

July 2020

Consultation on the proposed amendments to licence conditions for Direct Procurement for Customers including an uncertainty mechanism

About this document

The document sets out our proposed amendments of the conditions of the appointments ('licence') of six water companies¹ in England and Wales (listed in table 1) in relation to delivery of schemes through our direct procurement for customers initiative. 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.

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. This is dealt with in Part B of this document.

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 is also dealt with in Part B of this document.

The third proposed modification would also amend Condition B to create a specific interim determination mechanism for changes to price controls in relation to direct procurement for customers. This is dealt with in Part C of this document.

This document is the second non-statutory consultation on the licence amendments required to implement schemes associated with direct procurement for customers. It takes into account responses to our initial consultation in February 2020, [Consultation on proposed amendments to licence conditions for Direct Procurement for Customers](#). In addition, this is an initial non-statutory consultation for the proposed licence amendments required to implement a specific interim determination process in relation to direct procurement for customers. The comments we receive in respect of this consultation will inform the statutory consultation on final modifications that we propose to publish later this year.

¹ 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.

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 by **5pm, Monday 3rd September**. You can also submit your response by post to:

DPC Proposed Uncertainty Mechanism
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. 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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PART A

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 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 to drive efficiencies.

Direct procurement for customers involves arrangements where a water company competitively tenders for services and appoints a third-party competitively appointed provider (CAP). This means companies tendering to deliver more aspects of a service, including most importantly financing for the project.

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 February 2020 we published our [Consultation on proposed amendments to licence conditions for Direct Procurement for Customers](#). In that consultation we proposed a new condition for DPC and invited stakeholders to provide comments on the proposals made. We discuss feedback received to those proposals in Part B. However most water companies noted that DPC was a package and that it was difficult to understand the new condition without having sight of Ofwat's proposals for amending the Interim Determination provisions of the licence and without further guidance on the Allowed Revenue Directions.

We accept the need to provide companies with greater clarity and we have included in this consultation updated proposals for amendments to the Interim Determination provisions and greater guidance on how we expect Allowed Revenue Directions to work.

Part B of this consultation summarises the comments made to our February consultation, and sets out how we have taken those comments into account.

Part C of this consultation deals with the proposal to amend the Interim Determination provisions.

Who the proposed licence amendments will apply to

We are only proposing amendments to the licences for those water companies where DPC schemes are, or there exists the possibility of a DPC scheme, being procured within the 2020-25 control period, as identified in [PR19 final determinations: Delivering customer value in large projects](#). Table 1 below lists these companies. This does not preclude other companies coming forward with suitable schemes within the 2020-25 control period and the same amendments to their licences could be proposed if appropriate.

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

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

We are looking for indicative consent to the amendments from the six affected companies, by close of this consultation.

2. Overview of proposed licence changes and other DPC regulatory documents

Overview of licence changes

Licence Change 1 – new Condition U

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 carrying out a DPC procurement. In particular it will have the following key features:

- Ofwat agreement will be required for the company to undertake a DPC procurement;
- Ofwat agreement will be required for the company to enter into a contract with the third party provider (the CAP Agreement); and
- It will provide for an Allowed Revenue Direction to be issued by Ofwat. This will allow the Appointee to collect CAP charges from customers. Once the Allowed Revenue Direction has been issued, Ofwat would not be able to vary it without the agreement of the water company.

Licence Change 2 – Amendment to Condition B for recovery of CAP Charge

The second proposed modification will allow a water company to recover from its 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 its customers for services provided by the CAP we need to amend the charging condition within the licence

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. -Ofwat will continue to assess the value for money throughout the decision gates.

Licence Change 3 – Amendment to Condition B for DPC Interim Determination

The third licence change will be an amendment to the Interim Determination in Condition B to allow in specified circumstances the return of the project to an in-house delivery.

We have reviewed the DPC process and the interaction with the Interim Determination mechanism laid out in Condition B Part IV. We consider that the standard Notified Item may not be suitable in all cases for addressing a change of circumstances driven by either an exit from the DPC procurement process due to market forces or an early termination of a CAP contract. We are proposing changes to the licence to address these potential events using an alternative mechanism that could be specifically triggered on the exit of a scheme from the DPC process.

Allowed Revenue Direction

The Allowed Revenue Direction is an instrument created by Condition U (the new DPC Condition). This document will codify the DPC CAP charges that the water company collects from customers for the DPC project. It is intended to mirror the CAP Agreement payment schedule where possible.

We provide further guidance on the Allowed Revenue Direction in [Appendix 4](#).

DPC Briefing Note

Alongside our February [Consultation on proposed amendments to licence conditions for Direct Procurement for Customers](#) we published a briefing note (the “DPC Briefing Note”). This outlines our minimum expectations for the DPC procurement process. We have updated the Briefing Note and provide this in [Appendix 5](#).

PART B

3. The new DPC Condition and the recovery of DPC charges in Condition B

Introduction

We are proposing three licence amendments. This Part B deals with the first two amendments – the new DPC condition and amendments to condition B for the recovery of the CAP charge. We consulted on the proposed amendments in February 2020, asking stakeholders for their views on a number of questions. From the water companies we received 14 responses – 10 from water and sewerage companies and 4 from water only companies. We also received responses from Bazalgette Tunnel Limited, two investment funds and one independent consultant. We have separately published their responses alongside this consultation. Some companies chose to provide their views more generally on issues around DPC rather than answer specific consultation questions.

In this Part, we summarise respondents' feedback and then provide an update on how the drafting has changed following our consideration of that feedback. We also provide, in Appendix 1, an updated draft of Condition U (the new condition) and, in Appendix 2, we provide an updated draft of the amendments to Condition B for recovery of the CAP charge.

