

November 2020

**Direct procurement for customers:  
Statutory consultation on  
proposed changes to the  
conditions of appointment of five  
water and sewerage companies**

## About this document

The document sets out our proposed amendments to the conditions of appointment ('licence') of five water companies<sup>1</sup> in England and Wales (listed in [table 1](#)). The proposed amendments deal with the delivery of large infrastructure schemes through Ofwat's Direct Procurement for Customers initiative ('DPC'). 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.

This document and the attached appendices is a Notice under section 13 of the WIA91. Accordingly, it sets out the proposed licence modifications and their effect and sets out our reasons for proposing these modifications. It also invites comment on these proposals.

**Part A** of this document provides an overview of the licence changes and other regulatory documents being introduced to give effect to DPC. It also lists the five water companies whose conditions of appointment are being modified.

**Part B** of this document summarises the proposed modifications and their effect and sets out our reasons for proposing each modification.

We have already conducted two non-statutory consultations on the issues raised in this document. **Part C** of this document summarises the responses received to the second of those consultations and sets out how we have taken those responses into account in finalising this statutory consultation.

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

## Responding to this consultation

We invite stakeholders to comment on our proposed modifications by 4th January 2021. Companies should also indicate their agreement or otherwise of the proposed modifications by this date. You can email your responses to the address below.

Please send your responses to [DPC@ofwat.gov.uk](mailto:DPC@ofwat.gov.uk).

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

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

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## PART A

### 1. Introduction

Direct procurement for customers (DPC) involves a water company competitively tendering for services in relation to the delivery of certain large infrastructure projects, resulting in the appointment of a third-party competitively appointed provider (CAP). DPC will result in companies competitively procuring more aspects of an infrastructure project, including financing for the project. We believe that by outsourcing the delivery of infrastructure projects using DPC, companies can achieve significant benefits for customers. This includes both innovation and lower whole life costs of the project.

We set out in our [2019 price review \(PR19\) methodology](#) that we expected company business plans to consider 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 a non-statutory consultation - [Consultation on proposed amendments to licence conditions for Direct Procurement for Customers](#). In that consultation we proposed a new condition to enable us to regulate DPC projects, and we invited stakeholders to provide comments on the proposals made. We discuss feedback received to those proposals in Part C of this document. In their responses, most water companies commented 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 mechanism for recovering the CAP charges from customers - the Allowed Revenue Direction.

We therefore published a further non-statutory consultation in July 2020 - [Consultation on the proposed amendments to licence conditions for DPC including an uncertainty mechanism](#). This provided updated proposals on the provisions we had previously consulted on, and it proposed introducing a bespoke DPC interim determination. It

also sought to provide clearer guidance on how we expect Allowed Revenue Directions to work. Finally, it set out how we had addressed the responses received to our first non-statutory consultation.

Subsequent to publishing the July consultation we have engaged with the five companies impacted by these changes and have made further changes to our proposals to address various concerns raised by them.

**Part B** of this document summarises the licence modifications being proposed, and **Part C** summarises some of the comments received to our July 2020 consultation and sets out how we have addressed those comments.

## Who the proposed licence amendments will apply to

As set out in our previous consultations, we are only proposing amendments to the licences of those water companies that are, or are likely, to procure DPC schemes within the 2020–25 control period, as identified in [PR19 final determinations: Delivering customer value in large projects](#).

In our earlier consultations we said that we were proposing to amend Bristol Water’s licence conditions. In response to our July consultation, Bristol Water indicated that it was not prepared to accept the proposed licence amendments as it was still unclear whether their project identified for DPC delivery, should be delivered through DPC.

We will work with Bristol Water to understand its concerns when we have greater clarity on the progression of the relevant project. We have therefore agreed not to amend its licence conditions at this stage.

