (including in respect of designating a DPC delivered project and approving the commencement of a DPC procurement process, the award or termination of the CAP Agreement and to certain changes to a CAP Agreement); and
- where appropriate, collecting and reviewing information in relation to the management and termination of a CAP Agreement.

We are concurrently consulting on proposed licence amendments to facilitate DPC including our consents.

Appointee's role in DPC

Appointees will be the purchaser and run the procurement process. They will then oversee the CAP's performance under the CAP Agreement. We expect Appointees to run fair, transparent and open procurement processes and to comply with the requirements of the Utilities Contracts Regulations 2016 (or any relevant replacement procurement regulations) (**UCR 2016**) or, if applicable, the Concession Contracts Regulations 2016. Appointees may not award a CAP Agreement to an associated company.

We expect Appointees to enter into a long-term CAP Agreement with an appointed CAP. This would include a revenue stream to be paid to the CAP for the provision of services (**CAP Charges**). In turn this will require a direction to be issued by Ofwat pursuant to an Appointees' licence to allow them to recover relevant amounts of the CAP Charges from their customers – this will be undertaken via a DPC Allowed Revenues Direction (see current proposed licence amendments).

Where appropriate, we will make an adjustment at a price review to ensure that Appointees can recover their efficient costs of developing and tendering a DPC delivered project and efficient on-going costs of managing the CAP Agreement in accordance with business as usual regulatory principles.

We expect Appointees to be mindful of the risks being allocated to customers and the CAP. We do not expect Appointees to be risk neutral and Appointees will have to justify the allocation of risks. This will include providing sufficient and convincing evidence that customers are being protected.

CAPs role in DPC

The CAP will be responsible for the creation of the asset, its financing and potentially the operation and maintenance. We expect the CAP to achieve efficiencies which the Appointee would not be able to achieve. The CAP will be contracted for the delivery of DPC to the Appointee and will be managed by the Appointee in accordance with the terms of the CAP Agreement.

Rest of this Briefing Note

This Briefing Note sets out the processes sitting behind DPC and how Ofwat, the Appointee and where relevant the CAP interact. This document represents a broad framework for the DPC process through the lifecycle of the project. We expect the Appointee and CAP to consider the processes raised here when formulating their CAP Agreements.

1.3 Assurance during the DPC lifecycle

In our PR19 final methodology document, we stated that after we have made licence amendments to enable them to do so, Appointees can proceed with DPC procurement processes. The nature and the length of each procurement process will vary by DPC delivered project.

Appointees remain responsible for delivery of DPC delivered projects and their outcomes. DPC is a means of delivery for Appointees and not a relief from their responsibilities as undertakers. As such, Appointees are required to take ownership of their own DPC procurement processes to ensure customers' interests are protected. We will seek to engage with Appointees throughout their DPC procurement processes. In particular, we will require assurance from Appointees regarding their proposed arrangements for the procurement process and the CAP Agreement (for further details of the assurance process see Section 3 below). This will allow us to consider how such arrangements deliver best value for customers.

To give customers further protection and ensure we have a process that delivers best value for money, we are proposing additional consents within the Appointees licence. The consents are designating a DPC delivered project, providing an Appointee with consent to procure a CAP and consenting to award a CAP Agreement. We believe that such consents which we expect will be considered and approved at Ofwat board level will build confidence in DPC and promote customers' trust in the delivery of projects.

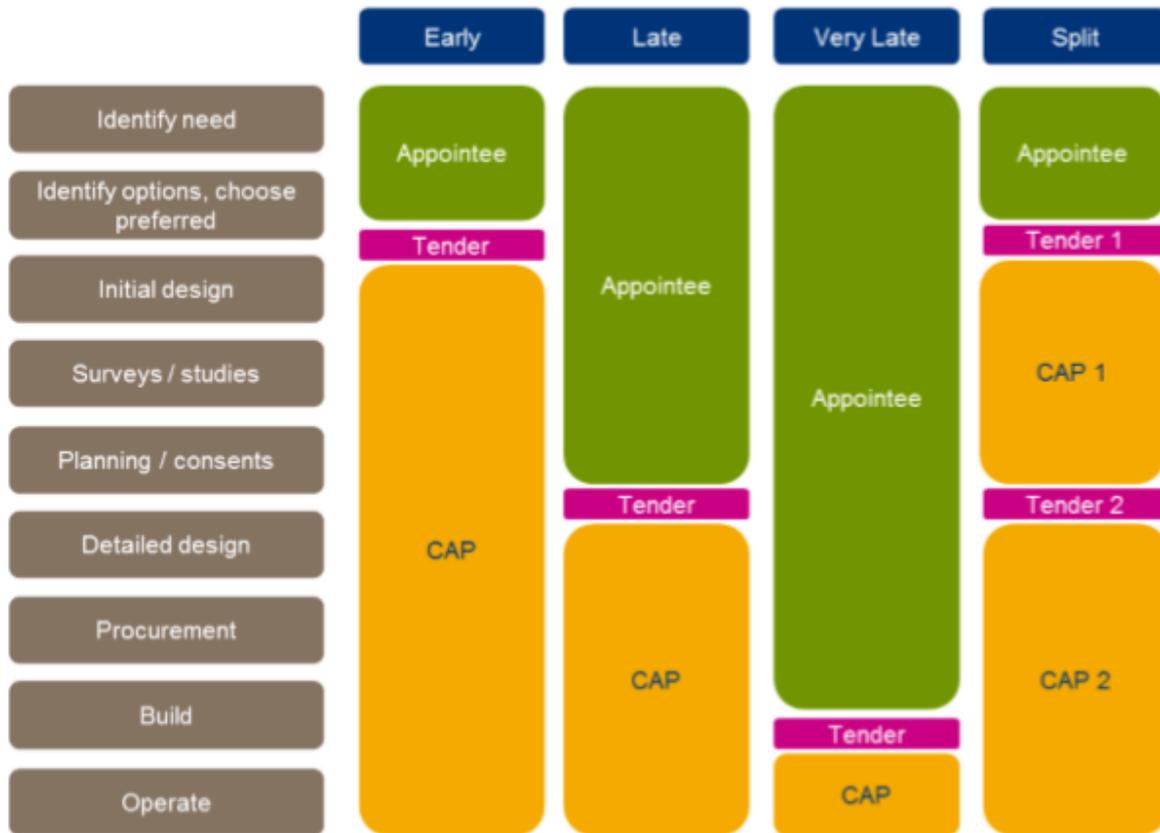
Furthermore, only where we are satisfied that the procurement process can deliver best value for money for customers, and the outcome of that procurement process for a DPC project confirms value for money, will we allow the Appointee to recover relevant amounts of the CAP Charge from its customers. The sums that can be recovered from customers will be set out by Ofwat in the DPC Allowed Revenue Direction published on award of the CAP Agreement.

1.4 Tender Models

In our PR19 final methodology document, we recognised that there is scope to tender a DPC delivered project at different Stages in the project lifecycle, and this gives rise to a range of possible tender models.

We consider that all tender models have the potential to drive significant customer benefits, although each model would focus competitive pressure in different areas. The appropriateness of any tender model will depend on the nature of the project itself.

1.4.1 Simplified representation of different tender models



We do not intend to establish a process which must be followed in its entirety or in all cases. Selecting the optimal procurement process and tender model is a matter for each Appointee. The processes outlined in the diagram above are based on processes that generally occur as part of the procurement of a project and best practice from other industries, such as in the electricity market. We would expect Appointees to consider customer interests and value for money in the choice of delivery model. Appointees should be prepared to justify their choice and demonstrate how it protects the interests of customers.

This Briefing Note assumes that an approach similar to or equivalent to the “Late” tender model will be used. This does not mean that Ofwat will not consider alternative tender models. Ofwat’s processes and procedures (as well as its requirements for assurance) may change if a different tender model is selected. However as set out above, Ofwat will require progressive assurance as the DPC delivered project progresses in all circumstances. Ofwat consent will always be required under an Appointee’s licence prior to commencement of a DPC

procurement process and the award of a CAP Agreement. The approval of Ofwat will always be required for designating a DPC delivered project.

In our PR19 final methodology document we noted that certain DPC delivered projects may be eligible to be specified under the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013. Where a project is so specified then the Appointee will necessarily be required to comply with statutory requirements. Ofwat's progressive assurance approach may also be subject to adjustment in such scenarios.