Feedback to our February 2020 consultation

Consultation Question 1: Do you agree with the key aspects of the proposed licence amendments outlined above?

Most respondents understood the need for the licence changes. However many commented that without the associated proposals for a DPC specific Interim Determination and without further guidance on the Allowed Revenue Direction it was difficult to assess the new DPC licence condition.

On the licence conditions themselves, some respondents wanted greater clarity around the proposed process for varying the Allowed Revenue Direction. They argued that the proposed process provided too much discretion for Ofwat to vary the Direction without the agreement of the appointee. Concern was also expressed at

the various consents required by Ofwat in the process and the risk this presented for companies.

Other companies made broader comments on the complexity of the licensing framework and the DPC process. They argued that companies were already well placed to deliver these procurements and that additional regulation of the process was not needed.

Ofwat Response:

Ofwat recognises that this is a package and we have sought in this consultation to provide the additional material so that companies have more information to better understand the DPC process.

We are mindful of the regulatory burden and have reflected on the comments made. In light of this we have introduced some further changes to Condition U. However we believe that Ofwat's consent at the key points in the procurement is appropriate particularly given our statutory duty to protect customer interests. When Ofwat's consent is required, Ofwat will work with companies to ensure that we can respond in a timely manner. We believe that the licensing framework provides the right balance between the regulatory burden and achieving value for money for customers.

We also note comments from some companies that the industry is already well placed to deliver these procurements without further guidance. Whereas the industry has considerable experience in managing procurements for ongoing delivery of their capital programmes we do not agree that all companies have equivalent experience in managing procurements for major projects inclusive of financing. In addition, we consider that the regulatory changes are necessary to ensure that customers get the best value solution and to incentivise water companies.

Consultation Question 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?

Most stakeholders said that companies already have sufficient incentives to manage the CAP and that further Outcome Delivery Incentives (ODIs) are not necessary. Some companies commented that setting ODIs is not appropriate as these would be based on a third party contract where it was not sufficiently clear if the appointee could exercise control and therefore would be inherently difficult to establish

appropriate performance incentives. Other companies commented that any further ODIs could drive the wrong behaviour by focussing on short term cost gains which may not necessarily promote long term value

Ofwat Response:

Ofwat is seeking to ensure that DPC achieves best value for money for customers. We believe that water companies have a role to support the successful delivery of DPC projects and that they should not remain risk-neutral. We will work with companies to achieve value for money for DPC projects.

At PR19 we proposed ODIs for the three projects confirmed as being delivered by DPC. We will not propose any further ODIs for those projects. For all other projects identified as having potential for DPC at PR19 we will not propose any further ODIs for the 2020-25 control period. We will assess the suitability of ODIs for future projects as part of our PR24 methodology.

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

Most stakeholders commented that Ofwat's consent to variations of the CAP Agreement should be subject to a materiality threshold. In broad terms, water companies noted that without a materiality threshold, consent would be required for very small changes, creating an administrative burden. Whereas, for example, Thames Water agreed a materiality level would be helpful it said that this could be difficult to apply in generic terms as it could vary between projects. South West Water meanwhile commented that it would be preferable for the Allowed Revenue Direction to set out those lifecycle control points where Ofwat consent is required in advance, rather than employing materiality triggers. South West Water also commented that in their experience the wider use clauses which require third party consent to vary CAP Agreements could dampen market interest in DPC given the perceived potential risk by investors.

Ofwat Response

Ofwat recognises the concerns raised by the majority of stakeholders that consenting to all variations made to the CAP Agreement would create a significant burden. We also recognise that this would be perceived by investors as introducing additional risk.

We therefore are no longer proposing that Ofwat consent is required for variations to the CAP Agreement. However, our consent will be required if the variation changes the amount charged to customers under the Allowed Revenue Direction. The Allowed Revenue Direction will include change protocols. The CAP and the Appointee would be free to make any changes to the CAP Agreement but the Appointee would only be entitled to collect relevant revenues from customers for such changes if they have complied with the relevant licence conditions and the change protocol in the Allowed Revenue Direction.

Once issued, the Allowed Revenue Direction cannot be amended by Ofwat without the agreement of the Appointee. However the Appointee must comply with the Allowed Revenue Direction including obtaining consent, where appropriate, from Ofwat. We believe this is a fair set of measures which protects customer interests while not creating uncertainty for investors.

We have updated the Allowed Revenue Guidance as part of this consultation.

Consultation Question 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?

Most companies, broadly, stated that the risk should be no greater for the appointee than if the project was to be delivered in house. If the appointee was exposed to greater risk this would, they argue, destroy the incentive for the appointee to undertake DPC. Some companies added that the process transferred too much risk to the appointee while at the same time not giving the appointee additional reward. Thames Water went further still and argued that there was insufficient certainty that the appointee could recover all the CAP costs which would be legitimately incurred.

Ofwat Response

For the PR19 methodology we stated in general, that risk should be allocated to those parties who are best able to bear it and that customers should not be exposed to any further risk through DPC than if the project had been undertaken in-house. We will review allocation of risk to customers for future projects as part of the PR24 methodology. However we believe that companies should be taking some risk and that being risk neutral will not create value for customers. If companies do not take any risk then they will not be sufficiently incentivised to manage the CAP and deliver the relevant projects.

We recognise the concerns that companies have raised about too much risk being allocated to them and that this will reduce any incentive they have to undertake DPC. We have amended the licence to ensure that there is sufficient certainty around the process thereby reducing the risk on companies (for example, the Allowed Revenue Direction cannot be amended without the agreement of the Appointee). We have also provided further guidance on the Allowed Revenue Direction which gives examples of the types of risk we see companies undertaking for DPC. We believe that the mechanisms contained in the amended draft licence condition, including the Allowed Revenue Direction, strike the right balance of risk between CAP, Appointee and customers.

