

DPC Licence changes consultation
Direct Procurement
Ofwat
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21 April 2020

Dear David

Re: Ofwat consultation on proposed amendments to licence conditions for Direct Procurement for Customers (DPC)

Thank you for the opportunity to review and provide comments on the proposed amendments of the conditions of the appointments of six water companies in relation to the delivery of schemes through the PR19 direct procurement for customers (DPC) initiative.

Although Yorkshire Water is not one of the appointees addressed directly by these proposals, the amendments may be relevant in future should it identify and progress with a scheme through DPC.

We acknowledge this consultation is an initial non-statutory consultation on Ofwat's current views on the licence amendments required to implement DPC, ahead of the statutory consultation on the final form of the modifications under section 13 of the Water Industry Act 1991.

We have provided appended to this letter our responses to the consultation questions about the proposed modifications and where we see any practical issues with their implementation.

We also provide some brief comments on specific clauses within the drafting of the licence text provided in support of the consultation. Having reviewed the draft text provided, we do not on the face of it see any further issues with the proposed licence condition drafting, over those detailed in the pages below.

However, we would wish to reserve our position regarding drafting until we had received the final proposed draft wording under a future statutory consultation for any such licence condition change.

Should you have any questions in relation to this response please let me know via email at

[REDACTED]

We look forward to further engagement with Ofwat and others within the sector on the development of these modifications towards their conclusion in support of this key component of Ofwat's PR19 framework.

Yours sincerely,

[REDACTED]

Colin Fraser
Regulatory Strategy Manager

Yorkshire Water response to the Ofwat consultation on proposed amendments to licence conditions for Direct Procurement for Customers (DPC)

Consultation questions and responses

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

We agree broadly with many of the key aspects of the proposed licence amendments outlined in the consultation and agree the delivery of a DPC Project should be in the best interests of customers and the associated procurement process should deliver upon conclusion the best value for customers.

We also have no objections to the proposed structure of the amendments into two licence conditions, namely a new DPC specific Condition U, and modifications to Condition B on charges.

In general, we believe that the aim of the modifications should be to deliver a practical balance between standardisation across the sector for both undertakers and CAP organisations that will also accommodate a level of freedom to allow the contracting parties flexibility to agree certain terms within CAP Agreement between them, including making variations to the Agreement over its life.

It remains for undertakers to be responsible for delivering an effective and ideally successful DPC Procurement Process, whilst ensuring market participants can participate on a level playing field. Nothing in the modifications should impede the undertakers' obligations to comply with general competition law.

Taking each key aspect in turn, Yorkshire Water make the following observations.

General: A licence condition which ensures that customer interests are protected.

We agree it is vital that customers interests are the primary focus of any plans to pursue a DPC solution to a scheme as opposed to using an in-house delivery approach, and that this in practice will often be simplified as 'best value for money' for customers.

We also have no objections to the staged Ofwat consent approach within the DPC procurement process as outlined.

We are clear that the appointee will be responsible for running an effective CAP procurement process and developing and negotiating a form of CAP Agreement that is determined to deliver best value for money for customers at that point in time. However, an approved DPC solution and agreement may not always continue to achieve the best value [for money] into the future, especially in an environment where innovation may bring forward alternative more efficient methods of delivering the same or improved outcomes for customers that may not have been known of or available at the time the Approved CAP Agreement was entered into.

As may be problematic for any party to ensure the approved DPC solution will remain the best value [for money] for customers over its whole life when compared with future as yet unknown solutions, it may be more suitable to expect that the appointee should use reasonable endeavours to manage an Approved CAP Agreement in the 'best interests' of its customers.

As Ofwat makes clear, the separate guidance document (the "DPC Briefing Note") provides much more detail of the generic view of the process but is not meant to be a substitute for licence conditions. Therefore, to maintain the flexibility we believe may be required to successfully enact DPC Projects and manage them through their full lifecycle, we would welcome an approach where the published guidance provides undertakers and prospective CAPs clarity on how they are to proceed and protect customers long-term interests. Acting as a foundation, we believe the licence conditions should reflect the DPC principles at a high level and should not set an overly prescriptive framework or inflexible approach that we may find in time restricts or frustrates in some way the progression to execution of the necessary commercial arrangements that will underpin DPC Projects.

Achieving best value: A licence condition that places an obligation on water companies to ensure that best value for customers is achieved in the DPC procurement.

We agree the undertaker will be responsible for undertaking the procurement of a CAP. We also believe it is reasonable for the licence to place an obligation on the undertaker to ensure the procurement process delivers outcomes that are assessed as part of that process as achieving best value for its customers in the long-term.