**Table 1** below lists the companies whose licences are proposed to be modified for DPC. This does not preclude other companies coming forward with suitable DPC 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**

<b>Water and sewerage undertakers:</b>	<b>Water only undertaker:</b>
<ul style="list-style-type: none"><li>• Anglian Water Services Limited</li><li>• Dŵr Cymru Cyfyngedig (Welsh Water)</li><li>• United Utilities Water Limited</li><li>• Southern Water Services Limited</li></ul>	<ul style="list-style-type: none"><li>• Affinity Water Limited</li></ul>

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

### Overview of licence changes

#### Licence Change 1 – new Condition U

The first proposed licence change is a new condition which 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
- The Condition 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 will not be able to vary it without the agreement of the water company.

A number of new definitions will be required for the proposed new Condition U and for the proposed changes to Condition B (summarised below). These new definitions will be included in Condition A (Interpretation and construction). Proposed changes to Condition A are set out in [Appendix 1](#) and the new Condition U is set out in [Appendix 2](#).

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

The second proposed licence change 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.

Owat will safeguard customer interests and ensure that value for money is achieved through a gated process whereby Owat's consent is required at key stages of the development of the DPC project. 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. Owat will continue to assess whether the project offers value for money throughout the various decision gates.

The proposed amendment is set out in [Appendix 3](#).

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

The third licence change will be an amendment to the interim determination provisions in Condition B. This will facilitate, in specified circumstances, the return of the project to delivery by the company rather than by the CAP.

We consider that the current interim determination provisions in the licence 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. In our July consultation, we proposed 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. Since then we have considered comments made by companies that there should be additional triggers for a DPC interim determination. We agree with these comments and the proposed drafting now lists various circumstances which could give rise to a DPC interim determination.

The effect of the proposed licence change 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 more appropriate materiality threshold for DPC. Items covered by the DPC interim determination mechanism will be excluded from the standard interim determination mechanism even if they are currently notified items. This will avoid the possibility of any overlap.

The changes to Condition B to give effect to a DPC interim determination are set out in [Appendix 4](#).

### **Allowed Revenue Direction**

The Allowed Revenue Direction is an instrument that will be created by Condition U (the new DPC Condition). The Allowed Revenue Direction 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. In our July consultation we provided further guidance on the Allowed Revenue Direction.

### **Guidance**

As part of our July consultation, we published a briefing note (the “DPC Briefing Note”). This outlined our minimum expectations for the DPC procurement process.

Since then we have engaged with companies about also issuing guidance – both generic for all projects, and specific guidance for particular projects. The purpose of guidance will be to provide greater regulatory certainty about how we intend to regulate DPC projects. It will also address one of the critical issues raised by companies in response to our July 2020 consultation, namely: providing greater regulatory certainty that end of contract payments due to the CAP will be recoverable from customers.

We propose consulting on changes to the briefing note and draft generic guidance separately.

## PART B

### 3. The modifications proposed and our reasons for proposing them

#### Introduction

In this part we summarise the proposed licence modifications, setting out the effect of each modification and why we propose making these changes. The full text of the proposed changes is attached in Appendices to this document.

A number of new definitions are required to give effect to the licence changes. These are set out in amendments to Condition A, and are attached in [Appendix 1](#).

#### Inserting a new condition U (Direct procurement for Customers)

We propose introducing a new condition to regulate DPC projects. We set out below in greater detail what we consider is needed in Condition U and why these changes are considered necessary.

Issue	What we need	Why we need it
<b>General:</b>	A licence condition to regulate DPC projects to enable us to ensure that customer interests are protected.	It is important a DPC project is in customers' interests and represents best value for money. The new Condition U will put in place appropriate controls in order to give Ofwat oversight over the delivery of a DPC project. Ofwat will not undertake the procurement. It will review the procurement process proposed and will provide consent at key stages to ensure the interests of customers are protected and the project being procured represents best value for money for customers.