Consultation Question 5: Please provide your comments on the processes outlined in the DPC Briefing Note?

Dŵr Cymru and Affinity Water both commented that the Briefing Note was generally a helpful tool to support the process. Other companies noted the extent of the control points and expressed concern about consents and the impact this could have on the procurement timetable. Southern Water also commented on the interaction between DPC lifecycle stages and the RAPID² decision gates.

South West Water commented about the lack of clarity about appeal processes. This was on two aspects. Firstly Ofwat's role and authority in the CAP Agreement – particularly the role of Ofwat in dispute resolution under the Construction Act. Secondly, the process for resolution should Ofwat and a water company not agree a position.

Ofwat Response

Ofwat is intending to keep the Briefing Note as a tool to support the DPC process. We believe that this provides stakeholders with transparency about the process and sets our expectations for consents. We draw attention to the fact that Ofwat has engaged the industry in working groups throughout 2019 which included the sharing

² RAPID refers to Regulators' Alliance for Progressing Infrastructure Development (RAPID). This is pan regulatory body covering Ofwat, Drinking Water Inspectorate and Environment Agency formed to address water infrastructure issues. Further detail can be found at <https://www.ofwat.gov.uk/regulated-companies/rapid/>. Further information on decision gates referenced above can be found <https://www.ofwat.gov.uk/publication/pr19-final-determinations-strategic-regional-water-resource-solutions-appendix/>

of draft Briefing Notes. Feedback from the working groups was taken into account in developing the Briefing Note for the February consultation.

We understand company concerns that delays in Ofwat giving consent could frustrate the process. However we believe that this can be managed and that companies can set out their expectations for the procurement timetable early. As we have made clear to the industry working groups in 2019 the early sight of information ahead of a main submission is key to achieving turnaround in a timely manner. Ofwat is keen to support companies in developing DPC projects and will work with companies to achieve successful outcomes.

Ofwat understands companies' need for clarity with regard to appeals. We will consider further company feedback to this consultation but we are not currently proposing to create new appeal routes to the Competition & Markets Authority to resolve disagreements between Ofwat and companies as we do not consider it to be appropriate or proportionate. Companies will of course continue to have the ability to seek a judicial review of Ofwat's decisions if they consider it to be appropriate to do so.

We have amended the Briefing Note to ensure alignment with the revised licence conditions.

Consultation Question 6: If a CAP terminates the CAP Agreement with the water company should this be anticipated by the new licence condition?

Anglian Water and Dŵr Cymru both said that the existing interim determination in Condition B was not adequate for dealing with the termination of the CAP Agreement. They stated that an amended interim determination needs to be sufficiently flexible, with an appropriate materiality threshold. Other stakeholders commented that the costs associated with termination can be material and that companies will need to be able to recover these costs. Severn Trent Water suggested that the licence conditions should consider when the appointee can terminate the CAP Agreement, for example due to under performance.

Ofwat Response

We recognise that the current interim determination should be modified to deal with the above situation. Our proposed approach is set out in Part C and the proposed amendments to Condition B in Appendix 3.

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

We received many comments on the proposed wording for the new DPC Condition (Condition U). We have published stakeholder responses alongside this consultation.

Most comments received have been reflected in the previous consultation questions above. However United Utilities made an additional point stating that the licence and Allowed Revenue Direction should also address collection issues and enable the recovery of bad debt. As an example, the water company may not be able to recover the entirety of the CAP charge due to bad debt in their customer charging base.

Ofwat Response

We provide an update on changes to the new condition and why we have made them in the following section of this consultation.

We believe bad debt should be addressed as part of a price control methodology and aligned with the development of wider policy. We have set allowances for bad debt at PR19 inclusive of DPC projects so this should not leave companies unduly exposed.

Summary of revised drafting

Licence Change 1 - new condition U

In light of the feedback, we have revised our draft for Condition U. The revised drafting is set out in Appendix 1. We summarise below the main changes made and our reasons for making those changes.

No.	Issue	Changes made and our reasons
1	Achieving Best value	In our previous drafting we placed a requirement on the water company to achieve best value when undertaking a DPC. The feedback from stakeholders was that this was unnecessary as it is already implicit in the procurement under the Utility Contract Regulations 2016. We have therefore removed this from this updated draft. We continue to emphasize value for money and we will assess this is in our role during the lifecycle of the project.
2	Specified Infrastructure Project status	<p>We previously drafted the licence condition so that projects which had been designated as Specified Infrastructure Projects under the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 could not also be designated as DPC projects. We no longer consider this to be necessary. The designation of a project as a Specified Infrastructure Project will create separate legal obligations for the water company.</p> <p>It is important to note that we do not expect projects which have been designated as a Specified Infrastructure Project under the Regulations to be also designed for DPC.</p>

No.	Issue	Changes made and our reasons
3	Appointee responsibilities	<p>We have simplified the drafting on Appointees' responsibilities, removing a restriction that companies could not use the fact that a project was being delivered by a third party as a defence in a prosecution against the water company. Similar provisions were contained in the conditions of some companies, but as from 13 July 2020, those provisions have been deleted.</p>
4	Consent to amend the CAP Agreement	<p>In the drafting published in February 2020 we required water companies to obtain Ofwat's consent before the CAP Agreement could be amended. We received various comments about this including suggestions for a materiality threshold. Given the variation between projects we accept that a uniform approach may prove challenging.</p> <p>We have amended the drafting to allow the CAP and the Appointee to agree changes to the CAP Agreement without the need for Ofwat's prior consent. However, the Appointee will only be entitled to collect relevant revenues from customers in respect of such changes if it has followed the change control protocol set out in an Allowed Revenue Direction, which may require Ofwat consent.</p> <p>In addition, we have changed the drafting to require the water company to notify Ofwat of material changes of the CAP Agreement.</p>

