

24 February 2020

# **Consultation on proposed amendments to licence conditions for Direct Procurement for Customers**

## About this document

The document invites comments on proposed amendments of the conditions of the appointments ('licences') of six water companies<sup>1</sup> in England and Wales (listed in table 1) in relation to the delivery of schemes through our direct procurement for customers initiative.

The first proposed modification would introduce a new licence condition to establish the processes by which the water company could undertake the procurement of a third party competitively appointed provider.

The second proposed modification would amend an existing licence condition (Condition B) to permit the water company to pass onto its customers the charges payable to the competitively appointed third party service provider.

This document is an initial non-statutory consultation on our current views on the licence amendments required to implement schemes associated with direct procurement for customers. The comments we receive in respect of this consultation will inform the statutory consultation on the final form of the modifications that we propose to publish later this year.

Under section 13 of the Water Industry Act 1991 ('WIA91'), the Water Services Regulation Authority ('Ofwat') may modify the conditions of a water company's licence if the company consents to the amendments.

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<sup>1</sup> For the purpose of this document, a reference to a water company or company means a company holding an appointment as a water and/or sewerage undertaker under the Water Industry Act 1991.

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## Responding to this consultation

We are keen to hear your views on our proposed licence amendments in respect of direct procurement for customers, your views on the discussion points raised and whether you think there are other considerations we should take into account.

Please send your responses to [DPC@ofwat.gov.uk](mailto:DPC@ofwat.gov.uk) by 5pm Monday 6th April 2020. You can also submit your response by post to:

DPC Licence changes consultation  
Direct Procurement  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA.

We may publish responses to this document on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk). Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), data protection law and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals with, among other things, obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

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## 1. Introduction

Markets can deliver a wide range of benefits for customers in terms of both the quality, choice and cost of the services they receive. Markets are a key driver for efficiency and innovation for the benefit of both customers and the environment.

Water companies in England and Wales are effectively monopoly providers of water and wastewater services. We use price controls to regulate the price and service package that these companies offer to ensure that customers are protected. We seek to create the incentives for innovation and drive efficiencies.

We set out in our [2019 price review \(PR19\) methodology](#) that we expected company business plans to consider direct procurement for customers (DPC) where this was likely to deliver the greatest value for customers. DPC promotes innovation and resilience by allowing new participants to bring fresh ideas and approaches to the delivery of key projects. In chapter 7 and Appendix 9 of the PR19 final methodology we set out our approach and expectations for DPC in relation to company business plans.

In our Final Determination technical appendix [PR19 Final Determination: Delivering customer value in large projects](#) we proposed to consult in early 2020 on the licence changes which we consider necessary to facilitate the delivery of DPC schemes and ensure there are appropriate controls in place to protect customers alongside mechanisms for the company to manage any associated issues.

## 2. Background

DPC involves arrangements where a water company competitively tenders for financing and delivery of the project by appointing a third-party competitively appointed provider (CAP).

We do not intend for DPC to replace the provisions companies currently make for outsourcing services to third parties to deliver ongoing operations, maintenance and capital investment. DPC's can provide significant benefits to customers including from customers benefiting from competition to provide financing, greater efficiency and driving innovation.

In our document [PR19 Final Determination: Delivering customer value in large projects](#) we set out our policy decisions related to how we intended to implement DPC for the water and wastewater sectors in the period from 1 April 2020. We noted that the licence changes that will be required to further DPC would be developed in consultation with the water companies concerned in early 2020.

### Developing the licence modification

We shared information on our developing thinking and earlier drafts of the proposed amendments with water companies in late 2019. The proposed amendments reflect, where appropriate, the feedback received from companies. We welcome the constructive approach taken by companies in this process.

### Who the proposed licence amendments will apply to

Table 1 below lists those companies that we currently envisage, subject to agreement, the licence amendments will initially apply to. At this stage we only propose to make licence amendments for those water companies in England and Wales where DPC schemes have been identified or where there exists the possibility of a DPC scheme being procured within the 2020-25 control period. This does not preclude other companies coming forward with suitable schemes within the 2020-25 control period and amendments to their licences could then be made when necessary.

**Table 1: List of the companies we propose the amendments will apply to initially**

<b>Water and sewerage undertakers:</b>	<b>Water only undertakers:</b>
Anglian Water Services Limited Dŵr Cymru Cyfyngedig (Welsh Water) United Utilities Water Limited Southern Water Services Limited	Affinity Water Limited Bristol Water plc

### **Interaction with PR19**

As part of our [PR19 Final Determination](#) we published our final decisions on DPC projects and the uncertainty mechanism. We discuss the uncertainty mechanism in section 4 of this document. For the avoidance of doubt this consultation does not include in respect of DPC any suggested licence changes relating to interim determination mechanisms, which we propose to consult on separately later in 2020.