Management of CAP: A licence condition to assure best management of the contract for customers throughout the life of the contract.

We currently have no objections to inclusion of a licence condition that requires an undertaker to manage the CAP Agreement in the best interests of customers over the term of that agreement, but we believe this condition should not require achievement of 'best value [for money]', as this will be hard to govern against an uncertain future environment.

By requiring undertakers to work in the 'best interests' of customers, this will ensure they are not be passive, but rather work within the boundaries of the CAP Agreement to deliver optimal outcomes, including consideration of commercial terms that may contain liability and penalty arrangements.

Designation of a DPC Delivered Project: Ofwat want to ensure that only suitable projects are procured through a DPC process.

We have no specific observations or comments on this proposed designation to be reflected in the licences of undertakers who already have DPC schemes reflected in their Final Determinations.

Requirement for written consent from Ofwat for the Appointee to undertake a DPC Procurement Process: Ofwat want to approve the planned DPC procurement process prior to it being undertaken.

We have no specific observations or comments on the proposal to include in the licences of relevant undertakers a requirement that a DPC Procurement Process shall not be instigated by the undertaker (including issuance of invitations to tender) until it has received a consent to do so from Ofwat.

We expect the associated detailed guidance published by Ofwat, and amended from time to time, will clearly explain the process for such consent being sought, expectations of undertakers in providing materials explaining the DPC project and the planned procurement process, and importantly the form and timescales for consent provision that Ofwat will reasonably adhere to.

Ofwat agreement required for a project to exit DPC: Ofwat want to agree to the exit of any project from the DPC regime.

Where a DPC Procurement Process fails or is irrevocably on the path to failure, and the undertaker is unable to appoint a CAP, we support the proposal that agreement from Ofwat should be sought to revoke the designation of the DPC Project ahead of exiting the DPC regime as the delivery mechanism for the scheme in question.

We expect the associated detailed guidance published by Ofwat, and amended from time to time, will clearly explain the process for such revocation consent being sought, expectations of undertakers in providing materials explaining the issues that have resulted in the failure of the DPC Procurement Process and that pursuing DPC with an alternative CAP organisation is not in customers best interests, and importantly the timescales for consent provision that Ofwat will reasonably adhere to.

Ofwat should not unreasonably withhold DPC revocation consent given designated DPC Projects are there to deliver major and critical schemes within the water companies plans to provide improved outcomes for current and future customers. A failed DPC Procurement Process will have already absorbed significant time and resources and an excessive delay in the provision of consent may put the alternative in-house delivery at a disadvantage.

Requirement for written consent from Ofwat for the water company to enter into a CAP Agreement: Ofwat want the water company to require its consent prior to entering into the CAP Agreement

We have no current objections to the principle that the undertaker should not formally enter into the negotiated CAP Agreement without first having the consent of Ofwat.

We expect Ofwat not to unreasonably withhold such consent and we would welcome that being made clear in the drafting of the licence condition.

Again, we expect the associated detailed guidance published by Ofwat will clearly explain the process and minimum information requirements for seeking such consent

and timescale for consent provision that Ofwat will reasonably adhere to. In practice, we believe an open and diligent DPC Procurement Process run by the undertaker would have shared with Ofwat details of key terms and conditions of the proposed agreement well ahead of the consent being sought.

It will be important to potential CAP organisations to see and understand the Ofwat consent gateways and associated criteria, so that they can prepare to engage and negotiate the agreement with the undertaker with clear knowledge that Ofwat consent will be a mandatory milestone.

Requirement for written consent from Ofwat for changes to be made to a CAP Agreement: Ofwat wants the water company to obtain consent from it to agree changes to a CAP Agreement where there is a potential material impact on customers' interests.

We have no current objections to the principle that the undertaker should not formally agree changes or variations to the price and non-price terms of the CAP Agreement that have the potential to have a material impact on customers' interests without first having the consent of Ofwat.

We expect Ofwat not to unreasonably withhold such consent and we would welcome that being made clear in the drafting of the licence condition. We therefore assume all non-material changes and variations can be made by the parties in accordance with the terms of the agreement without recourse to Ofwat, with the exception of a novation of the CAP Agreement in its entirety (where this represents a change in the Ultimate Controller of the CAP).

Again, we expect the associated detailed guidance published by Ofwat will clearly explain the process and minimum information requirements for seeking such consent and timescale for consent provision that Ofwat will reasonably adhere to.