No.	Issue	Changes made and our reasons
5	Ofwat determination of changes to the Allowed Revenue Direction	<p>A lot of the water companies expressed concern that under the drafting proposed in February Ofwat had too much discretion to limit CAP charges that were passed onto customers.</p> <p>We have amended this to provide that Ofwat cannot make changes to the Allowed Revenue Direction without the agreement of the water company, unless those changes are already anticipated by the change control procedures in an Allowed Revenue Direction.</p>
6	Ultimate Controller	<p>Our previous drafting required consent from the water company for changes to the ownership of the CAP. In feedback received stakeholders stated this could dampen market interest in DPC.</p> <p>We accept the concern and have amended the drafting to provide that Ofwat must be notified of any change of ownership (our consent will no longer be required).</p>
7	Provision of Information	<p>We have amended the requirements for provision of information so that there is better alignment with provisions already in the licence under Condition M.</p>

Licence Change 2 – Amendment to Condition B for recovery of CAP Charge

In the table below we outline the reasons for the amendment to Condition B for the recovery of the CAP charge and in the last column provide an update following the February consultation

Issue	What we need	Why we need it	Update from previous consultation
Pass through of CAP Charge	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.	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.	The need for the water company to recover the CAP charge is absolutely central to the DPC project. Companies stressed the need for water companies to recover the CAP charge. We have made some changes to how the Allowed Revenue Direction will work to ensure that both customers and water companies are protected. This is set out in Appendix 4

Consultation Questions – Part B

1. Do you agree with the key aspects of the proposed licence amendments outlined above in particular in respect of a) Licence changes 1, and b) Licence changes 2?
2. Please provide your comments on the proposed licence amendments set out in Appendix 1 and 2?
3. Do you have any comments on the Briefing Note?
4. Is there anything else that you wish to provide comment on associated to the proposals set out in this consultation document?

PART C

4. Proposed changes to the Interim Determination provisions of Condition B

Background

As part of our draft determinations for PR19, we proposed in July 2019 (see [PR19 draft determinations: Delivering customer value in large projects](#)) to allow for an uncertainty mechanism by which, in circumstances beyond its control, a company may seek appropriate recognition in price controls to deliver the scheme by way of a traditional in-house delivery process rather than through the expected DPC approach. We did so because we recognised that it was possible, albeit unlikely, that following our final determinations there is material change in circumstances, for example financial market conditions or changes in relevant legislation, which in changing the value for money assessment would justify revisiting the use of the DPC approach.

We requested views from stakeholder on two options for the form of the uncertainty mechanism:

- a) a Notified Item detailed in a company's final determination and which could, subject to relevant thresholds, lead to a change in the level of price controls through an interim determination, or
- b) the scheme costs incurred by a company during the relevant control period would be recorded and monitored for consideration at the next relevant price review and those costs deemed efficient would be added to a company's regulatory capital value (RCV).

We followed this proposal with our [Consultation on proposed PR19 uncertainty mechanisms in respect of Direct Procurement for Customers](#) in October 2019. In that consultation we stated that our preference was to utilise the interim determination mechanism under Part IV (Interim Determinations) of Condition B of water company appointments. We invited stakeholders' views on this approach and related issues, including materiality.

When we published our PR19 final determinations in December 2019 we explained in [PR19 final determinations: Delivering customer value in large projects](#) our decision that the appropriate uncertainty mechanism for the unlikely scenario in which

DPC schemes need to revert to in-house delivery during the 2020-25 price control period was a notified item that could be included in an interim determination. However we also recognised that interim determinations in their current form may have drawbacks for some schemes, which may make their application during the 2020-25 control period difficult. We therefore committed to consider the case for amending Condition B to introduce a specific interim determination process with bespoke criteria for DPC.

We are now proposing to amend Condition B to introduce a specific interim determination process (separate from the standard interim determination process) to address specific events within the DPC lifecycle to allow a water company to recover from customers the relevant incremental efficient costs that were not already allowed for within price controls. We provide in Appendix 3 the draft amendments to Condition B for the Interim Determination and we summarise the changes, and our reasons for proposing the changes, below.

Materiality and DPC Threshold in construction.

For PR19, the Final Methodology set a whole-life cost threshold at £100m for the consideration of a project for DPC. Water companies carried out analysis of their projects above this threshold and identified projects with initial capital costs above £60m which may deliver benefits to customers through a DPC procurement.

We identified that in some circumstances a scheme may need to transfer back into the traditional in-house model to ensure timely delivery, if there is material change in circumstances, for example, financial market conditions or changes in relevant legislation, which in changing the value for money assessment would justify revisiting the use of the DPC approach.

The normal interim determination mechanism in Condition B includes a requirement for the net present value of all eligible items (including any notified items) to collectively meet a materiality threshold equal to or exceeding ten per cent of the turnover attributable to the Appointed Business in the last financial year. For a number of companies this amount could be greater than the total initial capital cost or the predicted spend, on a larger project, in the relevant period.

Although there is a cost sharing mechanism for under and over spend within the period, due to the size and nature of these projects we consider that retaining the current materiality threshold would add more financial risk to water companies delivering the projects.

End of Contract final payments.