### **3. What are the changes we are proposing?**

The first proposed licence modification will establish the framework for the DPC procurement process. The new condition will specify the process which companies are to follow. In particular, under the new condition we propose that Ofwat agreement will be required for the company to:

- undertake a DPC procurement and obtain designated status;
- enter into a contract with the CAP;
- vary the contract; and
- revoke designated status.

The second proposed modification will allow a water company to recover from customers, outside of price controls, the designated charges that the water company has to pay to the CAP for services. These services will normally include the design, build, financing, maintenance and operation of assets. The CAP charges for these services have not been included in price controls as these will be determined through a competitive tender which, consistent with our views expressed in the PR19 methodology, can achieve significant benefits for customers. To allow the water company to charge customers for services provided by the CAP we need to amend the charging condition within the licence.

#### **Overview of the proposed licence amendments**

The proposed wording for these amendments is set out in Appendix 1. The key aspects of the proposed licence amendments are set out below.

#### **Licence Amendment 1 - new DPC Condition**

The first licence amendment will establish the processes by which a water company will undertake a DPC procurement.

The purpose of this new condition, Condition U, is to ensure that a water company, before entering into an agreement with a CAP, obtains relevant consents from Ofwat, takes appropriate steps to ensure customers are protected and best value is achieved and manages the CAP agreement in the best interests of its customers.



The licence amendment establishes the framework for the DPC procurement process and the appointment of the CAP and, if necessary, termination procedures that must be followed by a water company.

### **Licence Amendment 2 – Amendment to Condition B (Charges)**

The effect of the proposed licence amendment will be that designated charges payable by the water company to the CAP will be passed on to customers outside of price controls. This is necessary as water companies will not be funded for charges from the CAP within the current and subsequent price controls.

Ofwat will safeguard customer interests and ensure that value for money is achieved as the decision to proceed with the DPC will be taken through a rigorous procurement process with gated decisions. It is important to note that DPC arrangements do not allow the CAP to charge more than would be the case if the project were undertaken in house. Bill impacts are tested and this included affordability assessments during the price review. Ofwat will continue to assess the value for money throughout the decision gates.

We consider the DPC procurement process in the first licence amendment.

### **DPC Briefing Note**

Consistent with the new DPC condition and to support the procurement process we have published alongside this consultation a briefing note (the “DPC Briefing Note”). This outlines our minimum expectations for the DPC procurement process. We provide this in Appendix 2.

### **Explanation of the proposed licence amendments**

We set out below further detail on the proposed licence amendments and why they are needed. We believe DPC has the potential to deliver significant benefits to customers including lower whole life costs and innovative solutions. We also need to protect customers, to ensure value for money is achieved and that a water company procuring a DPC projects acts in the best interests of its customers.

### **Taking a proportionate approach**

In assessing the need for these proposed licence amendments, we have had regard to the potential for innovation, the need for customer protection and the regulatory

costs that would be incurred by water companies to secure compliance. We have taken a proportionate approach to managing risks.

**The proposed new DPC condition - Condition U**

Issue	What we need	Why we need it
<p><b>General:</b></p>	<p>A licence condition which ensures that customer interests are protected.</p>	<p>It is important a DPC project is in customers interests and represents best value for money. We need a licence condition to require there to be appropriate controls in place. Ofwat will not undertake the procurement. However Ofwat will be reviewing the procurement process undertaken and provide, if appropriate, consent at key stages to ensure the interests of customers are protected and a project represents best value for money.</p> <p>We have prepared a separate guidance document (the “DPC Briefing Note”) and already shared this with water companies as part of industry engagement to outline a generic view of the process.</p> <p>The DPC Briefing Note is not a substitute for the licence and retains flexibility about how the process is implemented. The licence will place critical obligations on a water company to ensure our principles outlined in our PR19 Methodology (and</p>

Issue	What we need	Why we need it
		restated again in July 2019) are met.
<b>Achieving best value</b>	A licence condition that places an obligation on water companies to ensure that best value for customers is achieved in the DPC procurement.	The water company will be responsible for undertaking the procurement of a CAP. We believe it is important the licence places obligations on water companies to ensure the procurement process delivers outcomes that achieve best value for customers.
<b>Management of CAP</b>	A licence condition to assure best management of the contract for customers throughout the life of the contract.	Under the contract model, the CAP is contracted to the water company (with the contract referred to as “the CAP Agreement”). To ensure the water company acts in its customers best interests we propose a licence obligation requiring the CAP Agreement to be managed by the water company in a manner that achieves best value for customers. We believe this obligation is important because if not in place a water company could take a passive role which may lead to sub-optimal outcomes for customers. We note that under the contract model Ofwat does not have a direct relationship with the CAP.