Requirement for written consent from Ofwat for the extension of the term of the CAP Agreement: Ofwat wants to approve any extension of the CAP Agreement.

We have no current objections to the principle that the undertaker should seek consent from Ofwat prior to extending the term of the CAP Agreement beyond any pre-determined extension period already incorporated within the agreement, subject to meeting its obligations under the CA98, or UCR16.

We expect Ofwat not to unreasonably withhold such consent where it can be demonstrated the CAP Agreement has performed well in the customers interests and an extension remains an efficient option. Such consent must also be accompanied by a new or revised DPC Allowed Revenue Direction from Ofwat to align with the duration of the extension. We would welcome this being made clear in the drafting of the licence condition (added to clause 6.6. or 7.3 – for example: “*Ofwat may (having consulted the Appointee and the relevant CAP) by written direction modify or extend the DPC Allowed Revenue Direction from time to time*”).

DPC Allowed Revenue Direction: Ofwat needs to be able to issue a direction for the company to collect revenue associated with DPC

We have no overall objections to the proposed DPC Allowed Revenue Direction.

Although as reflected in the drafting, Ofwat is required to consult with the undertaker and the CAP ahead of making a modification to a DPC Allowed Revenue Direction, it does not need to gain both or either parties agreement to make a modification. Given the potential for significant charges and revenues associated with DPC Projects and CAP Agreements, we would like Ofwat to consider the inclusion of an appeals process that the undertaker and/or CAP could pursue should they believe a modification will have a material impact on the CAP Agreements viability or be detrimental to the long term interests of customers (whether they be served directly by the DPC Project or those of the undertaker in general).

Ultimate Controller of the CAP: Ofwat wants the water company to ensure that the CAP has obtained consent from the water company before a change in Ultimate Controller (UC). In turn the water company has to seek Ofwat approval for consent.

We believe this proposed licence condition may be unworkable in a number of scenarios and may be seen as overly restrictive to prospective CAP organisations wishing to explore opportunities the DPC regime can otherwise bring forward.

Potential bidders for DPC Projects could come from a wide range of organisations, including joint ventures and special purpose vehicles with a plethora of corporate structures involving multiple UC's. The corporate structure and visibility of the relevant UC's should be made clear in the CAP Agreement and we accept a condition placed on the CAP organisation to keep the undertaker (and by inclusion Ofwat) informed of possible UC changes, where feasible before they occur. Naturally, there may be commercial confidences to consider in sharing knowledge of UC changes in advance and CAP organisations may seek assurances from Ofwat outside the CAP Agreement around how such sensitive corporate ownership or influence information is handled and protected.

We therefore think this proposal should be altered to be an information notification requirement and no consent stage should be included. The view that there should be a licence condition confirming the restriction on Associated companies in relation to DPC Projects is dealt with effectively elsewhere in the proposals under this consultation.

Provision of Information: Ofwat wants 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.

In order to keep the licence changes simple and straightforward we would welcome clarification on how the existing information requirements in undertakers' licences fall short of what is viewed as necessary in this proposed new condition U11.

Where Ofwat requests information in relation to the DPC Project or the performance of the CAP, we expect Ofwat to apply a judicious approach to the appropriateness of the assurance required against timescales for the information to be provided.

Independent Technical Adviser: Ofwat expects the water company to support information provided to it with evidence from a technical expert

We have no current objections to the proposal that information furnished to Ofwat in connection with the procurement process and the CAP Agreement must, if Ofwat so requires, be supported by evidence provided by an independent technical expert appointed by the undertaker and approved by Ofwat.

Responsibilities of the Company: The water company will continue to be the responsible provider of water and sewerage services

We agree the water company will rightly 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.

Prohibition on entering into CAP Agreements with Associated Companies: Ofwat wants to ensure that companies do not enter into a CAP Agreement with an associated party.

We have no objections at this time to this proposal as it is consistent with Ofwat's DPC framework as detailed in its PR19 Methodology and confirmed in the Final Determinations for companies with DPC schemes and its guidance.

Requirement for written consent for Termination: Ofwat wants to be able to approve or prevent a water company terminating a CAP Agreement

We think it prudent for undertakers to seek Ofwat consent ahead of terminating an Approved CAP Agreement, given the potential risks for customers interests to be impacted by such action.

However, there is no provision as currently drafted for the undertaker appeal a decision by Ofwat not to give its consent to a termination request, subject to the risks on the interests of customers being mitigated.

We would welcome the addition of an appeals process that could be called upon on the rare occasion the undertaker and Ofwat did not concur on the best action for dealing with a failing Approved CAP Agreement.

