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Dear Sir,

### **PRT Response to Ofwat's Consultation on Direct Procurement for Customers**

Thank you for the opportunity to comment on your consultation on Direct Procurement for Customers, which was published on 24 February 2020. We have the following comments on your seven questions.

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

Although we are not progressing a DPC scheme, we have considered the consultation documents at a high level in light of our experience of negotiating complex commercial contracts in a regulated environment.

We understand the need for Ofwat control, in order to protect customer interests. However, generally the overall consent process and controls proposed appear, to us at a high level, quite involved in terms of Ofwat intervention and uncertain as to outcome. This may not be the best approach in the early stages of the development of the DPC market where those involved may feel that they need a more streamlined process with more predictable outcomes.

The terms 'best value', 'value for money' and 'interests of customers' are used – in the context of DPC. As Ofwat will be aware these are complex and subjective commercial issues. Therefore Ofwat and companies need to be very clear what these terms mean from the outset. However, this may be challenging to achieve given the flexible nature of the terms and the context in which they are being applied.

Furthermore, we think the legal issues between the procurer and Ofwat in the consent process need to be very carefully managed - uncertainty in this area (i.e. ability to select a CAP provided in accordance with evaluation criteria) will be difficult for the procuring authority to manage and may also destabilise the procurement itself.

There is also an issue in terms of reporting of complex commercial positions. The detail of the positions and context can not necessarily be 100% represented through a reporting process so we require much more involvement from Ofwat. Is Ofwat, through RAPID or otherwise, anticipating such involvement?

**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?**

There needs to be appropriate **benefit** for water companies to manage these contracts well – this is, as the PPP experience shows, where value is gained or lost.

Care should also be taken to ensure that any incentive mechanisms do not promote a hard transactional approach to the management of the CAP provider, which in the long-run could be counter-productive. For example if the company is only focused on ensuring costs should be kept to a minimum, then although this may provide short term benefits such an approach may not provide overall best value over the long-term.

**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?**

Yes; we think that the parameters agreed for Government consent in the “Liaison Agreement” for the Tideway project may be a useful starting point.

Furthermore, we would suggest that Ofwat’s consents need to be qualified in places and also have a time period attached to granting any consent. The nature of consents required also need to be considered on an asset by asset basis as some assets (network) are more likely to be susceptible to change than others (water resources).

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

We suggest the key points for consideration are:-

- Constraints placed on water companies through the Ofwat approvals process.
- Early adopters of DPC are potentially more exposed to costs of market development than for a mature model – this should be reflected in cost allowances. Particularly in relation to the uncertainty of deliverability of early schemes (e.g. market interest, lender appetite, contract development).
- Overall approach appears to be much more ‘hands-on’ which we can understand on one level, but at the same time the responsibility for success is firmly with water companies. We do think this is an inherent tension in the overall methodology and does not reflect the fact that the sector as a whole will, in relation to the first phase of schemes at least, be learning as schemes progress both through procurement and beyond. For companies to be truly innovative in this area, they potentially need to be given some breathing space to find out what actually works and what doesn’t.

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

Whilst the processes appear appropriate at a high level, there is also significant uncertainty over what Ofwat will expect to see in an approval process. For example, what commercial positions will Ofwat expect to see and how will it assess whether such positions are acceptable or otherwise, both generally and on a scheme specific basis?

The legal expression of commercial positions reflects a detailed commercial and technical negotiation. How will Ofwat obtain the necessary context to make an appropriate judgement, particularly in the early stages of development of the DPC market?

**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?**

The termination liabilities following termination of the CAP Agreement are potentially significant, including break costs and there needs to be a revenue stream to support these. Ofwat has not specified the tests that would need to be met in order for a water company to assess this risk and uncertainty and to ensure that it has allowed revenue to meet such liabilities.

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

We have not reviewed these in detail but would be happy to do so to reflect the points above if required.

Yours faithfully,



**Helen Orton**  
**Regulation and Finance Director**