Issue	What we need	Why we need it
<p><b>Designation of a DPC Delivered Project</b></p>	<p>We want to ensure that only suitable projects are procured through a DPC process.</p>	<p>We believe it is important that DPC Projects are clearly identified. The process relating to the procurement and delivery of DPC Projects should be limited to those projects that are suitable for DPC.</p>
<p><b>Requirement for written consent from Ofwat for the Appointee to undertake a DPC Procurement Process</b></p>	<p>We want to approve the planned DPC procurement process prior to it being undertaken.</p>	<p>Before any DPC procurement process (by which we typically mean Invitation to Tender) is commenced, we want the water company to agree with Ofwat the key stages, timings and contact points.</p> <p>By having a “hard consent”, the procurement process cannot proceed until such time as Ofwat, having considered, among other things, the procurement process, the proposed terms and conditions of the CAP Agreement. This will ensure Ofwat is satisfied that the interests of customers will be protected and best value for money achieved.</p> <p>We expect a water company and Ofwat to agree the procurement process so that both are clear about their respective responsibilities at each stage of the procurement process.</p>

Issue	What we need	Why we need it
<p><b>Ofwat agreement required for a project to exit DPC</b></p>	<p>We want Ofwat to agree to the exit of any project from the DPC regime.</p>	<p>A procurement could fail during the procurement process itself such that the water company is unable to appoint a CAP (e.g. insufficient interest from bidders). The water company may then seek to return the project to an in-house delivery route. Under such circumstances Ofwat will want assurance that it is in customers' best interests to exit the DPC process instead of undertaking a further procurement process. Similar considerations will also apply in the event that a CAP Agreement is terminated and the water company wants to bring the project in-house. We therefore believe agreement with Ofwat to revoke the designation of a DPC Delivered Project and exit the DPC regime is an important mechanism to protect customers' interests.</p>
<p><b>Requirement for written consent from Ofwat for the water company to enter into a CAP Agreement</b></p>	<p>We want the water company to require consent from Ofwat prior to entering into the CAP Agreement</p>	<p>As a DPC procurement process enters preferred bidder stage further discussions with the prospective CAP may take place – which could include negotiations on key points in the contract. To protect the interests of customers we need to ensure that any key clauses have not been compromised</p>

Issue	What we need	Why we need it
		and/or additional clauses which are potentially to the detriment of customers interests have not been included.
<p><b>Requirement for written consent from Ofwat for changes to be made to a CAP Agreement</b></p>	<p>We want the water company to obtain consent from Ofwat to agree changes to a CAP Agreement where there is a potential material impact on customers' interests. We welcome suggestions on how this can be best achieved.</p>	<p>We believe it is important that controls are in place to ensure customer interests are protected. As such Ofwat's prior approval of proposed changes to a CAP Agreement which directly impact on customers interests represent a check within the process.</p>
<p><b>Requirement for written consent from Ofwat for the extension of the term of the CAP Agreement</b></p>	<p>We want to approve any extension of the CAP Agreement</p>	<p>We believe it is important that the water company seek Ofwat's consent should it wish to extend the term of the CAP Agreement. We would be concerned about extensions if, for example:</p> <ul style="list-style-type: none"> <li>• the performance of the CAP over the duration of the CAP Agreement was demonstrably poor and to the detriment of customers interests; or</li> <li>• market conditions or technology have significantly changed such that further efficiencies could be achieved under a different arrangement.</li> </ul>

Issue	What we need	Why we need it
<p><b>DPC Allowed Revenue Direction</b></p>	<p>We need to be able to issue a direction for the company to collect revenue associated with DPC</p>	<p>The DPC Allowed Revenue Direction will allow the company to collect CAP revenue from customers. The Direction is an approval by Ofwat on what can be recovered from customers.</p>
<p><b>Ultimate Controller of the CAP</b></p>	<p>We need the water company to ensure that the CAP has obtain consent from the water company before a change in Ultimate Controller. In turn the water company has to seek Ofwat approval for consent.</p>	<p>This supports the restriction in relation to Associated companies and ensures the interests of customers are protected from a change in ownership.</p>
<p><b>Provision of Information</b></p>	<p>We want the ability to obtain appropriate information in relation to the procurement of a CAP, the performance of the CAP and the delivery of the project</p>	<p>We will, from time to time, need information to understand how a DPC project is progressing (including procurement and delivery). As such we seek an obligation on the water company to provide this information, to the extent that it is not covered by existing obligations.</p> <p>Furthermore we also expect the water company to have reporting requirements in place within the CAP Agreement (e.g. progress against milestones). Some of the collected information would therefore be part of ongoing contract management. During the procurement and the term of the CAP Agreement information</p>