Issue	What we need	Why we need it
<b>Designation of a DPC Delivered Project</b>	We want to ensure that only suitable projects are procured through a DPC process.	If we agree with a company that a project should be delivered through DPC, we will designate that project as a DPC project. The effect of designation will be to clearly set out the scope of the project being procured. Ofwat will only be able to assign designated status to a project with the consent of the water company.
<b>Procuring a CAP</b>	Once a DPC project has been designated, the company must take steps to procure a CAP.	We believe that if projects have been agreed as being suitable for DPC then the appointee must make good its commitment and complete the procurement. This will ensure that customers have the opportunity to gain the benefits of DPC.
<b>Appointee responsibilities</b>	The water company will continue to be the responsible provider of water and sewerage services.	The company will continue to be responsible for meeting its statutory and licence obligations as a water company. The proposed licence changes make clear that the appointment of a CAP will not change these obligations.
<b>Ofwat consent to undertake the procurement</b>	Companies will not be able to commence a DPC procurement without our consent.	To ensure customers are protected and that potential benefits of the procurement are maximized, Ofwat consent will be required before the company can go to market. We will review a company's procurement plan to ensure it achieves best value for money for customers. If companies' proposals are deficient, and in order to protect customers, we will withhold consent.
<b>Requirement for written consent from Ofwat for the water company to enter into a CAP Agreement</b>	Companies will require Ofwat consent prior to entering into a CAP Agreement.	As a DPC procurement process enters preferred bidder stage further discussions with the prospective CAP may take place – which could include negotiations on key points in the draft CAP Agreement. To protect the interests of customers we need to ensure that any key clauses have not been compromised

Issue	What we need	Why we need it
		and that if additional clauses have been introduced, they are beneficial for customers.
<b>DPC Allowed Revenue Direction</b>	Ofwat will issue a DPC Allowed Revenue Direction to enable the water company to collect revenue from customers for a DPC delivered project.	The DPC Allowed Revenue Direction will provide the legal basis for a company to collect CAP charges from customers. The CAP Charge is not determined under a price control and a direction from us is therefore required to enable companies to collect CAP Charges from customers.
<b>Ultimate Controller of the CAP</b>	We need the water company to keep us informed about changes in the ownership of the CAP.	This is needed to protect customers' interests if there is a change in ownership of the CAP.
<b>Requirement for written notification on termination of the CAP Agreement</b>	A company will have to notify us if it seeks to terminate a CAP Agreement	The termination of a CAP Agreement may have a significant detrimental impact upon customers' interests. To protect customers the water company will need to notify Ofwat before termination.
<b>Prohibition on entering into CAP Agreements with Associated Companies</b>	We want to ensure that companies do not enter into a CAP Agreement with an associated party.	Consistent with our Contract Principles for the PR19 Methodology, any associated companies of the Company may not bid in a DPC procurement process or be appointed as the CAP.
<b>Information</b>	We need relevant and appropriate information to monitor the progress of the project. This will include, where relevant, information pertaining to the payment mechanism and charges to customers.	To ensure customers are protected we will require relevant information and the water company will be required to report to us on both its own and the CAP's activities and costs. We expect water companies to include information clauses in the CAP Agreement which enable accurate reporting from the water company and the CAP.
<b>Independent Technical Adviser</b>	We expect the water company to support information provided to Ofwat with evidence from a technical expert.	We see an Independent Technical Adviser (ITA) as having a crucial assurance role. This will protect customers by ensuring that reported information is assured and/or verified by an independent party.

## Amendments to Condition B (Charges)

In the table below we outline the reasons for the proposed amendments to Condition B. These amendments are to provide for the recovery of the CAP charge and to introduce a DPC specific Interim Determination.