The assets being constructed are long-life with estimated useful lives of over 100 years in some cases. We believe that at the end of some direct procurement contracts there may be a final payment to the CAP from the water company reflecting the remaining economic value of the asset. This payment would be recognised within the water company's price controls under the normal business planning and regular price review cycle.

Compensation on termination or early termination payments

Based on the experience from other sectors, the early termination of a contract, whilst a low probability, may have a high financial impact. In this event, a final payment may still be due and timing may not align with the regulatory periodic review cycle. A Notified Item may not adequately address this eventuality, particularly with regard to the materiality. We consider that including terminal payments from early termination within the scope of a DPC specific interim mechanism is necessary and that this should reduce the Appointee's risk exposure in the future.

Stakeholder Confidence.

DPC is a new approach to water and wastewater infrastructure projects that offers opportunities to new and existing stakeholders. The long term nature of the schemes and contracts means that they span multiple price control periods and may raise a number of questions and some uncertainty about the future treatment of these assets and contracts stakeholders. The proposed amendments to Condition B and the new Condition U, give a clear framework on the treatment of these assets whilst designated as DPC projects. However, the treatment of the asset at the end of the contract is equally important to give all stakeholders confidence in the recognition of these assets within the regulatory environment. We therefore consider that introducing a specific interim determination mechanism that can deal with the costs and payments associated with termination will add a significant level of assurance for stakeholders and structure for future regulation.

Our proposals

The key elements of the proposed changes are:

Trigger: We are proposing that for DPC schemes a company would be able to initiate the DPC interim determination process if there is a revocation by Ofwat of the designation of a DPC delivered project under the new Condition U (a “DPC event”).

We consider that the revocation could happen at three distinct points:

- a) If during the procurement phase DPC no longer offers customer value over in-house delivery.
- b) At the early termination of the contract during the construction phase.
- c) At the termination of the contract during the operational phase, either early or at contract completion.

In relation to the last point, at early termination of the contract a final payment may be required, which may not have been covered by the Allowed Revenue Direction or a relevant price control determination. Alternatively, at contract completion a final payment may be part of the contractual agreement which we would expect to be allowed for in the relevant price control determination for the period. However, at handover there may be adjustments to the final payment. In either of these cases, an application for an interim determination may be necessary.

We are considering whether the revocation of an Allowed Revenue Direction should also be included as a DPC Event to provide additional reassurance and cover the possibility that this might occur before the designation of a DPC delivered project was revoked. We would welcome views on this possible addition and whether it would help ensure the proposed specific interim determination process works as intended.

Allowable costs: Under the proposed process Ofwat would need to determine the question of what change to the level of price controls for the remainder of the price control period would be required. We expect that the following efficient costs would be considered when assessing the necessary adjustments to the relevant price control(s):

- a) Efficient direct costs to complete the asset to an operational state, should it be under construction or in the procurement phases. These efficient costs may have been determined by competitive market testing.
- b) Payments to the CAP upon termination as specified in the contract for the asset, based on its condition, at handover or agreed subsequently upon termination during construction.
- c) Appointees’ consequential incremental costs associated with the DPC event.

For clarification, in general, we expect that a DPC asset will be brought into the Appointee's regulatory assets for allowed revenue after termination of a DPC contract unless a follow on CAP agreement is procured. We consider that a DPC contractual final bullet payment, based on the condition of the asset, should be included within the price control at the time. However, this will not always be possible and the proposed DPC specific interim determination mechanism is intended to cover the situation where price controls do not provide for the payment, for example due to early exit or where the final payment is different from the expected amount.

Materiality: The materiality threshold in the standard interim determination process is ten per cent of the turnover attributable to the Appointed Business in the latest financial year for which accounting statements have been prepared. We propose that for the DPC specific interim determination mechanism the materiality amount would be reduced to two per cent of the turnover. This is similar to the triviality test that has been applied to individual items in the standard interim determination process.

Timetable: We consider that the deadline and timetable for a DPC interim determination should be the same as for a standard interim determination. Using the procedure for a standard interim determination, a company will be able to apply at any time after a DPC event and Ofwat would have 3 months to make a determination. For applications made after 15 September in any year (unless Ofwat agrees to a later date) changes would not affect price controls for the following charging year and would have to be implemented in the subsequent charging year(s).

Reference to the Competition and Markets Authority: As for a standard interim determination, we propose that an appointee should be able to appeal to the CMA if it disputes Ofwat's determination or if Ofwat fails to make a determination.

Details of the proposed DPC specific interim determination mechanism

The proposed wording for the proposed mechanism is set out in Appendix 3.

The effect of the proposed licence amendment will be to include a new DPC Interim Determination mechanism in Condition B in addition to the standard and substantial effect interim determination mechanisms.

This will allow water companies or Ofwat to initiate an Interim Determination if a **DPC Event** occurs, subject to a lower materiality threshold. Items covered by the DPC interim determination mechanism will be excluded from the standard interim

determination mechanism even if they are currently notified items to avoid the possibility of any overlap.

End of Concession Payment

It is not unusual for transactions similar in nature to DPC for service providers to have an End of Concession payment. This is where a large payment by the procuring authority (which for a DPC would be the water company) is made to the service provider for the transfer of the asset(s) at the end of the contract. This allows the service provider to recover any residual cost of delivering the asset(s). End of Concession payments do not arise if the service is re-tendered or the service contract is extended (where for DPC this would be governed by the proposed Condition U).

Our proposal for a specific Interim Determination mechanism would also cover any End of Concession Payment by the water company should such residual costs arise. This is discussed further in [Appendix 4 – Guidance on Allowed Revenue Direction](#).