Issue	What we need	Why we need it
		<p>requirements as set out in Ofwat’s Regulatory Accounting Guidelines may, after consultation, change and as such provision to obtain any information required to meet any such requirements would need to be reflected in the CAP Agreement.</p> <p>We will expect information provided to be appropriately assured by boards.</p>
<p><b>Independent Technical Adviser</b></p>	<p>We expect the water company to support information provided to Ofwat with evidence from a technical expert</p>	<p>We see an Independent Technical Adviser (ITA) as having a crucial role in providing supporting evidence for the procurement process and the CAP Agreement. This will promote customer protection by ensuring that Appointee actions in management of the CAP Agreement are assured and/or verified by independent parties.</p>
<p><b>Responsibilities of the Company</b></p>	<p>The water company will continue to be the responsible provider of water and sewerage services</p>	<p>The company will continue to be responsible for meeting its statutory and licence obligations as a water and/or sewerage undertaker. The appointment of a CAP will not change these obligations.</p>



Issue	What we need	Why we need it
<p><b>Prohibition on entering into CAP Agreements with Associated Companies</b></p>	<p>We want to ensure that companies do not enter into a CAP Agreement with an associated party.</p>	<p>Consistent with our Contract Principles any associated companies of the Company may not bid in a DPC procurement process or be appointed as the CAP.</p>
<p><b>Requirement for written consent for Termination</b></p>	<p>We need to be able to approve or prevent a water company terminating a CAP Agreement</p>	<p>The termination of a CAP Agreement may have a significant detrimental impact upon customers' interests. To protect customers the water company will need to seek and obtain written consent from Ofwat before termination.</p>

**The proposed changes to Condition B:**

Issue	What we need	Why we need it
<p><b>Pass through of CAP Charge</b></p>	<p>The licence needs to be amended to allow a company to collect from its customers outside of price controls the appropriate DPC charges payable to the CAP.</p>	<p>Under the contract model CAP charges are determined through a competitive tender, a CAP charges a water company for the services provided, which in turn are recovered by a water company through charges to customers.</p>

**Consultation Questions**

1. Do you agree with the key aspects of the proposed licence amendments outlined above?
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?
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?
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?
5. Please provide your comments on the processes outlined in the DPC Briefing Note?
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?
7. Please provide your comments on the proposed licence amendments set out in Appendix 1 and their wording?

## 4. Uncertainty mechanisms: Interim Determination for Direct Procurement for Customers

In our [PR19 Final Determination: Delivering customer value in large projects](#) we affirmed our decision that a notified item will during the 2020-25 price control period be the form of uncertainty mechanism for the unlikely scenario in which DPC schemes need to revert to in-house delivery with the control period. It is our view that reversion to in-house delivery within a control period should be a rare event and this approach best aligns with the responsibility of the water company to manage the process.

However we also recognised that the interim determination process that applies to notified items has drawbacks for some schemes. We therefore committed to consider the case for amending Condition B to introduce a specific interim determination process with bespoke criteria for DPC.

We intend to engage with stakeholders during 2020 on an interim determination for DPC mechanism. We expect this to raise issues as there would be interactions between any interim determination mechanism for direct procurement and other aspects of the price control provisions in licences. We will consult with the industry and other stakeholders as part of our engagement as it is important that any amended interim determination mechanism is fit for purpose. We will only propose amendments which allow for the in-house delivery of a scheme during the 2020-25 price control period whilst protecting the interests of customers.

For the avoidance of doubt we will not be seeking to amend condition B to introduce a direct procurement interim determination mechanism as part of the proposed licence amendments pursuant to this consultation and not before further engagement.

## 5. Next steps

We invite stakeholders to comment on the proposed amendments and DPC Briefing Note by no later than 5pm Monday 6th April. You can email your responses to [DPC@ofwat.gov.uk](mailto:DPC@ofwat.gov.uk) or post them to:

DPC Licence changes consultation  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA.

We will aim to undertake a statutory consultation later this year.

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## Appendix 1: Proposed amendments

### New Condition U – Direct Procurement for Customers (Generic)

#### Introduction

This Condition requires that, where the Appointee plans, procures and/or undertakes DPC Delivered Projects, the Appointee must:

- (1) obtain relevant consents from Ofwat;
- (2) take appropriate steps to ensure their customers are protected; and
- (3) achieve best value for customers.