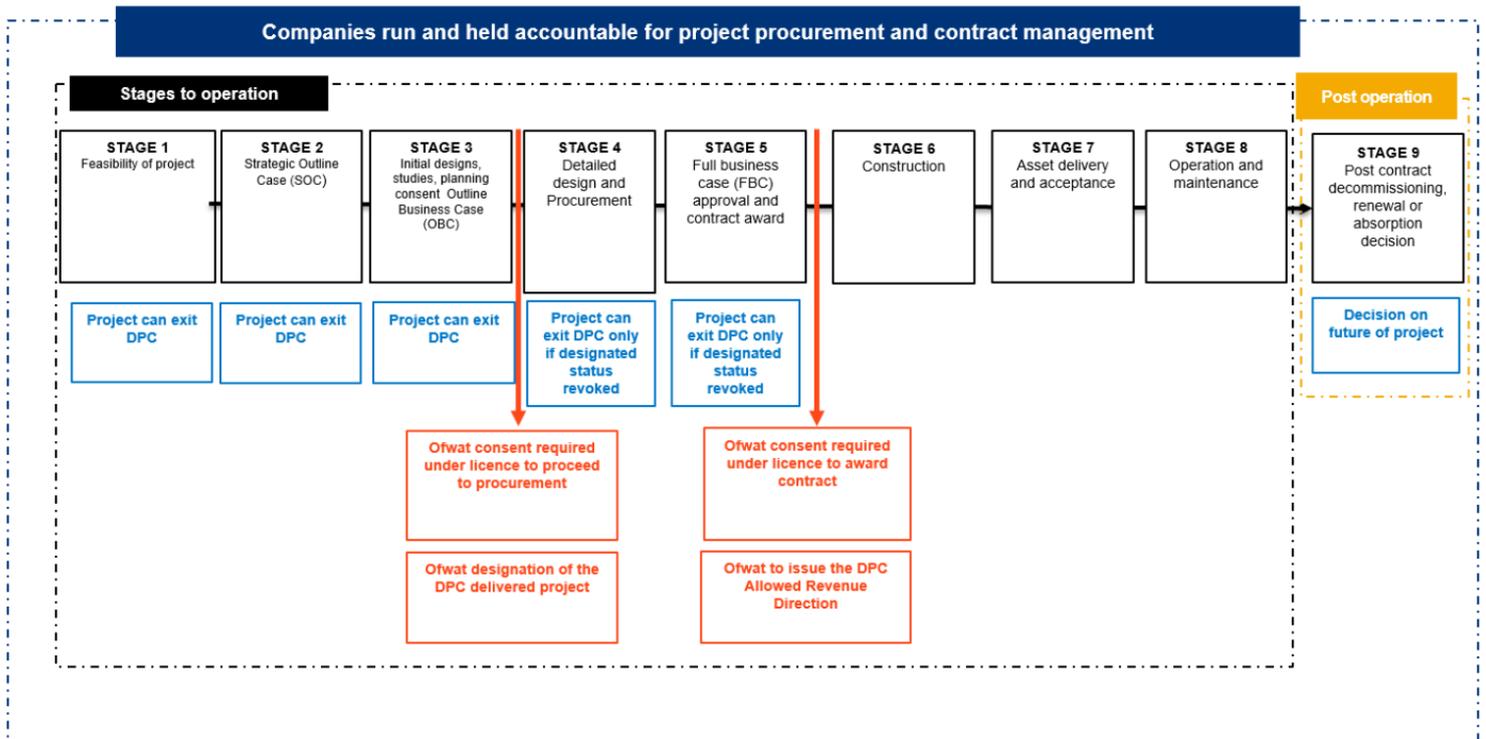
2. Outline of DPC across project lifecycle

There are a number of different models of project lifecycles. All of these generally include project identification, appraisal, procurement, managing asset creation and/or operation and contract expiration.

The order and sequencing of any DPC delivered project lifecycle will depend on the nature of the project, the asset and the tender model implemented.

As set out above, we have based this Briefing Note on an approach similar to or equivalent to the “Late” tender model. Requirements may change where a different model is employed. For a typical “Late” tender model project we have identified 9 Stages which we anticipate will occur within DPC. The Stages are set out below:

The detailed 9 Stages of a DPC delivered project



The stages are listed below:

- Stage 1 – Feasibility of project
- Stage 2 – Strategic Outline Case (**SOC**)
- Stage 3 – Initial designs, studies, planning consents, procurement document development and Outline Business Case (**OBC**)
- Stage 4 – Detailed design and procurement
- Stage 5 – Full Business Case (**FBC**) consent and contract award
- Stage 6 – Asset creation
- Stage 7 – Asset delivery and acceptance
- Stage 8 – Operation and maintenance
- Stage 9 – Post contract - decommissioning, renewal or absorption decision

The exact requirements for each DPC delivered project at each of the Stages described above will vary and will need to be determined by the Appointee after consulting with Ofwat (who will advise as to the required level of assurance and/or information it expects at each Stage).

As part of this Briefing Note we have detailed the project lifecycle and some of the potential requirements at each of these project Stages. Each of these Stages will involve activities by the Appointee and CAP and there will be various contact points (and in some cases, assurance requirements) with Ofwat.

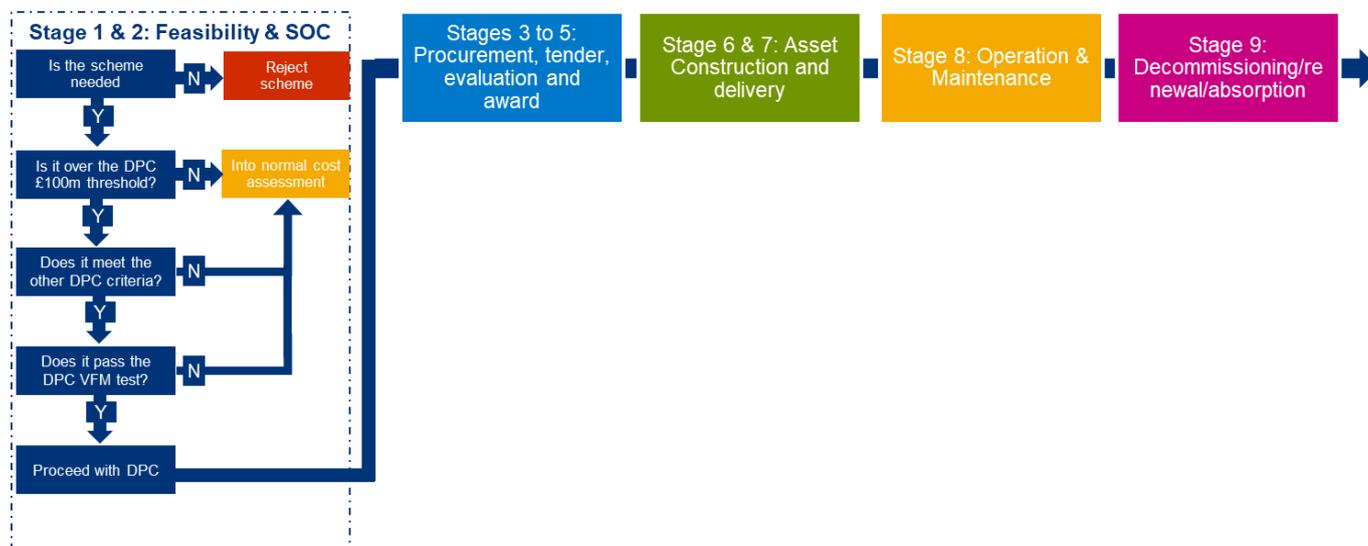
To aid market participants and Appointees we describe the information flow that we would expect to be occurring between the Appointee/CAP and Ofwat at each Stage.

We have also set out the information that Ofwat would expect to receive during DPC process.

What follows is necessarily generalised. We would expect Appointees to provide us with a tailored plan taking into account the unique elements of their projects and providing a process by which they will provide adequate assurance to Ofwat at relevant Stages.

How these Stages group across the profile of a DPC delivered project

In the figure below, there is an outline of a DPC delivered project from the initial consideration of projects against the £100m Totex threshold through to the eventual decommissioning, contract renewal/re-tendering or absorption of the asset at the end of its lifecycle under the control of a CAP.



2.1 Broad outline of grouped Stages

- **Stages 1 & 2 - Feasibility and SOC.** These are the early stages of DPC. Their purpose is to identify the needs case for relevant projects and to consider relevant delivery routes (including to assess whether the project offers better value for money through DPC).

Examples of activities within Stage 1 & 2:

- initial feasibility analysis of the project including developing a needs case;
- SOC submission to Ofwat; and
- **Control Points** met to Ofwat's satisfaction (see Sections 3 and 4).

- **Stages 3 to 5 - Procurement, tender, evaluation and award.** These Stages take a project from the design Stage to award of the CAP Agreement. Within these Stages the lifecycle sees the development of a full business case to determine if DPC offers best value to customers.

Examples of activities within Stages 3 to 5:

- specification and designation of the DPC delivered project;
- initial designs;
- planning consents;
- submission of OBC and procurement plan, review of OBC;

- procurement documents and CAP Agreement developed;
 - procurement process undertaken;
 - internal (Appointee) governance and commercial process developed;
 - development of full business case;
 - full business case approved;
 - CAP Agreement award;
 - clarification as to DPC allowed revenues related to the project;
 - CAP/Ofwat/Appointee information flows established, and
 - **Control Points** met to Ofwat's satisfaction (see Sections 3 and 4).
- **Stages 6 & 7 - Asset creation and Delivery.** This is the point at which asset creation occurs. If issues were to arise solutions would depend on the CAP Agreement that was in place and the backstops that had been agreed.

Examples of activities within Stages 6 & 7:

- asset creation;
 - acceptance of asset; and
 - CAP/Ofwat/Appointee information flows.
- **Stage 8 – Operation and maintenance.** This is the point at which operation and maintenance takes place. If issues were to arise solutions would depend on the CAP Agreement that was in place and the backstops that had been agreed.

Examples of activities within Stage 8:

- operation and maintenance of asset; and
 - CAP/Ofwat/Appointee information flows.
- **Stage 9 - Decommissioning/renewal/re-tendering/absorption.** Ofwat expects Appointees to set out a plan for future use, operation, maintenance and financing of the asset (including potentially decommissioning).

Examples of activities within Stage 9 include submitting plans for all of the above activities and agreeing an approach (going forwards) with Ofwat.

2.2 Taking a holistic approach to the procurement process

The above Stages contain within them the designation, identification, justification, procurement, asset creation, operation and end of asset life Stages of a DPC delivered project. We consider this the widest form of procurement where a holistic approach to the project is taken to ensure that the best value for customers can be achieved.