Issue	What we need	Why we need it
<b>Pass through of CAP Charge</b>	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; and these in turn are recovered by a water company through charges to customers. Without a licence amendment, a company would have no legal basis for charging its customers for the CAP charges.
<b>DPC interim determination: general</b>	There needs to be a mechanism for funding water companies if a project that has been designated for delivery via DPC is brought back in-house because of a failed procurement; because the designation of the project or the Allowed Revenue Direction have been revoked or because the Approved CAP Agreement is terminated or expires.	Interim determinations are required to ensure companies can finance their functions if an unexpected event occurs between price reviews. We consider that companies need certainty that they will be funded if a DPC project is brought back in-house.
<b>Threshold for DPC interim determination</b>	We need to set a threshold to determine when a company can bring a DPC interim determination. The threshold must be set at a level that takes into account the different scale of projects relative to the size of the water companies delivering the project and that prevents trivial applications being brought to us for determination. We consider that the lesser of 2% of turnover or £10 million is an appropriate threshold.	The normal interim determination mechanism has a threshold of 10% of the company's turnover. 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. A bespoke interim determination is therefore required with an appropriate threshold.
<b>End of Contract final payments.</b>	We need the interim determination in place in the event there is an early termination of a CAP Agreement.	Based on the experience from other sectors, the early termination of a contract, whilst a low probability, may have a high financial impact.

Issue	What we need	Why we need it
		In this event, a final payment may still be due and timing may not align with the regulatory periodic review cycle.

## PART C

### 4. Responses to our July 2020 consultation

We provided an updated consultation on the proposed amendments in our July 2020 document, titled: [Consultation on the proposed amendments to licence conditions for Direct Procurement for Customers including an uncertainty mechanism](#). From the water companies we received eleven responses – ten from water and sewerage companies and one from a water only company. We also received responses from Transmission Capital (an investor with experience of renewable energy including electricity Offshore Transmission). We have separately published the responses received alongside this consultation.

In this Part, we summarise some of the respondents’ feedback received and provide an update on how the drafting has changed following our consideration of that feedback. Of the five affected companies, two welcomed the proposals and had no further comments on the drafting. They both indicated their consent to the modifications. The other three had further comments which we worked through with them in subsequent engagement. We have now addressed their additional concerns and all five companies have provided indicative consent to these modifications.

#### Feedback to our July 2020 consultation

Companies’ two primary concerns were:

- the interim determination provisions and in particular, the triggers for an interim determination and the 2% of turnover threshold for qualifying to bring an interim determination; and

- getting greater clarity from us on how end of contract payments due to a CAP would be funded on the early termination or expiration of a CAP Agreement.

In addition, the following concerns were raised:

- i) A number of companies raised concerns about Ofwat’s discretion to revoke a project’s designation as revocation of designation was the sole proposed trigger for the interim determination. They also said that the licence should deal with a partial revocation – that is where part of project could be retained as DPC while another part de-designated and transferred back in house.
- ii) One company raised concerns about the vagueness of the concept of ‘best value for customers’.
- iii) Companies were concerned about Ofwat’s discretion in issuing the Allowed Revenue Direction and required assurance that that all aspects of the CAP charge will be recoverable under the Allowed Revenue Direction.
- iv) Some companies wanted greater clarity that water companies’ own costs associated with DPC projects would be recoverable.
- v) There was comment on the extent of Ofwat’s regulatory oversight in Condition U, with companies expressing concern at the regulatory burden that the process could impose upon them.
- vi) Companies also asked for greater clarity on the role of the Independent Technical Adviser (ITA). Specifically it was not clear at what stage in the DPC lifecycle should the services of the ITA be used and that Ofwat should clarify whether this included during the procurement process.

## Ofwat Response

We have reflected on the feedback received and have made a number of further changes to the drafting which we summarise below.

## The DPC interim determination

We have extended the triggers for the interim determination mechanism. We have also changed the threshold for the interim determination.

A number of respondents said that the triggers for the DPC interim determination should include the revocation of an Allowed Revenue Direction; the revocation of DPC designation; the termination or expiry of the CAP agreement; and other change events.

We have considered the various scenarios raised by companies and have amended the drafting to include the following triggers:

- a failed DPC procurement;
- where the designation of a DPC Delivered Project has been modified or revoked;
- where a DPC Allowed Revenue Direction has been revoked; and
- the termination or expiration of an Approved CAP Agreement.

We consider that this range of triggers will allow companies sufficient access to the licence mechanism for the situations where projects need to be brought back in-house for delivery by the relevant water company or back into their ownership at the end of a DPC contract.