#### 1. Interpretation

**[Note: The following definitions may be set out in Condition A]**

Unless the context otherwise requires, in this Condition:

“Approved CAP Agreement” means a CAP Agreement that has been consented to by Ofwat in accordance with paragraph U6.1;

“CAP” means a limited company that enters into a CAP Agreement with the Appointee and who has been competitively appointed to be the provider in accordance with a DPC Procurement Process in respect of a DPC Delivered Project;

“CAP Agreement” means an agreement (including the schedules to such an agreement) between the Appointee and a CAP in respect of a DPC Delivered Project;

“CAP Charges” means all those sums that become due to a CAP from the Appointee pursuant to a CAP Agreement;

“DPC Allowed Revenue Direction” has the meaning set out in paragraph U7.1 of Condition U;

“DPC Delivered Project” means such project and associated activities that are so designated from time to time by Ofwat in accordance with paragraph U2 of Condition U;

“DPC Procurement Process” means a procurement process undertaken by the Appointee - the intended result of which is the award of a CAP Agreement;

“Independent Technical Adviser” means the person appointed pursuant to paragraph U12.1 of Condition U; and

“Ultimate Controller of the CAP” means any person who, whether alone or jointly and whether directly or indirectly, is, in the reasonable determination of Ofwat, in a position to control or in a position to materially influence the policy or affairs of the CAP or any Holding Company of the CAP.

1.1 Unless the contrary intention appears, references in this Condition to an Approved CAP Agreement includes reference to any modification of that Approved CAP Agreement made in accordance with paragraph U6.5.

## 2. Designation of a DPC Delivered Project

2.1 Ofwat may, with the agreement of the Appointee and by direction, from time to time:

- 2.1.1 designate an infrastructure project as a DPC Delivered Project;
- 2.1.2 modify the designation of a DPC Delivered Project (designated pursuant to paragraph U2.1.1); and/or
- 2.1.3 revoke the designation of a DPC Delivered Project (designated pursuant to paragraph U2.1.1).

2.2 As part of any direction issued pursuant to paragraphs U2.1.1 and U2.1.2, Ofwat will set out in writing the scope (or, if applicable, the modified scope) of the DPC Delivered Project.

2.3 No project will be designated as a DPC Delivered Project pursuant to this paragraph U2 to the extent the project is an infrastructure project specified in accordance with the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013.

2.4 In this paragraph U2 “infrastructure” means infrastructure relating to:

- 2.4.1 the provision of a system, or part of a system, of water supply, or the securing of supplies of water, or
- 2.4.2 the provision of a system, or part of a system, of sewers, or the provision of means for emptying, or dealing effectually with the contents of, sewers.

### 3. Procuring a DPC Delivered Project

3.1 The Appointee must put a DPC Delivered Project (including the financing of such a project) out to tender in accordance with paragraph U5.

3.2 Save only to the extent otherwise approved in writing by Ofwat, the Appointee must appoint a CAP (or more than one CAP) to undertake a DPC Delivered Project in accordance with paragraph U6.1.

### 4. Appointee’s Responsibilities

4.1 The designation of a DPC Delivered Project, any consent issued by Ofwat (or failure to issue such consent) and the appointment of a CAP to undertake a DPC Delivered Project does not reduce, restrict, limit or diminish the responsibilities,

obligations or liabilities of the Appointee as a relevant undertaker in respect of the DPC Delivered Project (including pursuant to the Appointment).

4.2 The Appointee must not, if it is prosecuted for any alleged offence or accused of any breach of any provision in the Water Industry Act 1991 or the Water Resources Act 1991, or any regulations made under either such Act, which is alleged to have occurred in relation to any of its functions as the Appointee the performance (or non-performance) of which was, at the relevant time included in:

4.2.1 the scope of any Approved CAP Agreement; or

4.2.2 the scope of any DPC Delivered Project,  
raise any defence of:

4.2.3 due diligence, such as that in section 70(3)(b) of the Water Industry Act 1991 (or any provision to similar effect); or

4.2.4 lack of responsibility,  
on the grounds that responsibility for compliance rested with a CAP or the function was part of a DPC Delivered Project.

**[Consultation Discussion Point: The objective of paragraph 4 is to make it clear that the Appointee retains responsibility pursuant to law and its licence as the relevant undertaker notwithstanding the implementation of a CAP Agreement. Similar provisions are currently included in Condition F1 (Procurement of Services) of the licences of Anglian Water and Dŵr Cymru.]**

## 5. DPC Procurement Process

5.1 The Appointee must not, without the prior written consent of Ofwat, commence or undertake any DPC Procurement Process. Any such consent from Ofwat may be partial or issued in phases, with consent issued for a prescribed stage of the procurement process only. Further, any such consent may be conditional and, in carrying out a DPC Procurement Process, the Appointee must comply with any

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conditions imposed by Ofwat in commencing or undertaking any DPC Procurement Process.

5.2 The Appointee must use all reasonable endeavours to ensure that each DPC Procurement Process (including all relevant procurement documents, any selection and evaluation criteria, any procurement plans and the form and provisions of the proposed CAP Agreement put out to tender) achieves best value for customers.