We do, however, recognise that there may be specific procurement/purchasing processes/options for various parts of a project such as, engineers, contractors, operators etc.

We have included in the next Section of this document a detailed breakdown of each Stage, including the points at which we believe interactions with Ofwat should occur.

3. Ofwat information and assurance requirement

3.1 Control and Information Points

Below we outline two types of information flows Ofwat would expect to occur within the various Stages of a DPC delivered project. The reason for defining two types of information flow is to ensure that the regulatory requirements remain proportionate to the activity that is being undertaken.

Whereas the Appointee is providing information to Ofwat and on certain instances Ofwat is providing consent to proceed, as we have previously discussed the Appointee remains responsible for the procurement of DPC projects. This should include any innovation in the various Stages of the procurement and should be supported by appropriate value for money assessments. The Appointee will also remain wholly accountable for the delivery of the DPC delivered project in its capacity as a water undertaker or sewerage undertaker. The undertaking of a DPC delivered project remains part of an Appointee's Regulated Activities pursuant to its licence. Information flows from the Appointee to Ofwat are there to provide assurance that the Appointee delivers best value for customers on an on-going basis.

The proposed licence amendments in respect of DPC delivered projects place a requirement on Appointees to share relevant information with and provide relevant information to Ofwat. There are two types of information flow that the Appointee must provide to Ofwat within the lifecycle of a DPC delivered project. These are **Control Points** and **Information Points**.

Below we outline in more detail the distinction between these two points.

Control Point – This is a point at which the Appointee is required to provide assurance that the process it is undertaking is robust and meets relevant requirements (See Section 3). This allows for Ofwat to request data/information to ensure the process is fit for purpose. We specifically note the following

- At Control Point C (or potentially later within Stage 3 up to Control Point E) Ofwat would expect to designate the scope of the DPC delivered project in accordance with the Appointee's licence.
- At Control Points E (Stages 3 and 5), Ofwat's consent is required under the Appointee's licence conditions before it can commence the procurement

- At Control Point F Ofwat consent is required for the Appointee to enter into the CAP Agreement. Also note at Control Point F Ofwat would issue an Allowed Revenue Direction.

Ofwat may choose to agree progression from control points. Furthermore Ofwat may also choose to consider additional agreement and clarification on particular issues depending on the projects and the risks within other control points. These additional issues will depend on projects and their associated risks.

The purpose for having these Control Points is that it enables both Ofwat and the Appointee to review and identify issues early. This helps to promote a successful outcome that leads to ultimate approval of the Appointee awarding the CAP agreement. Appointees may consider the use of an independent technical adviser to provide evidence and assurance (indeed this may be required on occasion by Ofwat).

These points will reduce regulatory uncertainty for both the Appointee and the CAP's investors as the process develops that risks/issues are being managed and which will ultimately benefit customers.

We outline further below the points we consider to be Control Points and what form we believe assurance and/or information provided to Ofwat should take at such Control Points. However, as above, we note that requirements and process may change from project to project and Ofwat reserves the right to request additional information.

Information Point – These are flexible points within the project lifecycle where Ofwat requires information from the Appointee.

Designated Status of Project - It should be noted that projects identified as being DPC will have designated status in accordance with the Appointee's licence. Once a project has been designated as being a DPC delivered project it will be delivered through a DPC procurement route. If an initial procurement was unsuccessful we would expect the tender process to be re-run unless evidence was provided for an alternative approach.

3.2 Timelines for Procurement

It is important that dates for **Control Points**, planned engagement and time windows for consent are well understood by all.

We would strongly encourage Appointees to provide detailed timelines for the procurement as early as possible.

Ofwat would look to support these timelines (as well as provide input on the time it will need to undertake review, assurance and provide any consents required). Furthermore Ofwat could seek clarifications around any timelines to ensure the process is well understood.

3.3 Phased submissions of SOC and OBC

Appointees may wish to consider phased submissions of the SOC and OBC. Early oversight of these may help progress issues. If Appointees choose a phased submission then these should be flagged clearly in the timelines described above.

3.4 Form of Consent

Ofwat may grant consents at relevant Control Points.

The form of the consent may vary according to the project and risks. Consents may be partial and/or conditional. It is not possible for Ofwat to set out exhaustively what issues it will consider at relevant Control Points. However in each instance Ofwat will act in accordance with both its statutory obligations and the core principle of considering whether a relevant proposal for a DPC delivered project represents best value for customers.

Any consent issued by Ofwat will be without prejudice to its future rights.

Furthermore in reviewing submissions at relevant Control Points Ofwat may seek further clarifications before consent would be granted.

3.5 Control Points–Assurance

When a Control Point is reached by an Appointee we expect the Appointee to be able to provide Ofwat with assurance and/or information as to how the DPC delivered project is progressing and any potential risks/issues/delays. At Control Points, Ofwat may raise queries or questions of Appointees in a form that it considers appropriate. Assurance to be provided may take different forms, as outlined below in this document.

The proposed licence amendments in respect of DPC delivered projects make specific provision not just for the provision of information but also the provision of assurance in a form satisfactory to Ofwat. Further supporting evidence from an independent technical adviser may also be required.

Any information provided by Appointees at Control Points will need to be accompanied by a signed assurance statement provided by a person with sufficient responsibility and authority for or on behalf of the Appointee (this is likely to be an appropriate member of the board). The assurance statement should set out the information provided and provide a summary. It should also set out that the information/assurance provided is true and accurate to the knowledge of the Appointee.

Whilst we are not mandating that information or assurance is externally assured in all circumstances, Ofwat may require reports from an independent technical adviser through the life of the DPC procurement process and the CAP Agreement.

3.6 Where should information be sent

The information/assurance at each Control Point should be sent to DPC@ofwat.gov.uk or posted to:

DPC Assurance Team
Ofwat
7 Hill Street
Birmingham
B5 4UA

4. Procurement process guidance – detailed touch points and expectations

This Section sets out the detailed Stages of the procurement of a DPC delivered project and Ofwat's assurance and/or information requirements.

The diagrams included in this Section outline the process which Ofwat envisages Appointees will undertake to procure DPC delivered projects. These are a guide and we have tried to distinguish the process between transitional and/or process Stages where Appointees will be engaged in activity and points where we expect an Appointee to engage with Ofwat.

As such:

Arrowed boxes represent actions/processes we consider Appointees should be undertaking.

Square boxes represent the Stages at which we believe Appointees should be engaging with Ofwat.

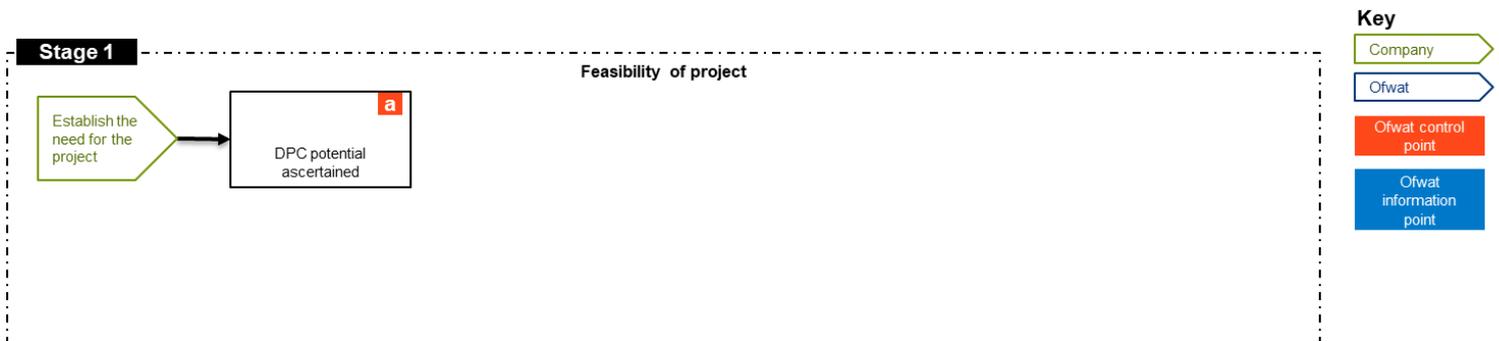
Stage 1 – Feasibility of project

In the first Stage, the Appointee must consider and establish the needs case for a project, its feasibility and whether or not it should be considered as a DPC delivered project (this consideration should be made against the criteria set out in Ofwat’s PR19 final methodology document, although this criteria may be reviewed at subsequent periodic reviews).

In respect of projects to be procured within the 2020-2025 price control period, Stage 1 has already been undertaken by Appointees as part of the process in the formation and submission of Business Plans. We would typically expect for a price review that this Stage would be set out within an Appointee’s Business Plan submission (although this may not always be so).

Where an Appointee considers it appropriate to commence a DPC delivered project midway through a price control period, Ofwat would expect to be informed of this approach.

- **Control Point A** – Included as a **Control Point**. Projects not deemed suitable and so not meeting the requirements of DPC would need to be undertaken (if at all) within an Appointee’s price control (see further Section 5).



4.1.1 Assurance

- For Ofwat to gain assurance at this Stage, Appointees will need to provide a sufficiently detailed and evidenced needs case, threshold assessment and technical review (this may be undertaken as part of a Business Plan submission and will include an initial assessment of project delivery options).
- The level of evidence required would, for example, be equivalent to that required as part of an Appointee’s PR19 Business Plan submission. Assurance would be required as for all of the matters specified. The current

level of assurance required is more fully described in Ofwat's [PR19 final methodology](#) document.