## End of contract payments

End of contract payments are CAP Charges but they are recoverable via normal price review processes rather than via the Allowed Revenue Direction. We have amended the drafting to clarify that “any CAP Charges that are payable as a consequence of the termination or expiration of an Approved CAP Agreement to the extent that those CAP Charges have not been included as part of the Appointee’s DPC Allowed Revenue” will be recoverable via the price review process or an interim determination.

We have also said that we will issue the following guidance:

**General Guidance** – this will be relevant to all water companies undertaking a DPC delivered project and will provide assurance about the recoverability of certain CAP Charges via future periodic reviews or (if applicable) an interim determination;

**Specific Guidance** – this will relate to specific DPC delivered projects and will be issued when we issue the relevant DPC Allowed Revenue Direction. This will set out any circumstances where Ofwat would not allow the water company to recover from customers as part of any future periodic review or (if applicable) interim determination, (whether in full or in part) any applicable:

- payment due at the expiration of the Approved CAP Agreement in respect of the residual value of the regulated asset; and
- payments due upon early termination of the Approved CAP Agreement.

### Other issues

- i) We consider that the issue of a partial revocation is adequately dealt with in that the designation of a DPC project can be modified, with the company's consent. This means that we can remove some of the scope of the original designation, so that the balance of the project is delivered in-house.
- ii) We consider that the concept of 'best value for customers should remain in the licence although we have agreed to remove the concept from the procurement provisions as companies must in any event comply with the Utility Contract Regulations 2016 and our approval to a procurement plan is required.
- iii) With respect to the Allowed Revenue Direction we consider that companies are protected in that the Allowed Revenue Direction will be developed to align with the payment mechanisms set out in the CAP Agreement. A draft of the Allowed Revenue Direction will be available when the project is put out to tender so there will be no surprises in our approach.
- iv) We understand companies' concerns around greater clarity for recovery of their own costs. At PR19 we made allowances for companies to manage and develop their DPC projects for the duration of the control period. We are committed to allowing the recovery of efficient costs associated with

managing DPC projects. We will provide further guidance on this in due course.

- v) In respect of the concern about regulatory burden we iterate that we are seeking to keep the process flexible where we can, and minimise the administrative burden. We draw attention to feedback provided by other stakeholders that has flagged the process as being helpful. As this is new for the water industry it is important an appropriate process supported with sufficient guidance is developed. We believe our process provides a clear framework for all stakeholders, including water companies and CAP investors, whilst protecting the interest of customers.
- vi) On the role of the Independent Technical Adviser (ITA), we will revise our guidance in the Briefing Note to make it clear that a water company is not a required to appoint an ITA for the procurement.

## 5. Next steps

Responses to this consultation must reach us by no later than 4th January 2021. The five companies whose licence conditions are being modified must also indicate by that date whether or not they accept the modifications proposed.

Subject to agreement, and having taken into account any comments received in relation to this consultation, we aim to amend the companies' licences in **mid-January 2021**.

## Appendix 1

### Proposed modifications to Condition A (Interpretation and construction)

#### These definitions are relevant for Condition U and for the modifications to Condition B

“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” means, in relation to any Charging Year, the total of the CAP Charges due to be paid to one or more CAPs by the Appointee in that Charging Year (and any such other amounts) that are recoverable in accordance with a DPC Allowed Revenue Direction;

“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.

## Appendix 2

### New Condition U: Direct Procurement for Customers (DPC)

#### 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
- (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 any instance of payment default or late payment other than an instance of payment default or late payment that is trivial in nature by reference to its significance for the CAP.