5.3 The Appointee must notify Ofwat as soon as practicable if it considers it is unable to complete a DPC Procurement Process or intends to suspend or abandon (whether in whole or in part) a DPC Procurement Process. Any suspension or abandonment of a DPC Procurement Process will not automatically result in the revocation of the designation of a DPC Delivered Project.

5.4 The Appointee must notify Ofwat as soon as practicable in the event of any legal challenge (or threatened legal challenge) of any nature related to the DPC Procurement Process.

5.5 The Appointee must undertake a DPC Procurement Process in accordance with the Utilities Contracts Regulations 2016 (as updated, amended and replaced from time to time) (or, if applicable, the Concession Contracts Regulations 2016 as updated, amended and replaced from time to time).

## 6. CAP Agreement

6.1 The Appointee must not, without the prior written consent of Ofwat, enter in to a CAP Agreement. Any consent issued by Ofwat will be conditional upon the specific form of the CAP Agreement.

6.2 The Appointee must:

- 6.2.1 comply with the terms of any Approved CAP Agreement; and
- 6.2.2 notify Ofwat as soon as practicable of any breach or non-compliance with any Approved CAP Agreement by the Appointee or the CAP.

6.3 In undertaking any action or omission related to an Approved CAP Agreement (including undertaking its obligations (or failing to do so), exercising (or not exercising) or waiving its rights), the Appointee must at all times use all reasonable endeavours to ensure it achieves best value for customers.

6.4 The Appointee must not, without the prior written consent of Ofwat, assign, novate, transfer or suspend an Approved CAP Agreement (whether in part or in whole).

6.5 The Appointee must not, without the prior written consent of Ofwat, adjust, vary, modify or amend an Approved CAP Agreement (or any part thereof).

**[Consultation Discussion Point: We would welcome industry views as to what level of non-material changes should be permissible without Ofwat's consent.]**

6.6 The Appointee must not, without the prior written consent of Ofwat extend the term of an Approved CAP Agreement.

## 7. DPC Allowed Revenue Direction

7.1 Ofwat may by written direction, from time to time, issue a DPC Allowed Revenue Direction in relation to an Approved CAP Agreement. Such DPC Allowed Revenue Direction will set out those CAP Charges (or categories of CAP Charges) approved by Ofwat and eligible for inclusion as part of DPC Allowed Revenue (“**DPC Allowed Revenue Direction**”).

7.2 Any DPC Allowed Revenue Direction may (amongst other things) set out:

- 7.2.1 the period of time for which the DPC Allowed Revenue Direction will subsist;
- 7.2.2 the commencement date for the collection of the relevant DPC Allowed Revenue;
- 7.2.3 arrangements in respect of any over/under collection of the relevant DPC Allowed Revenue by the Appointee;
- 7.2.4 those categories of CAP Charges eligible for inclusion as part of the Appointee's DPC Allowed Revenue;
- 7.2.5 those categories of CAP Charges that may be eligible for inclusion as part of the Appointee's DPC Allowed Revenue provided that relevant amounts of such CAP Charges are approved by Ofwat from time to time;
- 7.2.6 any express evidential requirements (including reports by the Independent Technical Adviser) that Ofwat may require prior to approval of any categories of CAP Charges as part of the Appointee's DPC Allowed Revenue; and
- 7.2.7 those CAP Charges that will not be eligible to be included in the Appointee's DPC Allowed Revenue.

7.3 Ofwat may (having consulted the Appointee and the relevant CAP) by written direction modify the DPC Allowed Revenue Direction from time to time.

7.4 Ofwat may (having consulted the Appointee and the relevant CAP) by written direction revoke the DPC Allowed Revenue Direction from time to time.

**[Consultation Discussion Point: Ofwat would welcome comments on these provisions, including any comments about the form and process for the DPC Allowed Revenue Direction –and any potential consultation or areas of guidance that may be helpful..]**

## 8. Ultimate Controller of the CAP

8.1 Save where Ofwat consents in writing to any alternative arrangement, the Appointee must ensure that each CAP Agreement includes a provision requiring the CAP to seek the written consent of the Appointee to changes to the Ultimate Controller of the CAP.

8.2 The Appointee must maintain and keep up to date and in written form, accurate information about the Ultimate Controller of the CAP.

8.3 The Appointee must not, without the prior written consent of Ofwat, approve any change in the Ultimate Controller of the CAP.

#### 9. Termination of an Approved CAP Agreement

9.1 The Appointee must not, without the prior written consent of Ofwat, terminate any Approved CAP Agreement.

9.2 The Appointee must notify Ofwat as soon as practicable if any circumstances arise which may reasonably be considered likely to lead to the termination of an Approved CAP Agreement.

9.3 If an Approved CAP Agreement is terminated for any reason, Ofwat may, having consulted the Appointee and the relevant CAP, direct the Appointee as to the treatment of any revenue collected by the Appointee with respect to the CAP Charges payable pursuant to the Approved CAP Agreement that it has not already passed on to the relevant CAP, and the Appointee must comply with any such direction.