- Ofwat may set out specific additional assurance requirements it considers necessary within the context of a specific project.
- Ofwat may review the case put by an Appointee and indicate (whether as part of a periodic review process or otherwise) whether it considers a project is suitable for DPC. Ofwat would also undertake appropriate due diligence to assess whether Appointees have adequately considered DPC for relevant projects.
- If undertaken as part of a periodic review, we anticipate that this Stage may not require a separate assurance statement but an assurance statement signed by appropriate persons may be required if projects are considered within price control periods.

4.1.2 Helpful Guidance

- [PR19 final methodology document and Appendix 9.](#)

Stage 2 – Strategic Outline Case (SOC)

In Stage 2 Appointees are required to develop a Strategic Outline Case:

A SOC should include (as a minimum):

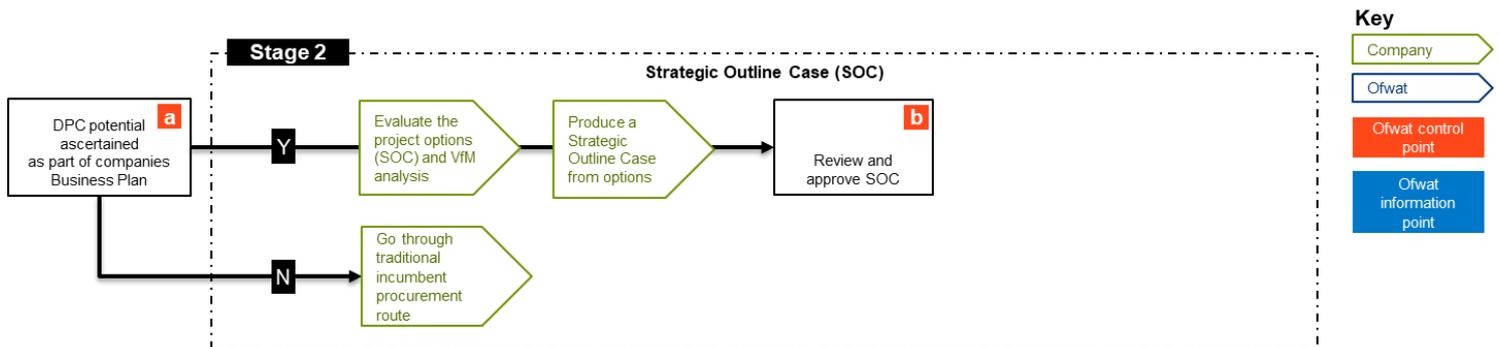
- The strategic context for the project. If not covered in a periodic price control the needs case for the project and optioneering around solutions should also be included.
- Business and customer needs to be met by the project – as well as the interaction between this project and existing arrangements.
- The scope of the project.
- The project's benefits, risks, constraints and dependencies. In particular, risk allocation of different procurement options should be considered.
- Setting out critical success factors for the project.
- Selection of tender model.
- Assessing the range of delivery options (both technical and contractual) and recommending a way forward (including why DPC is considered to be the preferred option).
- Value for Money (VfM) case for the use of DPC.
- Procurement timetable including key milestones. If appropriate this should also flag any phased submissions.
- Any other requirements Ofwat has asked an Appointee to address at this Stage.

In respect of projects for the PR19 price control period, this Stage may have already been undertaken (or is already being undertaken) by Appointees as part of the periodic review process in the formation and submission of Business Plans. Under these circumstances we will discuss with Appointees the submission requirements. However, if projects have materially changed from the initial submission in the Business Plan, we will require a new SOC to be submitted.

As part of the SOC, Ofwat would encourage Appointees to provide procurement timetables as early as possible – including expectations around timeframes for future consents and other critical points in the procurement process. Ofwat would seek discussion with the Appointee such that both parties have a common understanding around the procurement process moving forward.

Timetables provided are expected to be credible and supported by appropriate consideration of external factors, for example planning processes. Ofwat may require the Appointee to demonstrate that consideration of relevant factors have been made.

- **Control Point B** - Projects not deemed suitable to be delivered by way of DPC at this Stage would need to be undertaken (if at all) within an Appointee’s current or future price control (see further Section 5).



4.1.3 Assurance

- For Ofwat to gain assurance at this Stage the level of evidence required would be equivalent to that required as part of an Appointee’s Business Plan submission. Assurance would be required for all of the matters specified above.
- The level of assurance provided should be reflective of good industry practice and the Stage of development of the project being submitted.
- Ofwat may require specific additional assurance where it considers this necessary within the context of a specific project.

This Stage, if undertaken as part of a periodic review, would not require an assurance statement but an assurance statement signed by an appropriate person may be required if projects are considered within price control periods.

4.1.4 Helpful Guidance

- [PR19 final methodology document and Appendix 9 thereof](#).
- [HM Treasury “Guide to Developing the Project Business Case” \(2018\)](#).

Stage 3 – Initial designs, studies, planning consents, procurement document development and Outline Business Case (OBC)

In Stage 3 we envisage there being three **Control Points** prior to commencement of the procurement process.

During this Stage the Appointee is expected to prepare appropriate documents that will enable it to proceed with its procurement process (including CAP Agreement and procurement documents). Where necessary, and so to achieve best value for customers, we would expect the Appointee to carry out sufficient preparatory work, including potentially relevant design work. Whilst not being prescriptive on this it is hoped that Appointees will take the necessary steps to ensure the tender is successful to enable the project to proceed

As part of this Stage we expect that a number of key documents will need to be produced by the Appointee.

The Appointee will need to develop a Procurement Plan at **Control Point C** in accordance with good industry practice. In general this should include (as a minimum):

- A summary of the scope of the DPC delivered project and the CAP Agreement to be tendered.
- The selected procurement route/procedure (with a rationale as to why a specific route and procedure has been selected) and an explanation as to how Ofwat's procurement principles (see [PR19 final methodology](#) document and [Appendix 9](#) thereof) will be met.
- A summary of market engagement exercises that have been undertaken and a summary of market appetite and availability for this project.
- An explanation of the contracting strategy – which should include a high level approach to risk, payment, termination/exit/asset management post CAP Agreement and incentivisation provisions as well as a high level explanation as to how Ofwat's contracting principles will be met.
- An explanation as to the level of design and technical readiness that is intended by the date of release of any contract notice and at the issuance of any Invitation To Tender (ITT), Invitation to Negotiate (ITN) or Invitation To Participate in Dialogue (ITPD).
- An explanation of how the procurement plan will maximise competition and deliver best value for customers; including information on the number of

tenderers to be invited to tender and/or negotiate/ participate in dialogue and information on selection and award methodology and criteria.

- Procurement and contract timetable. If appropriate this should flag phased submissions
- Evidence of market testing.
- A summary of key interfaces of the proposed CAP Agreement with other activities of the Appointee.
- The Appointee's CAP Agreement management approach.
- An initial explanation of resilience considerations undertaken – including: (a) how has the procurement been designed to enable flexibility (for the Appointee in the event of any DPC Exit) and (b) how the CAP Agreement will be designed to enable flexibility post award (including in respect of CAP failure or early termination).

In most circumstances Ofwat would expect **Control Point C** to be an appropriate point at which to designate the DPC delivered project. This process is undertaken by Ofwat although it will require the agreement of the Appointee. The proposed DPC licence amendments in respect of DPC enable Ofwat to designate the scope of a DPC delivered project. Once designated the Appointee will be required to put the DPC delivered project out to tender (as opposed to undertaking it directly). We would expect, as part of **Control Point C** that the Appointee would submit a draft scope of the DPC delivered project. Ofwat would consider this and then issue a designation of the DPC delivered project. The designation of the scope of the DPC delivered project will be undertaken at a high level but should clearly distinguish between tasks to be undertaken by the Appointee (which will not be included in the DPC delivered project) and those to be undertaken by the CAP.

It may be more appropriate to designate the DPC delivered project at a different stage (Ofwat will need to take a view on a project by project basis as to when the project is sufficiently developed to enable such an activity).

At **Control Point D**, the Appointee should have developed the full suite of procurement documents that will be released upon OJEU² and ITT/ITPD/ITN. This includes the form of CAP Agreement. We may agree (or require) that **Control Point D** be a two Stage **Control Point** with some aspects of the **Control Point D**

² References in this document to OJEU will include any replacement form of contract notice (by way of example a PIN can sometimes be used as a replacement OJEU process).