Consultation Questions – Part C

1. Do you agree with the key aspects of the proposed licence amendments outlined above?
2. Do you consider that adding the revocation of an Allowed Revenue Direction as an additional trigger would help ensure that the proposed specific interim determination process works as intended?
3. Please provide your comments on the proposed licence amendments set out in Appendix 3 and their wording?

5. Next steps

Once we have received and considered responses to this consultation, we intend to conduct a statutory consultation on the proposed licence amendments - in September 2020 (under section 13 of the Water Industry Act 1991). Following that statutory consultation, and subject to any further comments raised and final consent from the six affected companies, we aim to make the amendments to the licences of those companies in October 2020

Appendix 1: Proposed Drafting for Licence Change 1 – Condition U (new condition for DPC)

Revised Licence Modification – Condition U – Related to Direct Procurement for Customers

Definitions to be included in Condition A: Interpretation and Construction

“Approved CAP Agreement” means a CAP Agreement that has been consented to by Ofwat in accordance with sub-paragraph U5.1;

“CAP” means a limited company 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 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 an Approved CAP Agreement;

“DPC Allowed Revenue Direction” has the meaning set out in sub-paragraph U6.1 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 U1 of Condition U and which designation has not been revoked in accordance with sub-paragraph U1.1(3) of Condition U;

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

“Independent Technical Adviser” means the person appointed pursuant to sub-paragraph U11.1 of Condition U; and

“Ultimate Controller of the CAP” means any person who, whether alone or jointly and whether directly or indirectly, is in 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.

NEW CONDITION U – DIRECT PROCUREMENT FOR CUSTOMERS (DPC) (GENERIC)

Introduction

This Condition requires that, where the Appointee plans, procures, manages and carries out activities in respect of a DPC Delivered Project, the Appointee must:

- (1) obtain relevant consents from Ofwat; and
- (2) take appropriate steps to ensure its customers are protected.

1 Designation of a DPC Delivered Project

1.1 Ofwat may, with the consent of the Appointee, by direction from time to time:

- (1) designate an infrastructure project as a DPC Delivered Project;
- (2) modify the designation of a DPC Delivered Project (designated pursuant to sub-paragraph U1.1(1)); and/or

- (3) revoke the designation of a DPC Delivered Project (designated pursuant to sub-paragraph U1.1(1) or any modified designation of a DPC Delivered Project modified pursuant to sub-paragraph U1.1(2)).
- 1.2 As part of any direction issued pursuant to sub-paragraphs U1.1(1) and U1.1(2), Ofwat will set out in writing the scope (or, if applicable, the modified scope) of the DPC Delivered Project.
- 1.3 In this paragraph U1 “infrastructure” means infrastructure relating to:
 - (1) the provision of a system, or part of a system, of water supply, or the securing of supplies of water; or
 - (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.
- 2 Procuring a DPC Delivered Project
- 2.1 Save only to the extent otherwise approved in writing by Ofwat, the Appointee must:
 - (1) put a DPC Delivered Project (including the financing of such a project) out to tender in accordance with paragraph U4; and
 - (2) appoint a CAP (or more than one CAP) to undertake a DPC Delivered Project in accordance with sub-paragraph U5.1.
- 3 Appointee’s Responsibilities
- 3.1 The designation of a DPC Delivered Project, any consent issued by Ofwat (or failure to issue such consent) pursuant to this Condition U and the appointment of a CAP to undertake a DPC Delivered Project does not diminish the responsibilities, obligations or liabilities of the Appointee as a relevant undertaker in respect of the DPC Delivered Project (including, without limitation, pursuant to the Appointment).
- 3.2 The Appointee’s procurement of a DPC Delivered Project and its management of any Approved CAP Agreement must ensure that the Appointee is and continues to be able to carry out its functions as a relevant undertaker.
- 4 DPC Procurement Process
- 4.1 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 issued in stages, with consent issued for a prescribed stage of the DPC Procurement Process only. Further, any such consent may be conditional and, in carrying out a DPC Procurement Process, the Appointee must comply with any conditions imposed by Ofwat in commencing or undertaking any DPC Procurement Process.
- 4.2 Ofwat may withhold consent under sub-paragraph U4.1, including where it considers that a DPC Procurement Process (and any relevant proposed procurement documents, any proposed selection and evaluation criteria, any proposed procurement plans and the form and provisions of the proposed CAP Agreement to be put out to tender) is not likely to achieve best value for customers.
- 4.3 The Appointee must notify Ofwat in writing 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.
- 4.4 The Appointee must notify Ofwat in writing 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 CAP Agreement
- 5.1 The Appointee must obtain Ofwat’s prior written consent before entering into a CAP Agreement.

5.2 The Appointee must:

- (1) comply in all material respects with the terms of any Approved CAP Agreement; and
- (2) notify Ofwat in writing as soon as practicable of any material breach or non-compliance with any Approved CAP Agreement by the Appointee or the CAP

For the purposes of this sub-paragraph U5.2 a "material breach" or a failure to "comply in all material respects" shall include, without limitation, any instance of payment default or late payment.

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

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

5.5 The Appointee must notify Ofwat in writing in the event that an Approved CAP Agreement is (whether in whole or in part):

- (1) materially amended;
- (2) suspended; or
- (3) extended.

5.6 Any suspension, amendment or extension of an Approved CAP Agreement will not give rise to an automatic increase in DPC Allowed Revenue (except as expressly permitted in accordance with the DPC Allowed Revenue Direction). Where the Appointee seeks an increase in DPC Allowed Revenue as a result of any amendment, suspension or extension of an Approved CAP Agreement, the Appointee will be required to comply with the requirements of the DPC Allowed Revenue Direction, which may include obtaining Ofwat consent.