9.4 The direction given by Ofwat under paragraph U9.3 may relate to all revenue collected by the Appointee with respect to the CAP Charges payable pursuant to the Approved CAP Agreement but not yet passed on to the relevant CAP at the

date the relevant Approved CAP Agreement terminates, and any revenues subsequently collected by the Appointee in respect of the DPC Allowed Revenue.

9.5 Any termination of any Approved CAP Agreement will not automatically result in a revocation of any designation of a DPC Delivered Project.

## 10. Associated Companies

10.1 The Appointee must not, without the prior written consent of Ofwat:

10.1.1 bid in its own DPC Procurement Process;

10.1.2 permit an Associated Company to bid in a DPC Procurement Process;  
or

10.1.3 award a CAP Agreement to an Associated Company.

10.2 For the purposes of paragraphs U10.1.1 and U10.1.2 to “bid in a DPC Procurement Process” includes each of the following:

10.2.1 submitting a bid in its own name;

10.2.2 being part of any consortium or group of entities submitting a bid; or

10.2.3 being named (including as a contractor or sub-contractor of any tier) in any bid as the entity undertaking the DPC Delivered Project (or any part thereof).

10.3 Save where Ofwat consents in writing to any alternative arrangement, the Appointee must ensure that no Associated Company or the Appointee itself undertakes any DPC Delivered Project (or any part thereof) as a contractor (or sub-contractor of any tier).

## 11. Information

- 11.1 The Appointee must provide Ofwat such Information as it may reasonably require for the purpose of carrying out its activities under this Condition or otherwise in connection with any DPC Delivered Project, any DPC Procurement Process, any DPC Allowed Revenue Direction, and CAP Agreement and any CAP.
- 11.2 Information required under paragraph U11.1 must be provided in such form and manner, at such time and place, and be accompanied or supplemented by such explanations and supporting evidence, as Ofwat may reasonably require.
- 11.3 The Appointee must ensure that all Information and accompanying explanations and evidence provided pursuant to paragraphs U11.1 and U11.2 must be accurate and accompanied by such assurance as Ofwat may reasonably require. Such assurance may include a certificate warranting the accuracy of the information provided in a form acceptable to Ofwat that is:
- 11.3.1 signed by all directors of the Appointee on the date of submission; or
  - 11.3.2 approved at a meeting of the Board of the Appointee, convened in accordance with the Appointee's articles of association.
- 11.4 For the purposes of this Condition the definition of "Information" in paragraph 3 of Condition A has effect as if references to information that the Appointee holds or can reasonably obtain include information that any CAP holds or can reasonably obtain.

## 12. Independent Technical Adviser

- 12.1 Any Information furnished to Ofwat in connection with any DPC Delivered Project, a DPC Procurement Process, any CAP, any CAP Agreement or any DPC Allowed Revenue Direction must, if Ofwat so requires, be supported by evidence provided by a person appointed by the Appointee and approved by

Ofwat (such approval not to be unreasonably withheld) (“**Independent Technical Adviser**”).

12.2 In relation to each DPC Delivered Project the Appointee must enter into a written contract of engagement with the Independent Technical Adviser which must:

12.2.1 set out that the responsibility for the costs associated with any services provided by the Independent Technical Adviser must be paid by either the Appointee or the CAP;

12.2.2 set out that the Independent Technical Adviser has a duty of care to Ofwat;

12.2.3 where evidence is required by Ofwat under paragraph U12.1, require the Independent Technical Adviser to prepare and furnish to Ofwat, and separately to the Appointee, a written report addressed jointly to Ofwat and the Appointee in form and substance such as may be specified by, or consistent with any guidelines specified by, Ofwat at the time when it requires the report to be furnished, the matters so specified being reasonably appropriate to enable Ofwat to make any direction or decision under the Appointment; and

12.2.4 include a term that the Independent Technical Adviser will provide such further explanation or clarification of their report as Ofwat may reasonably require and such further Information in respect of, or verification of, the matters which are the subject of their report as Ofwat may reasonably require.

12.3 The contract of engagement may also include provisions requiring the Independent Technical Adviser, their employees and agents to keep confidential and not to disclose, except to Ofwat and the CAP or as required by law, any information which the Independent Technical Adviser obtains in the course of preparing their report.