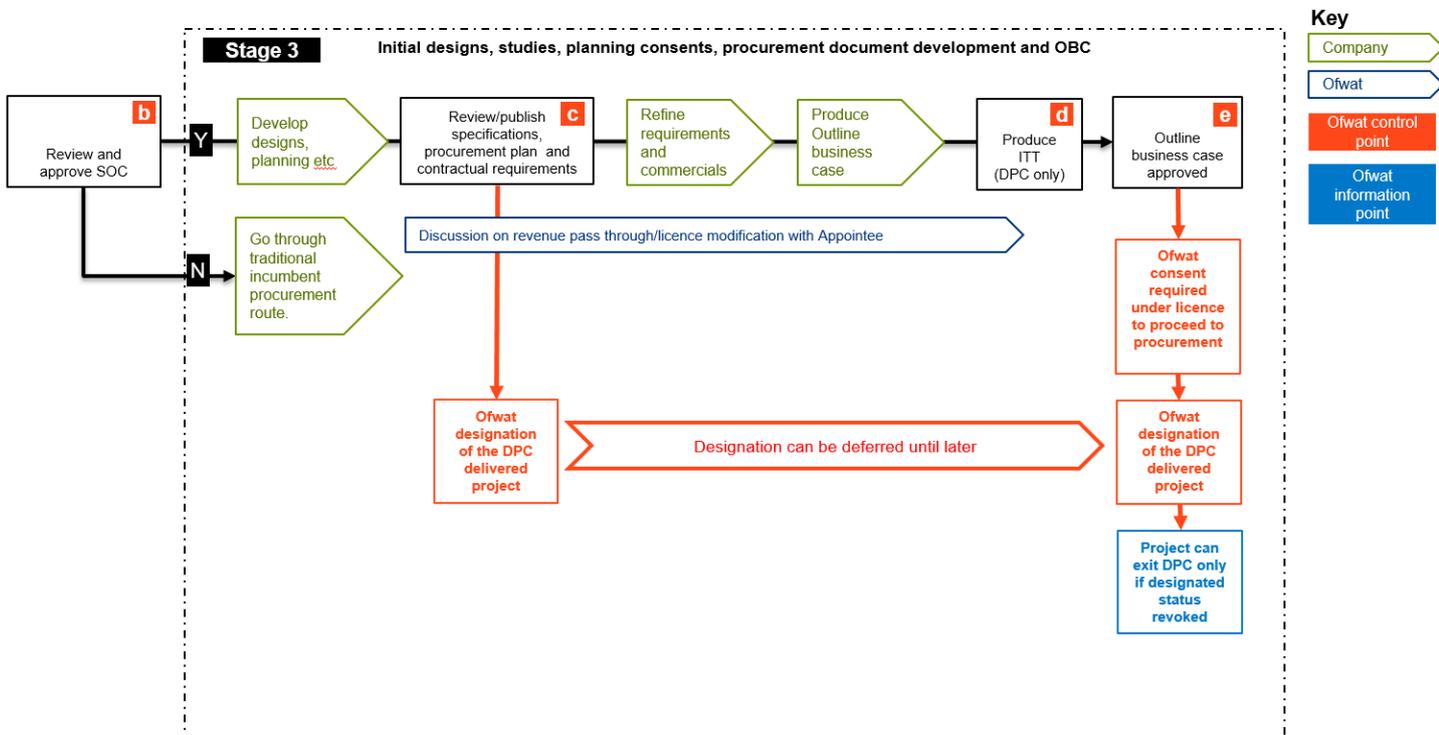
undertaken prior to release of ITT/ITPD/ITN. This alternative is provided in light of the fact that it is acknowledged that it is not always the case that all procurement documents are completed and provided on release of the OJEU Notice.

At **Control Point E**, the Appointee will be required to produce an OBC in accordance with good industry practice. This will in general be expected to include (as a minimum):

- Revisiting the SOC and confirming approach.
- Undertaking economic appraisals for relevant delivery options including DPC.
- Undertaking a benefits and risks appraisal.
- Selecting preferred option for the project (including delivery, contracting and procurement).
- Confirming the selected procurement strategy (including any detailed developments from the procurement plan (above)).
- Determining required outputs and service levels.
- Setting out payment mechanisms and risk allocations.
- Setting out contractual issues.
- Considering accounting treatment.
- Setting out plans for successful delivery.

The following diagram shows the **Control Points** within Stage 3. Whilst these may occur sequentially there is also the possibility that they can run in parallel.

- **Control Point C to E** – Projects no longer deemed suitable and so exiting DPC would need to be undertaken (if at all) within an Appointee's current or future price control (see further Section 5).



4.1.5 Assurance

- At **Control Point C** Ofwat would expect to receive appropriate assurance on the procurement plan, scope of the DPC delivered project and associated project development in accordance with industry best practice. The assurance provided should set out a summary of all of the information outlined in respect of Control Point C (above). Ofwat may request additional information to consider the documentation provided.
- At **Control Point D** Ofwat will expect to be provided with the full and finalised suite of documents with which the Appointee will go out to the market. In addition Ofwat will expect to be provided with a letter of assurance in respect of (as a minimum):
 - a summary of the procurement process;
 - confirmation that Ofwat’s procurement principles have been complied with;
 - a summary of the selection and award criteria (including how they maximise competition, obtain best value for customers and ensure that only appropriate persons fit to control the CAP are selected);

- a rationale for the inclusion or non-inclusion of any equity and/or funding competitions as part of the procurement process;
- the level of design information to be provided as part of the procurement process and why this has been optimised to achieve best value for customers;
- an explanation as to how resilience is built in to the process; and
- a statement confirming compliance with procurement law and other relevant legal requirements.

In terms of the CAP Agreement the letter of assurance at **Control Point D** (As a minimum) should include:

- a statement confirming compliance with Ofwat contracting principles;
- a full summary of how CAP Charges are built up (including any reopeners and any handback payments at the end of the term and a view as to which such CAP Charges should be included in the DPC Allowed Revenue Direction);
- a statement about how the contracting approach interacts with the Appointee's finances and clarity that this project will not cause the Appointee to be in breach of its licence conditions (including the ring-fencing provisions); and
- the approach to the following critical areas (and in each case a summary of how customers are protected and optimal value is being sought):
 - asset creation cost overruns;
 - change in control;
 - the use and role of an independent technical adviser to provide review and comfort of costs;
 - disputes;
 - duration;
 - design risk (and level of design);
 - security;
 - resilience (in particular in respect of sub-contracting);
 - pricing and indexation;
 - consents;
 - asset creation delay;
 - revenue reopeners;
 - remote events;
 - compliance with consents;
 - level of specifications and requirements;
 - maintenance approach;
 - rights to carry out works;

- acceptance (and verification thereof);
- land and asset ownership;
- termination (and compensation on termination);
- remedies approach;
- payment commencement;
- interface with the Appointee (i.e. what assets or activities is the Appointee required to provide and/or perform);
- indemnities;
- third party asset protection arrangements;
- under performance and deductions (as well as service level requirements);
- loss of areas of the Appointees supply area or Appointee special administration;
- handover/end of the term including residual values; and
- refinancing gain share.

Ofwat will consider publishing additional guidance with respect to these topics in order to assist Appointees to develop their CAP Agreements.

To the extent the Appointee considers that any further licence modification is needed to the Appointee's licence (i.e. beyond the proposed generic DPC amendments) in order to facilitate the DPC delivered project – Ofwat will discuss this with the Appointee during Stage 3. We would not expect this to be necessary in the majority of cases.

At **Control Point E**, Ofwat would expect to see an assurance statement confirming that the OBC had been prepared in accordance with good industry practice and that it reflects the suite of procurement documents provided and that the project (and delivery approach) continues to provide value for money. This statement should set out a summary of all of the information outlined in respect of Control Point E (above).

Ofwat reserves the right to request additional information or to consider the OBC in full. Ofwat may set out specific additional assurance requirements where it considers necessary within the context of a specific project – this may include evidence from the independent technical adviser.

Ofwat will only issue its consent to commence the procurement of the CAP (pursuant to an Appointee's licence) once it considers that **Control Points C-E** have been satisfactorily met. The proposed licence amendments in respect of DPC prohibits

Appointees from commencing and undertaking any DPC procurement process without the prior consent of Ofwat. Ofwat considers commencement of a DPC procurement process arises at the point of the issuance of the Contract Notice – namely issuance of the OJEU (or equivalent). Written consent required under the licence to commence and undertake the procurement process of a DPC will be provided as part of **Control Points C-E**.

Where a two stage Control Point D is implemented then consent may be staggered with the procurement only able to progress to a point stipulated by Ofwat without further consent.

If required for procurement of the DPC delivered project Ofwat may also make available a draft version of its intended DPC Allowed Revenue Direction. This will be informed by the draft CAP Agreement and will be subject to amendment and adjustment.

Notwithstanding that Ofwat may review the full suite of documentation at **Control Points C-E** the Appointee shall remain fully responsible for its documents and compliance with its regulatory requirement.

Ofwat will discuss with Appointees the timeframe for consent under **Control Point E**. Ofwat will adapt the timeframe for consent depending on the availability of information provided. Information provided and agreed early in the process would assist with a shorter period of consent. Conversely, we would expect a relatively longer period for consent if this is not the case.

4.1.6 Helpful Guidance

- [PR19 final methodology document and Appendix 9 thereof](#).
- [HM Treasury “Guide to Developing the Project Business Case” \(2018\)](#).