5.7 The Appointee must ensure that any Approved CAP Agreement requires the CAP to give to the Appointee all such information as may be necessary to enable the Appointee to comply with the requirements of the conditions of this Appointment (and any requirements for information related to any DPC Allowed Revenue Direction).

5.8 Unless the contrary intention appears, references in this Condition U to an Approved CAP Agreement include any modification of that Approved CAP Agreement.

6 DPC Allowed Revenue Direction

6.1 Ofwat, having consulted the Appointee, will issue a direction in relation to an Approved CAP Agreement setting out those amounts that the Appointee can collect from customers (whether related to CAP Charges or certain other amounts) ("DPC Allowed Revenue Direction"). Such direction may include, without limitation, those matters described in sub-paragraph U6.2 in relation to an Approved CAP Agreement.

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

- (1) the period of time for which the DPC Allowed Revenue Direction will subsist (and any conditions for extension of that period);
- (2) those matters that will require a report from the Independent Technical Adviser;
- (3) any forecast and outturn reporting that the Appointee is required to provide (and the process and Information requirements for such forecasts and outturn reports) in respect of the CAP Charges;
- (4) any adjustment to the DPC Allowed Revenue to reflect the time value of money;
- (5) the commencement date (and/or the method for determining the commencement date) for the collection of DPC Allowed Revenue;

- (6) arrangements in respect of any over/under collection of the relevant DPC Allowed Revenue by the Appointee;
 - (7) those categories of CAP Charges (and any other amounts) eligible for inclusion as part of the Appointee's DPC Allowed Revenue;
 - (8) those categories of CAP Charges (and any other amounts) that may be eligible for inclusion as part of the Appointee's DPC Allowed Revenue provided that relevant amounts are approved by Ofwat from time to time (as well as the process that Ofwat will apply when considering such CAP Charges);
 - (9) any Information or evidence (including reports by the Independent Technical Adviser) that Ofwat may require prior to agreeing any amounts as part of the Appointee's DPC Allowed Revenue; and
 - (10) those categories of CAP Charges that will not be eligible to be included in the Appointee's DPC Allowed Revenue.
- 6.3 Ofwat may, with the consent of the Appointee, by direction, modify a DPC Allowed Revenue Direction issued pursuant to sub-paragraph U6.1 from time to time. The Appointee's consent will not be required for any decisions Ofwat takes pursuant to or in accordance with a DPC Allowed Revenue Direction.
- 6.4 Where any Approved CAP Agreement is terminated or expires Ofwat may (having consulted the Appointee and the relevant CAP) by direction revoke the relevant DPC Allowed Revenue Direction.
- 7 Ultimate Controller of the CAP
- 7.1 The Appointee must maintain and keep up to date and in written form, accurate information about the Ultimate Controller(s) of the CAP.
- 7.2 The Appointee must inform Ofwat in writing where it becomes aware that:
- (1) arrangements are in progress or in contemplation which, if carried into effect, may lead to a change to the Ultimate Controller(s) of the CAP; or
 - (2) arrangements have been put into effect which might be considered to have led to a change to the Ultimate Controller(s) of the CAP.
- 8 Termination of an Approved CAP Agreement
- 8.1 The Appointee must notify Ofwat in writing where any Approved CAP Agreement is terminated.
- 8.2 The Appointee must notify Ofwat in writing as soon as practicable if any circumstances arise which may reasonably be considered likely to lead to the termination of an Approved CAP Agreement.
- 8.3 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 in accordance with the relevant DPC Allowed Revenue Direction that it has not already passed on to the relevant CAP, and the Appointee must comply with any such direction.
- 8.4 The direction given by Ofwat under sub-paragraph U8.3 may relate to all revenue collected by the Appointee in accordance with the relevant DPC Allowed Revenue Direction 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 under the DPC Allowed Revenue Direction.
- 8.5 The termination of any Approved CAP Agreement will not automatically result in a revocation of any designation of a DPC Delivered Project or a DPC Allowed Revenue Direction.

9 Associated Companies

- 9.1 The Appointee must not, without the prior written consent of Ofwat:
- (1) bid in its own DPC Procurement Process;
 - (2) permit an Associated Company to bid in the Appointee's DPC Procurement Process; or
 - (3) award a CAP Agreement to an Associated Company.
- 9.2 For the purposes of sub-paragraphs U9.1(1) and U9.1(2) to "bid in the Appointee's DPC Procurement Process" includes each of the following:
- (1) submitting a bid in its own name;
 - (2) being part of any consortium or group of entities submitting a bid; or
 - (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).
- 9.3 Save where Ofwat consents in writing to any alternative arrangement, the Appointee must not and must procure that any Associated Company does not undertake any DPC Delivered Project (or any part thereof) as a contractor (or sub-contractor of any tier).

10 Information

- 10.1 For the purposes of this Condition and Condition M, 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" includes all information that any CAP holds or can reasonably obtain.

11 Independent Technical Adviser

- 11.1 In relation to each DPC Delivered Project the Appointee (whether jointly with the CAP or otherwise) must appoint an Independent Technical Adviser, approved by Ofwat.
- 11.2 Any Information furnished to Ofwat in connection with a DPC Allowed Revenue Direction must, if Ofwat so requires, be accompanied by a written report from the Independent Technical Adviser verifying the Information.
- 11.3 The report referred to in sub-paragraph U11.2 must be in such form and address such substance as may be specified by Ofwat, and must be consistent with any guidelines issued by Ofwat.
- 11.4 The Appointee must enter into a written contract of engagement with the Independent Technical Adviser which must:
- (1) set out that the responsibility for the costs associated with any services provided by the Independent Technical Adviser must be paid by the Appointee and/or the CAP;
 - (2) set out that, the Independent Technical Adviser has a duty of care to Ofwat (such right must be directly enforceable by Ofwat);
 - (3) include a term that the Independent Technical Adviser will act in accordance with good industry practice;
 - (4) require the Independent Technical Adviser, its employees and agents to keep confidential and not to disclose, except to Ofwat, the Appointee and the CAP or as required by law, any information which the Independent Technical Adviser obtains in the course of preparing its report;
 - (5) where required by Ofwat under sub-paragraph U11.2, require the Independent Technical Adviser to submit reports to Ofwat; and
 - (6) include a term that the Independent Technical Adviser will provide such further Information, explanation or clarification in respect of any report furnished to Ofwat, as Ofwat may reasonably require.