12.4 The Appointee must (and must ensure that the CAP must) co-operate fully with the Independent Technical Adviser to enable them to prepare their report, including without limitation, so far as is necessary for that purpose:

12.4.1 subject to reasonable prior notice, giving to the Independent Technical Adviser access at reasonable hours to any assets and to any premises occupied by the Appointee (or the CAP) in relation to the DPC Delivered Project; and

12.4.2 subject to reasonable prior notice, allowing the Independent Technical Adviser at reasonable hours:

(1) to inspect and make copies of, and take extracts from, any books and records of the Appointee (or the CAP) maintained in relation to the DPC Delivered Project;

(2) to carry out inspections, measurements and tests on or in relation to any such premises or assets; and

(3) to take on to such premises or on to or in to any assets such other persons and such equipment as may be necessary for the purposes of preparing and completing their report.

12.5 Nothing in paragraph U12 will require the Appointee:

12.5.1 to do anything which is outside its reasonable control; or

12.5.2 to allow the Independent Technical Adviser to do anything which would materially disrupt the Appointee's business or the DPC Delivered Project (unless it is essential that that thing be done to enable the Independent Technical Adviser to prepare their report).



## Amendments to Condition B (Charges)

**[Please note that these proposed amendments, and the paragraph numbers referred to, relate to Condition B of the licence of the 4 water and sewerage undertakers to whom we propose the amendments will apply to initially. They would be adapted as appropriate for the 2 water only undertakers.]**

1. Insert the following sub-paragraph after sub-paragraph 1.6:

“1.7 To permit the Appointee to levy charges for the purpose of collecting any DPC Allowed Revenue for the relevant Charging Year.”

2. Delete sub-paragraph 9.1 and replace it with the following:

“The Appointee shall levy charges in a way best calculated to:

- (1) comply with the Price Control or Price Controls determined by the Water Services Regulation Authority pursuant to sub-paragraph 9.3 or sub-paragraph 9.4; and
- (2) collect any DPC Allowed Revenue (which shall not be included in the Price Control or Price Controls).”

3. Exclusion of DPC projects from price controls through a change to sub-paragraph 9.4(1) (proposed new text shown highlighted and underlined):

“(1) In respect of the Appointed Business's Water Resources Activities, Bioresources Activities, Network Plus Water Activities and Network Plus Wastewater Activities except for those activities for which there are Excluded Charges or those activities that constitute a DPC Delivered Project, the Water Services Regulation Authority shall determine separate Price Controls in accordance with this sub-paragraph [...].”

4. Insert new sub-paragraph 10.2 as follows:

“The Appointee may from time to time be required to publish charges fixed for the purposes of demonstrating how the Appointee is collecting any DPC Allowed Revenue. Such requirement shall be made by way of a notice from the Water Services Regulation Authority to the Appointee specifying the information to be provided, the method of publication, the time by which publication is required (being a reasonable period of time) and the period for which the published charges are to be effective. The Appointee shall comply with the said requirement by notice and adhere to the charges accordingly published.”

5. Amend the interim determination provisions to exclude any costs, receipts or savings that relate to a project being delivered through a DPC project and that will therefore not be relevant to changes to the level of price controls through interim determinations. Insert a new paragraph 14.2(3)(i)(E) as follows (proposed new text shown highlighted and underlined):

“(i) no account shall be taken of:

[...]; or

(E) any costs, receipts or savings that are associated with a DPC Delivered Project; and”

6. Amend sub-paragraph 16.2 to reflect the changes to sub-paragraph 9.1 in the provision that covers the levying of charges in the event of a price control reference to the CMA (proposed new text shown highlighted and underlined):

“Where the Appointee requires the Water Services Regulation Authority to make a reference to the Competition and Markets Authority under sub-paragraph 16.1 in the case referred to in section (3) of that sub-paragraph, the Appointee shall levy charges in a way best calculated to comply with the Price Control or Price Controls determined by the Water Services Regulation Authority (and to continue to collect any DPC Allowed Revenue) as if a reference had not been made until the Competition and Markets Authority

makes its determination following such reference. The determination made by the Competition and Markets Authority shall then take effect as if it had been made by the Water Services Regulation Authority.”

**[Consultation Discussion Point: Ofwat would welcome comments on these amendments]**

**New definition to be inserted into Condition A: Interpretation and Construction at the relevant place:**

“DPC Allowed Revenue” means, in relation to any Charging Year, the total of the CAP Charges due to be paid to one or more CAPs by the Appointee in that Charging Year that are both:

- (1) recoverable in accordance with a DPC Allowed Revenue Direction; and
- (2) justifiable and fully evidenced (by reference to the Appointee’s accounts and any report required by Ofwat from an Independent Technical Adviser);

but that have not become due and payable as a result of a breach of a CAP Agreement by, or the fraud, misconduct or negligence of, the Appointee (or its agents or contractors);

**[Consultation Discussion Points: Ofwat would welcome discussion with Appointees on timing challenges in respect of collecting the DPC Allowed Revenue and tariff setting.]**

Ofwat (The Water Services Regulation Authority)  
is a non-ministerial government department.  
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