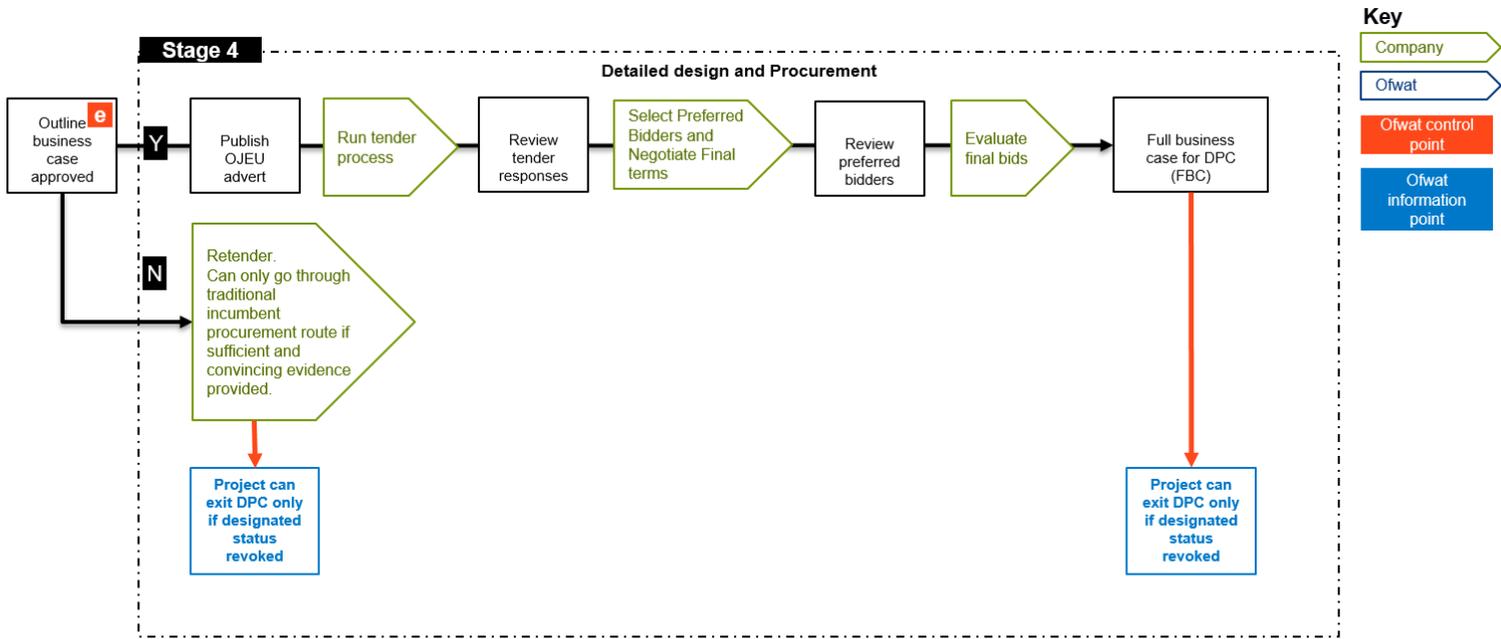
Stage 4 – Procurement

Following **Control Points C to E**, the Appointee will, have obtained the consent of Ofwat under its licence to commence and undertake its DPC procurement process. To ensure a successful procurement we expect Appointees to undertake their DPC tender in accordance with relevant legislation and undertakings in their CAP Agreement. It is in customers' interests that we have a robust DPC process that meets procurement legislation and allows for an effective competition.

There are no formal Control Points in Stage 4 (although, as above, note that it is possible that Control Point D may be staggered with part of the Control Point taking place prior to ITT/ITN/ITPD release and not the release of the OJEU). This reflects that the running of the DPC procurement process is a matter for the Appointee.

However it is possible that during the procurement process the Appointee might wish to make amendments to the documents that have previously been shared with Ofwat (e.g. the proposed CAP Agreement).

We note that such changes may occur during negotiation or competitive dialogue Stages of a procurement. If changes to key issues arise (such as the payment mechanism or reopens to the revenue stream or changes to any other issue which would impact on revenues collected from customers), Ofwat would expect the Appointee to inform it of any such proposed changes and the rationale for such changes. Failure to do so may risk that Ofwat may be unable to approve the FBC (at **Control Point F** – see Stage 5).



Stage 5 - Full Business Case (FBC) consent and contract award

The FBC is important as it provides the final proposition, value for money calculations etc. and provides the Appointee with their final view of the project given responses from the market as part of the procurement process.

At **Control Point F**, the Appointee will be required to produce an FBC in accordance with good industry practice. Much of the work involved in producing the FBC focuses upon revisiting and updating the conclusions of the OBC and documenting the outcomes of the procurement. The FBC will in general be expected to include (as a minimum):

- Revisiting the OBC and case for change.
- Revisiting the OBC options (and value for money options).
- Details of the procurement process and evaluation process.
- Setting out final deal and contractual arrangements.
- Setting out financial implications for final deal (including financial consequences for the Appointee).
- The proposed nature and number of **Information Points** during delivery (Stages 6 and 7).
- Confirmation that CAP Agreement still aligns with Ofwat DPC principles and represents best value for customers.
- Setting out project management/change/risk management arrangements.
- Setting out post project approach (including handback and payments).

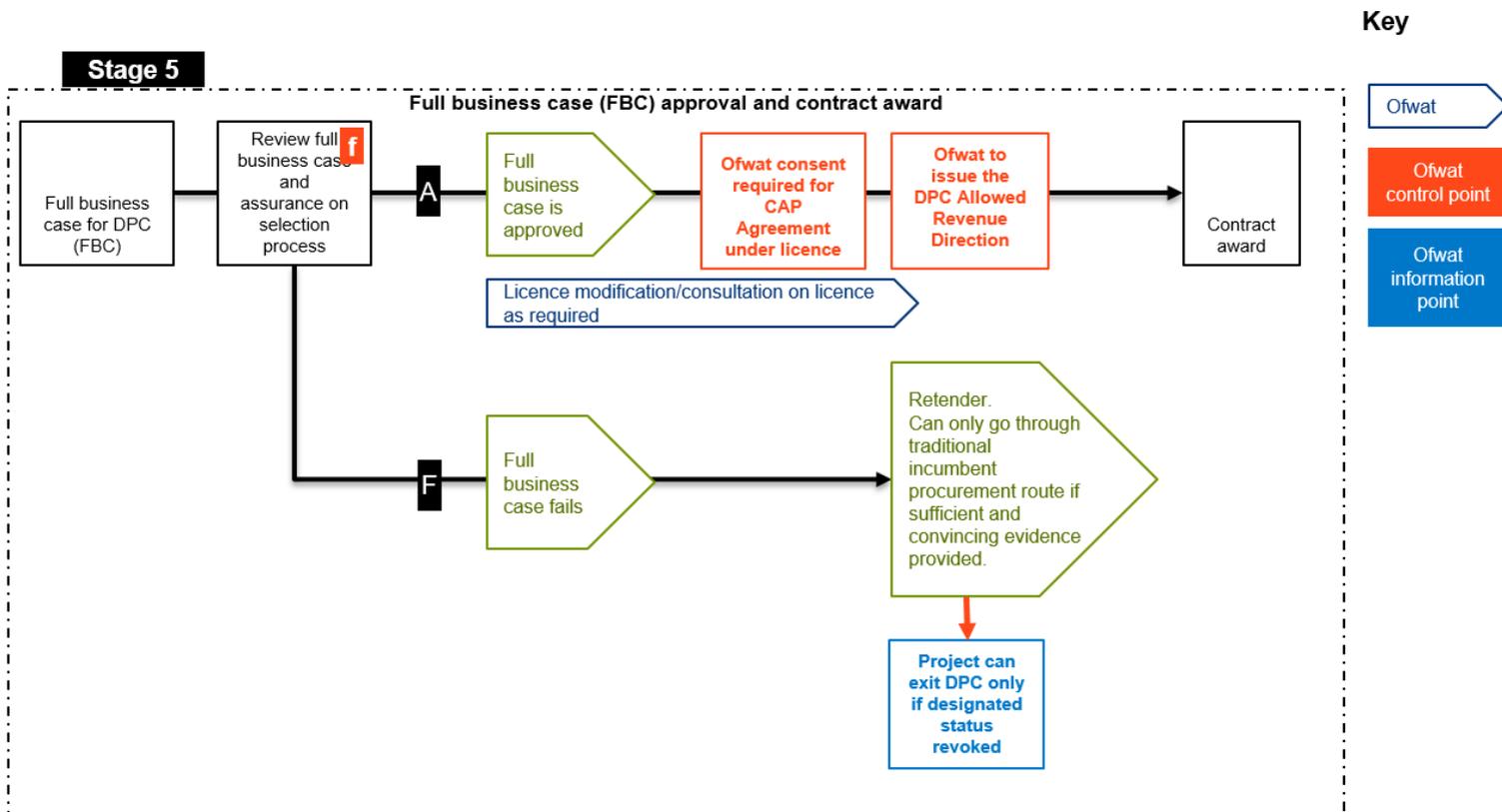
Ofwat will also expect to receive and review the full and final suite of CAP Agreement documents (as well as any ancillary documents) at **Control Point F**.

It is only after **Control Point F** that Ofwat would give final consent for the CAP Agreement to be awarded pursuant to the Appointee's licence. Alongside the consent process Ofwat will consult on and confirm any final required licence modification to facilitate the CAP Agreement arrangements (in the majority of circumstances Ofwat would not expect this to be required). Ofwat will also issue any DPC Allowed Revenue Direction. This would then enable the Appointee to award the CAP Agreement for the DPC delivered project.

It should be noted that the consent from Ofwat to award a CAP Agreement is a separate consent to that to commence and undertake a DPC procurement process. Ofwat reserves the right to consider the completed and final value proposition at the end of the procurement process (including an assessment of whether best value for

customers has been achieved) notwithstanding its prior consent for any pre-tender documentation.

- Control Point F** – Included as a **Control Point**. Projects no longer deemed suitable and so exiting DPC would need to be undertaken (if at all) within an Appointee’s current or future price control (see further Section 5). Where an Appointee intends to carry out a failed DPC delivered project in-house, where the project had been designated consent from Ofwat would be required.



4.1.7 Assurance

- At **Control Point F**, Ofwat would expect an assurance statement to be provided confirming that the FBC had been undertaken (reflecting all of the matters set out above) in accordance with good industry practice, that it reflected the suite of procurement documents provided and that the DPC

delivered project (and delivery approach) continued to provide best value for customers.

- At **Control Point F** Ofwat will expect to see the full and final CAP Agreement that the Appointee proposes to enter in to (as well as an assurance statement setting out any changes (and the rationale for such changes) from the statement provided at **Control Point D**).