- 11.5 The Appointee must (and must include a requirement in any Approved CAP Agreement that the CAP must) co-operate fully with the Independent Technical Adviser to enable it to prepare any report, including without limitation, so far as is necessary for that purpose:
- (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
 - (2) subject to reasonable prior notice, allowing the Independent Technical Adviser at reasonable hours:
 - (a) 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;
 - (b) to carry out inspections, measurements and tests on or in relation to any such premises or assets; and
 - (c) 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.
- 11.6 Nothing in paragraph U11 will require the Appointee or the CAP:
- (1) to do anything which is outside its reasonable control; or
 - (2) to allow the Independent Technical Adviser to do anything which would materially disrupt the Appointee's (or CAP'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).

Appendix 2: Proposed Drafting for Licence Change 2 – Amendments to Condition B for recovery of CAP Charges for DPC projects

Proposed Amendments to Condition B related to Direct Procurement for Customers

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.”

New Definition to be inserted in to Condition A: Interpretation and Construction

“**DPC Allowed Revenue**” means, in relation to any Charging Year, the total of the CAP Charges (and such other amounts) 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).

Appendix 3: Proposed Drafting for Licence Change 3 – Amendments to Condition B for DPC specific Interim Determination

Drafting for possible interim determination provisions to cover circumstances in which DPC projects are brought in-house

[Note: Reference to paragraph numbers of Condition B is to Condition B of a WaSC other than HDD. For any paragraph number greater than 2 deduct 1 to get the equivalent paragraph number of Condition B for a WoC or HDD.]

Draft licence modifications:

1. Insert the following paragraph into Part IV. Interim Determinations of Condition B:

“15A Interim Determinations relating to DPC Delivered Projects

15A.1 Where the designation of a DPC Delivered Project is revoked pursuant to paragraph [U1.1(3)] of Condition U (the “**DPC Event**”) the Appointee may refer to the Water Services Regulation Authority for determination by it the questions set out in sub-paragraph 15A.2. Such reference shall be made by notice to the Water Services Regulation Authority and, unless the Water Services Regulation Authority otherwise consents, shall be given not later than the fifteenth day of September immediately preceding the first of the Charging Years in respect of which the Appointee wishes the change to the level of a Price Control or Price Controls to take effect.

15A.2 All of the following:

(1) whether the DPC Event has or will have a relevant effect on the Appointed Business (and for this purpose an effect shall not be regarded as relevant in any

case unless, if the questions set out in sub-paragraph 14.2 were to be asked in relation to the DPC Event, the answer to that in 14.2(7) (taking the reference in it to ten per cent as a reference to two per cent) would be in the affirmative); and

(2) if so, what change to the level of a Price Control or Price Controls over the period beginning with the first of the Charging Years referred to in sub-paragraph 15A.1 (in a case where a Reference Notice has been given in respect of sub-paragraph 15A.2) or sub-paragraph 15A.3 (in any other case) until the first of the Charging Years for which the next Periodic Review falls to be carried out is appropriate as a consequence of the DPC Event.

15A.3 Where the designation of a DPC Delivered Project is revoked pursuant to paragraph U1.1(3) of Condition U the Water Services Regulation Authority may, having given notice to the Appointee of its intention to do so no later than the fifteenth day of September immediately preceding the first of the Charging Years in respect of which it proposes the change to the level of a Price Control or Price Controls to take effect, determine the questions set out in sub-paragraph 15A.2.

15A.4 For the purposes of sub-paragraph 15A.2 a single reference may be made, and a single notice may be given, in respect of any number of DPC Events and sub-paragraph 15A.2 shall be construed accordingly.

15A.5 References in this Condition to Relevant Changes of Circumstance, Notified Items and Relevant Items shall be taken, for the purposes of any Interim Determination, to exclude any item notified by the Water Services Regulation Authority to the Appointee as not having been allowed for (either in full or at all) in making a Relevant Determination to the extent that the Water Services Regulation Authority could allow for that item in making a determination of the questions set out in sub-paragraph 15A.2. ”

Consequential and related changes to ensure that the existing deadline and CMA reference provisions also apply to Interim Determinations relating to DPC Delivered Projects:

2. Amend the definition of “Reference Notice” in Condition A (new text shown underlined, deleted text shown as strikethrough):

“means a notice given to Ofwat under paragraph 11, or 14 or 15A of Condition B”

3. Amend the definition of “Interim Determination in paragraph 2 of Condition B (new text shown underlined):

“means a determination by the Water Services Regulation Authority of the relevant questions pursuant to a reference by the Appointee under paragraph 14 or pursuant to paragraph 15 or 15A or, as the case may be, a determination by the Competition and Markets Authority of the relevant questions or of a disputed determination subject to a reference to it pursuant to paragraph 16 that relates to a reference by the Appointee under paragraph 14 or a determination pursuant to paragraph 15 or 15A”

4. Amend paragraph 16.1(2) to insert “or paragraph 15A” after the first reference to “paragraph 14”.

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