- 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 Save where Ofwat agrees otherwise, 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;
  - (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 and in accordance with a DPC Allowed Revenue Direction.
- 6.4 Where the period for which a DPC Allowed Revenue Direction is stated to subsist (as set out in a DPC Allowed Revenue Direction) has expired, Ofwat may (having consulted the Appointee and the relevant CAP) by direction, revoke the relevant DPC Allowed Revenue Direction. For the avoidance of doubt, when Ofwat is conducting a Periodic Review the circumstances which are relevant in the light of the principles which apply by virtue of Part I of the Water Industry Act 1991 include, without limitation, any CAP Charges that are payable as a consequence of the termination or expiration of an Approved CAP Agreement to the extent that these CAP Charges have not been included as part of the Appointee's DPC Allowed Revenue.
- 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, provided that the Appointee shall not be in breach of this sub-paragraph 10.1 or Condition M (insofar as such sub-paragraph and condition impose obligations that relate to Information held by the CAP or that the CAP can reasonably obtain) where it has used all reasonable endeavours to obtain any Information the 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) subject to reasonable exceptions set out in the contract of engagement, 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 U11.5 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 its report).

## Appendix 3

### Proposed amendments to Condition B for recovery of CAP Charges for DPC projects

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

“1.7 To permit the Appointee to levy charges for the purpose of collecting any DPC Allowed Revenue for the relevant Charging Year.”
2. Delete sub-paragraph 9.1 and replace it with the following:

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

  - (1) comply with the Price Control or Price Controls determined by the Water Services Regulation Authority pursuant to sub-paragraph 9.3 or sub-paragraph 9.4; and
  - (2) collect any DPC Allowed Revenue (which shall not be included in the Price Control or Price Controls).”
3. Exclusion of DPC projects from price controls through a change to sub-paragraph 9.4(1) (proposed new text shown highlighted and underlined):

“(1) In respect of the Appointed Business's Water Resources Activities, Bioresources Activities, Network Plus Water Activities and Network Plus Wastewater Activities except for those activities for which there are Excluded Charges or, to the extent that CAP Charges are recoverable in accordance with a DPC Allowed Revenue Direction, 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.”

## Appendix 4

### Proposed amendments to Condition B to introduce a DPC specific Interim Determination

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

“15A Interim Determinations relating to DPC Delivered Projects

- 15A.1 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 a DPC Event has occurred;
  - (2) if so, whether, under sub-paragraph 15A.4, the DPC Event has or will have a relevant effect on the Appointed Business;
  - (3) if the DPC Event has or will have a relevant effect on the Appointed Business, 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 to the Authority under this paragraph) 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 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(2), an effect will only be regarded as relevant if the questions set out in sub-paragraph 14.2 (after excluding sub-paragraph 14.2(3)(i)(E))<sup>2</sup> were to be asked in relation to the DPC Event and the Materiality Amount was equal to or exceeded the lesser of £10 million or two per cent of the turnover attributable to the Appointed Business in the latest financial year for which accounting statements have been prepared and delivered to the Water Services Regulation Authority under Condition F, as shown by those accounting statements, and for this purpose where the Materiality Amount is a negative figure it shall be treated as though it were a positive figure.

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<sup>2</sup> This will provide that in answering the questions in sub-paragraph 14.2(3) “(i) no account shall be taken of: [...] or (E) any costs, receipts or savings that are associated with a DPC Delivered Project.”

- 15A.5 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.6 For the purposes of this paragraph a “DPC Event” is any of the following:
- (1) where a DPC Procurement Process is, for reasons outside the reasonable control of the Appointee, no longer in the best interests of customers;
  - (2) where the designation of a DPC Delivered Project has been modified pursuant to sub-paragraph [U1.1(2)] of Condition U or revoked pursuant to sub-paragraph [U1.1(3)] of Condition U;
  - (3) where a DPC Allowed Revenue Direction has been revoked pursuant to sub-paragraph [U6.4] of Condition U;
  - (4) the termination or expiration of an Approved CAP Agreement.
- 15A.7 In determining the question set out in sub-paragraph 15A.2(3) in circumstances where an Approved CAP Agreement has been terminated or has expired, the Authority must, without limitation, consider what change to the level of a Price Control or Price Controls is appropriate in relation to CAP Charges payable as a consequence of the termination or expiration of the Approved CAP Agreement to the extent that those CAP Charges have not been included as part of the Appointee’s DPC Allowed Revenue.

- 15A.8 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.  
We regulate the water sector in England and Wales.**

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