At **Control Point F** Ofwat will consider consultation on any licence amendments between Stages 3 and 5 that it considers are necessary to facilitate the DPC delivered project. Appointees should discuss any licence amendments they consider that they require at Stage 3 (as above) with the aim to have the licence modification complete for CAP Agreement award. Ofwat would not typically expect any additional licence amendments (i.e. those amendments additional to Ofwat's generic DPC licence amendments) to be required.

Ofwat will only issue its consent (under an Appointee's licence) to award the CAP Agreement once it considers that the requirements of **Control Point F** have been satisfactorily met.

Likewise Ofwat will only issue a DPC Allowed Revenue Direction at the point where the CAP Agreement has been awarded. This DPC Allowed Revenue Direction will enable the Appointee to collect certain of the CAP Charges payable to the CAP from its customers.

Notwithstanding that Ofwat may review the full suite of documentation at **Control Point F** the Appointee shall remain fully responsible for its documents and compliance with its regulatory requirements.

4.1.8 Helpful Guidance

- [PR19 final methodology document and Appendix 9 thereof](#).
- [HM Treasury "Guide to Developing the Project Business Case" \(2018\)](#).

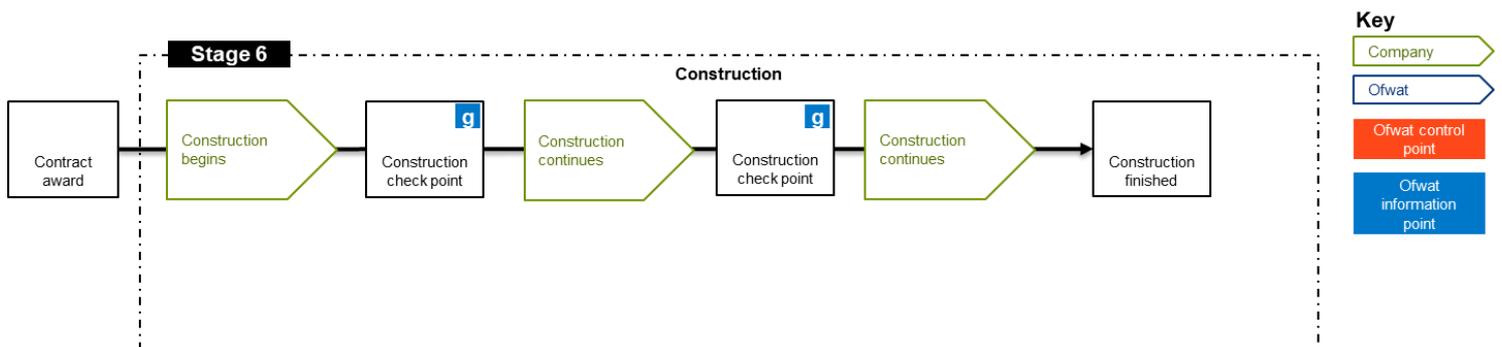
Stage 6 – Asset creation

During this Stage the CAP will be responsible for the asset creation of the DPC delivered project and the Appointee will oversee the CAP's performance in line with the CAP Agreement.

Appointees are expected to undertake regular reviews of the DPC delivered project to monitor delivery versus the final CAP Agreement and the FBC. They are also ultimately responsible for delivering the DPC delivered project including managing risks and taking mitigating actions, including projected overspends, delays to delivery and not meeting other deliverables.

- Information Point G** – Ofwat expects to receive regular updates on DPC delivered project progress etc. This may include reports from an independent technical adviser. Ofwat does not intend to intervene in the day-to-day undertaking or management of the DPC delivered project but expects to be kept informed of the DPC delivered project's progress and to see how the Appointee is managing any underperformance. Pursuant to the Appointee's licence, the Appointee will be required to provide Ofwat with such information related to the DPC delivered project as Ofwat reasonably requests.

The precise number and nature of the Information Points during the asset creation Stage will be agreed between the Appointee and Ofwat prior to the start of the Stage, and is expected to be documented in (and agreed with Ofwat at the time of) the FBC.



4.1.9 Assurance

Ofwat may request information in respect of a number of matters including:

- Progress versus programme.
- Spend versus forecast.

- Significant changes in issues and risks.
- Significant changes to DPC delivered project outcomes/specification.
- Significant changes to DPC delivered project management team.
- Significant changes to DPC delivered project delivery partners.

Notwithstanding that there are no Ofwat Control Points during the asset creation stage, the Appointee's licence will place restrictions on the manner in which the Appointee can act. For example the Appointee would not be entitled to agree material changes to the CAP Agreement without Ofwat's express consent.

Stage 7 - Asset delivery and acceptance

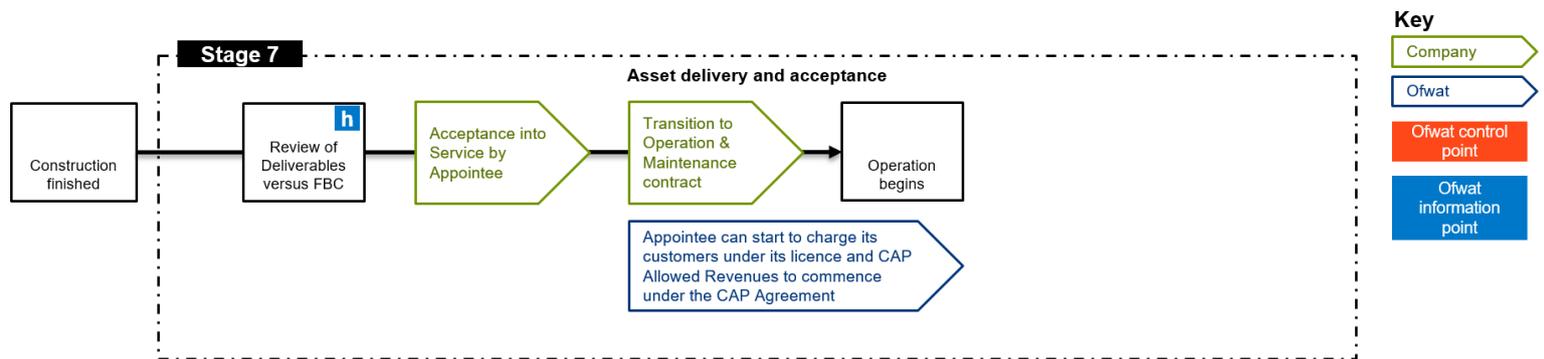
During this Stage the CAP will be responsible for the delivery, testing, commissioning and acceptance of the DPC delivered project and the Appointee will manage the CAP in line with the CAP Agreement. The Appointee will collect relevant allowed revenues related to the DPC project from customers in line with Ofwat's issued DPC Allowed Revenue Direction.

Appointees are expected to undertake regular reviews of the DPC delivered project to monitor delivery versus the final CAP Agreement and the FBC. They are also ultimately responsible for delivering the DPC delivered project including managing risks and taking mitigating actions, including projected overspends, delays to delivery and not meeting other deliverables.

Appointees are expected to monitor delivery versus the FBC and risks and mitigating actions, including projected overspends, delays to delivery and not meeting other deliverables.

- **Information Point H** – Ofwat expects to receive regular updates on DPC delivered project progress etc. Including (critically) at asset acceptance. Ofwat expects to be kept informed of the DPC delivered project's progress and how the Appointee is managing performance of the CAP. Pursuant to the Appointee's licence, the Appointee will be required to provide Ofwat with such information related to the DPC delivered project as Ofwat reasonably requests (this may also include a requirement for evidence from the independent technical adviser).

The precise number and nature of the **Information Points** during the Asset delivery and acceptance Stage will be agreed between the Appointee and Ofwat depending upon the status of the DPC delivered project. In certain circumstances completion and asset acceptance may be staggered (this will depend on the nature of the project).



4.1.10 Assurance

Items to consider include:

- When acceptance is likely to occur and when commissioning and testing under the CAP Agreement occurs.
- If the constructed asset provides a service that meets/falls short of expectations, what mitigations have been put in place and what is the impact on customers.
- What lessons have been learnt about the delivery of the DPC scheme and can these lessons be applied to future DPC and in-house projects.
- The CAP Charge will need to begin under the CAP Agreement and the Appointee will need to start recovering relevant amounts of the CAP Charges (as permitted by the DPC Allowed Revenue Direction) from its customers at the appropriate point (it is possible dates may have shifted), it is therefore important that there is close co-ordination with the CAP/Appointee and Ofwat at acceptance (Ofwat consent of revenue commencement will likely be required).
- The appropriate amount of Information Points during the operation and maintenance Stage (Stage 8 – see below).

Notwithstanding that there are no Ofwat Control Points during the asset delivery and acceptance Stage, the Appointee's licence places restrictions on the manner in which the Appointee can act. For example the Appointee will not be entitled to agree changes to the CAP Agreement without Ofwat's consent.