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 is a clear incentive for the undertaker to manage an Approved CAP Agreement effectively and successfully. The CAP Agreement is the means for the undertaker to deliver

the intended benefits to its customers in the form of efficiencies, of performance improvements, of environmental protection improvements, or innovation.

We do not believe an additional incentive via a performance commitment with associated ODI is required.

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

We have not evaluated in any significant detail what materiality threshold could be applied to seek consent to vary an Approved CAP Agreement in a material way beyond the variations that may already be allowed within its price and non-price terms.

However, we believe it would be practical to have such a threshold set ahead of the CAP Agreement being signed off. It may be that such a threshold is specific to each individual CAP Agreement based on its value, term and complexity.

Our early thoughts are where a variation would result in the CAP charges relating to the remaining period over which the Agreement runs changing by more than +/-5% beyond that already allowed for under the Agreement, then consent for that variation to proceed should be sought.

The use of a threshold should not be considered to limit an undertaker engaging with Ofwat about proposed non-trivial variations to a CAP Agreement. However, we believe undertaker and CAPs should have flexibility to amend Agreements in non-material matters, for example:

- Change of payment process or terms.
- Technical scope change that doesn't materially introduce a new risk or increase an existing risk – especially if there no material cost changes.
- Addition of clauses to keep long-standing agreements up to date, such as new legislative requirements similar to modern slavery, GDPR, etc.
- A partial novation of the Agreement on existing terms, where it can be demonstrated there are no cost or performance degradations.

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

We believe it is appropriate for the water company to take the balance of the risk but that Ofwat should provide a secure and considered method for reversing out of a DPC Procurement Process or CAP Agreement should the circumstances require it, and be willing to allow the company to use these to protect the interests of all its customers.

Specifically, the water company should carry the following risks:

- The success of the DPC Procurement Process.
- The compliance of the DPC Procurement Process with the UCR16.

- That an active market exists for the services to be delivered.
- The performance of CAP under the CAP Agreement.

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

We are aware of the processes outlined in the DPC Briefing Note and believe these are well explained and sensible. We do not at this stage envisage these processes causing significant creating implementation issues for water companies or CAP organisations, as relevant.

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

We have assumed that where a CAP terminates the CAP Agreement and effectively exits from the DPC Project, this would lead to reversion of the scheme to in-house delivery, whether this was in a construction or active delivery phase.

We do not necessarily see this should be met with a new licence condition, but the guidance could be supplemented to outline Ofwat's expectations of both parties in such circumstances. If the revenues from the DPC Allowed Revenue Direction were still being recovered from customers, we would welcome clarity on whether these could be automatically retained by the water company to avoid the need for an Interim Determination.

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

We have made some observations and proposed drafting revisions against a select number of licence conditions as presented in the consultation document.

New Condition U – Direct Procurement for Customers (Generic)

Introduction – amend text under part (3) to read: “*use reasonable endeavours to achieve best value for customers.*”

Condition U5.1 – Add a sentence at the end stating: “*Nothing in this Condition should restrict the Appointees ability to meet the requirements of Condition U5.5.*”

Condition U6.3 – amend text to read: “*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~~ meets the customers best interests.*”

Condition U6.4 – amend text to read: “*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).~~*”

Condition U7.3 – amend text to read: “*Ofwat may (having consulted the Appointee and the relevant CAP) by written direction modify **or extend** the DPC Allowed Revenue Direction from time to time.*”

New Condition U7.5 – draft a new Condition that provides the Appointee or the CAP with a predetermined route to appeal a decision by Ofwat to modify or revoke the DPC Allowed Revenue Direction under Conditions U7.4 and U7.4.

Condition U9.1 – add text: “*The Appointee must not, without the prior written consent of Ofwat, terminate any Approved CAP Agreement. **Such consent will not unreasonably be withheld.***”

New Condition U9.6 - draft a new Condition that provides the Appointee with a predetermined route to appeal a decision by Ofwat not to provide consent to terminate an Approved CAP Agreement under Conditions U9.1.

Amendments to Condition B (Charges)

The proposed insertion of new sub-paragraph 10.2, requesting that 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. We would like to understand whether Ofwat believe there is value in providing a demarcation on customers’ bills for charges that relate to the collection of DPC Allowed Revenues? We understand the clause as drafted does not necessitate such an action, and we would wish to be consulted along with other stakeholders should Ofwat consider the presentation of DPC Allowed Revenues on customers’ bills.