Stage 8 – Operation and maintenance

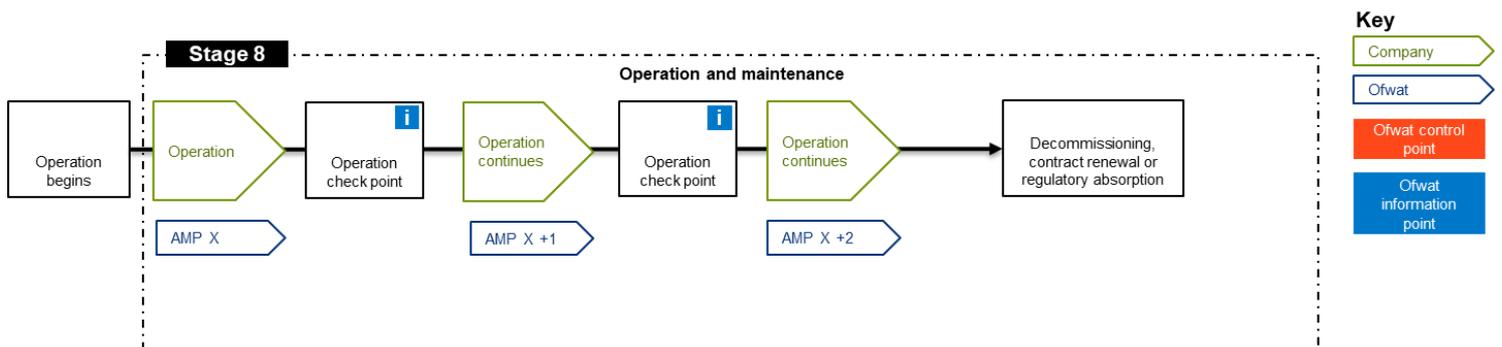
During this Stage the Appointee will manage operation and maintenance of the DPC delivered project in line with the CAP Agreement.

Appointees are expected to undertake regular reviews of the DPC delivered project to monitor delivery versus the final CAP Agreement and the FBC. They are also ultimately responsible for delivering the DPC delivered project including managing risks and taking mitigating actions, including projected overspends, delays to delivery and not meeting other deliverables.

Appointees are expected to undertake regular reviews of the DPC delivered project management to monitor delivery, risks and mitigating actions, including performance. During this stage Appointees will collect relevant revenues related to the DPC project from customers in accordance with the issued DPC Allowed Revenue.

- Information Point I** – Ofwat expects to receive regular updates on DPC delivered project performance and expects to be kept informed of the project’s progress. The Appointee will be required to provide Ofwat with such information related to the DPC delivered project as Ofwat reasonably requests.

The precise number and nature of the Information Points during the operation and maintenance Stage will be agreed between the Appointee and Ofwat at acceptance (i.e. Stage 7 – see above).



4.1.11 Assurance

Ofwat may request information in respect of a number of matters including:

- Progress versus programme.

- Spend versus forecast.
- Performance outcomes.
- Significant changes in issues and risks.
- Whole life considerations.
- Significant changes to DPC delivered project outcomes/specification.
- Significant changes to DPC delivered project management team.
- Significant changes to DPC delivered project delivery partners.

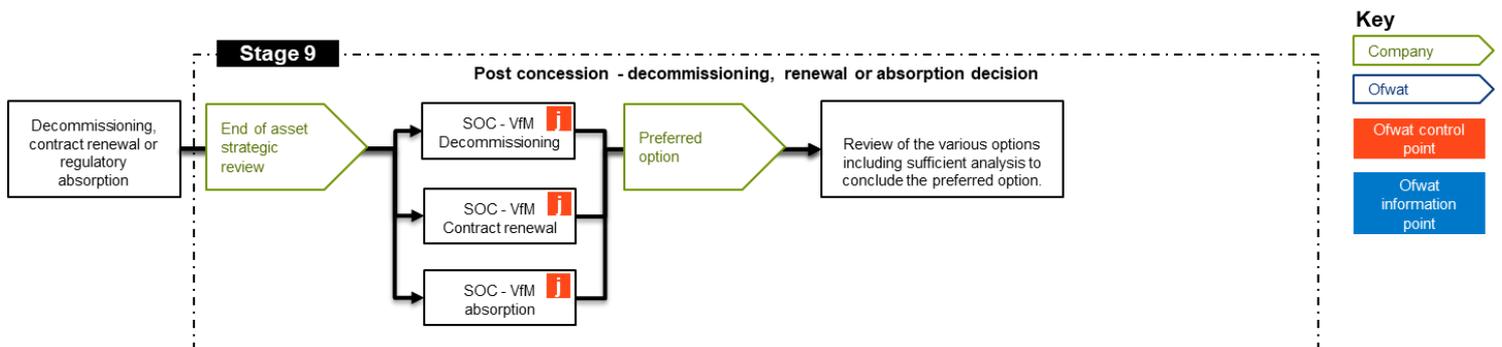
Notwithstanding that there are no Ofwat Control Points during the operation and maintenance Stage, the Appointee's licence places restrictions on the manner in which the Appointee can act. For example the Appointee will not be entitled to agree certain material changes to the CAP Agreement without Ofwat's consent.

Stage 9 – Post contract - decommissioning, renewal or absorption decision

As the CAP Agreement approaches the end of its term it is important that a process is undertaken to determine the future of the asset (and its operation and maintenance). It is expected that an Appointee will consider all of its options at the time, including:

- Decommissioning of the asset (this is likely to only be appropriate if the asset is at the end of its useful life).
- Renewal of the existing CAP Agreement (this will require CAP approval and is likely to only be viable where express options are included within the original CAP Agreement).
- Tendering out the future financing, operation and/or maintenance of the asset on a “Very Late” Tender Model.
- Bringing the asset in-house (this would require a regulatory adjustment, revocation of the designation of the project as a DPC delivered project and appropriate regulatory treatment to be agreed with Ofwat).

Ofwat would consider at **Control Point J** the various proposed options including appropriate evidence submitted by the Appointee to determine the preferred option. This will include consideration of potential cash flow and revenue adjustments that may need to be made.



5. DPC – Additional considerations

5.1 DPC Exit

This Section concerns exit from DPC. DPC Exit is distinct from termination of the CAP Agreement post award of the CAP Agreement and during its term.

DPC Exit is where it is determined that delivery through DPC may not provide the best value for customers or be the optimal mechanism by which to deliver a project. This determination may be either by the Appointee or by way of a refusal of Ofwat to designate a project as a DPC delivered project, grant consent to award a CAP Agreement or grant consent to progress or procure the DPC delivered project at a **Control Point**.

Once a DPC delivered project has been designated then an Appointee would require express Ofwat consent to revert to any non-DPC based means of delivery.

DPC Exit may arise:

- **At Stages 1-3** – If the project has not been designated as a DPC delivered project pursuant to the licence then the Appointee will not require any express consent for any alternative means of delivery (although obviously consultation with Ofwat will be required as to future project funding and delivery).
- **At Stage 4** – where (after a DPC delivered project has been designated) an Appointee proposes to terminate a DPC procurement or a DPC procurement process fails. The appointee should agree with Ofwat the alternative delivery route and how funding will be achieved.
- **At Stage 5** – where an Appointee does not consider there is value for customers in proceeding by way of DPC or fails to convince Ofwat to provide consent to award the CAP Agreement (and proceed using DPC).

Ofwat considers that the likelihood and appropriateness of DPC Exit decreases as the Stages above progress.

Exit from DPC could occur at a number of Stages of a DPC procurement but also at any stage within a price control period. Where DPC Exit is proposed by an Appointee or occurs questions will arise as to:

- how the relevant project should be delivered (if at all); and

- the efficiency of the Appointee's costs incurred to date in respect of the DPC delivered project. We consider that different scenarios will pose different challenges in this regard and as such our approach requires flexibility.

We have set out below a table setting out possible factors that may impact upon our decision:

Actions that would be considered by Ofwat	Factors that may influence the decision made by Ofwat
<ul style="list-style-type: none"> • Ask the Appointee to provide further evidence as to why DPC Exit is required. • Ask the Appointee to reconsider one of its findings (or an element of its analysis that has led it to request DPC Exit). • Ask the Appointee to re-tender the project as a DPC delivered project. At this stage the Appointee may, after re-work, need to reapply for consent to commence and undertake a DPC procurement process. • Allow the Appointee to carry out the project (or work thereon) directly, i.e. outside of DPC, in which case we would need to consider whether any (and, if so, what) additional allowable Totex should be included within the relevant price control(s) at an appropriate opportunity. We would also need to consider reversing any designation of the DPC delivered project. • Review efficiency of the Appointee's costs. 	<ul style="list-style-type: none"> • Whether adequate reason (and evidence) for DPC Exit has been provided. • Whether the reason for DPC Exit was reasonably foreseeable (or should have been reasonably foreseeable) to the Appointee. • Whether the need for DPC Exit has arisen as a result of the Appointee's own error or lack of diligence. • Whether circumstances have arisen beyond the Appointee's control. • Proximity to the next periodic review. • Resilience measures adopted by the Appointee. • The time critical nature of the relevant asset being constructed. • The Stage of the procurement process at which DPC Exit took place. • Viability of the project. • Legal compliance by the Appointee. • Appointee compliance with best practice.

	<ul style="list-style-type: none">• Any other relevant issues.
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5.2 PR19 Uncertainty Mechanisms

We would only expect a DPC delivered project to be transferred back to an in-house delivery route where there are unusual and extreme circumstances (e.g. adverse financial conditions). Furthermore the change to the in-house delivery route must demonstrate compelling evidence of the benefit to customers and protection of customer interests.

In our PR19 final determination we say that the appropriate uncertainty mechanism to facilitate a DPC delivered project being transferred back to an in-house delivery route would be Interim Determination as set out in Licence Condition B, Part IV.

5.3 Termination Post-Contract Award

Where a termination scenario has arisen Ofwat will take in to account all relevant factors to determine cost treatment and appropriate cost allowances for any continuation of the project going forwards. This includes use of any uncertainty mechanism discussed above.

Any subsequent allowances will depend on the circumstances including the reasons for any termination.

Ofwat (The Water Services Regulation Authority)
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