

June 2021

Direct Procurement for Customers (DPC) – Reasons for designating certain components of Anglian Water’s Elsham Transfer and Treatment scheme a DPC Delivered Project

About this document

At the 2019 Price Review (PR19), we introduced a new delivery model – Direct Procurement for Customers (DPC) – to introduce greater competition into the delivery, financing, ownership and operations of large infrastructure projects. Where projects are suitable for delivery under DPC, we are able, with the agreement of the relevant water or sewerage company, to designate the project as a project that must be delivered via the DPC mechanisms. Once designated, the project must be competitively tendered by the relevant water or sewerage company.

In February 2021, we amended Anglian Water's conditions of appointment (licence) to regulate delivery of infrastructure projects via DPC. Amongst other things, a new condition U sets out the process and requirements for designating a project for delivery by DPC and changes to condition B allow a company to apply for an interim determination if a designation is revoked or modified.

A designation notice must set out the scope of the project that must be put out to tender. At PR19, we initially considered that all elements of Anglian Water’s Elsham Transfer and Treatment scheme should be delivered via DPC. Subsequently, we have agreed with Anglian Water that only parts of the scheme should be delivered by DPC, with the remaining components being delivered in-house by Anglian Water.

In order to give effect to the decision, it has been necessary to first designate the whole of the scheme and then to modify that designation so that only parts of the scheme are delivered via DPC. This process is necessary to enable Anglian Water to bring an interim determination to us requesting an allowance in price limits for those components that will now be delivered in-house.

This document is a notice under section 195A of the Water Industry Act 1991 (the Act), setting out our reasons for our decision to firstly designate the whole scheme, and then to modify that designation notice to reduce the scope of the scheme to be delivered via DPC.

Both the [notice](#) designating the whole Elsham Transfer and Treatment scheme and the subsequent [notice](#) modifying that designation, are on our website.

Contents

1. Background	3
2. Reasons for issuing a designation notice	5
3. Reasons for modifying the designation notice	6

1. Background

At the 2019 Price Review (PR19) we introduced Direct Procurement for Customers (DPC) in order to introduce competition into the delivery of large infrastructure projects. The approach requires companies to put out to competitive tender large infrastructure projects where delivery by a third party is likely to offer better value for money for customers. A Competitively Appointed Provider (the CAP) may be appointed to design, build, finance, operate and maintain the relevant infrastructure. We set out in our 2019 price review methodology that we expected water company business plans to consider DPC for the delivery of large projects against the following three eligibility criteria:

- Size (approximately £100m or more whole life totex);
- Discreteness of the project; and
- Value for money for customers.

At PR19, five projects were identified where DPC is likely to offer better value for money for customers. Three projects are currently being developed for delivery via DPC, namely:

- Anglian Water: Elsham Transfer and Treatment scheme
- Dŵr Cymru: Cwm Taf Water Treatment Works
- United Utilities: Haweswater Aqueduct Resilience Programme.

In February 2021, we modified five companies’ licences to give effect to the DPC delivery model, establishing the framework for the regulation of DPC projects and allowing Ofwat, with the agreement of the water company, to designate a project as a DPC Delivered Project and require the company to deliver the project via DPC.

In order to be delivered as DPC projects, these three projects will need to be designated by us under these new licence conditions.

The new licence conditions also allows us to modify a designation notice and introduces new grounds allowing companies to apply for an interim determination. This enables us to provide companies with an allowance for delivery in-house, if a decision is taken to reduce the scope of the designated project.

We have also published separate [guidance](#) on the process companies should follow to develop and deliver DPC projects. The guidance sets out the various stages and control points companies must pass through before procuring the project and awarding a contract to the CAP.

1.1 Elsham Transfer and Treatment Works

At PR19, Anglian Water requested funding for the Elsham Transfer and Treatment scheme, which will comprise of a large transfer pipe, a conditioning plant, and a water treatment works. Anglian Water requires the scheme to enable it to:

- Ensure it is resilient to meet 1 in 200 year droughts by March 2025
- Contribute to the alleviation of forecast supply demand deficits across its region
- Enable it to meet its statutory environmental obligations by March 2025

At PR19, we accepted the need for the scheme and determined that it was suitable to be delivered via DPC. We therefore did not provide an allowance for the company to deliver the scheme itself, but rather required the company to put the project out to competitive tender for a third party to design, build, finance, operate and maintain the scheme. We instead allowed £9.4m for Anglian Water to design the project and to put it out to tender.

Following our final determinations in December 2019, Anglian Water said that it considered delivery of the full scheme by DPC would not allow it to meet its statutory environmental obligations by March 2025 and it asked that it be permitted to deliver the transfer pipe and conditioning plant components of the project in-house. After discussions with the Environment Agency and Anglian Water, we have agreed to this request and Anglian Water will be submitting an application for an interim determination to us in order to obtain funding for it to deliver in-house the transfer pipe and conditioning plant components of the project.

Under condition B of Anglian Water’s licence, a company can request an interim determination in relation to a DPC project, where we modify a DPC designation. Therefore, to enable the company to submit an application for an interim determination, we must first designate the full project before modifying the designation to remove certain elements of the project from the scope of the designation notice.

Accordingly, we have issued two notices. The first is a designation notice designating Anglian Water’s Elsham Transfer and Treatment Scheme as a DPC Delivered Project under condition U1 of Anglian Water’s licence. The second notice is a designation modification notice, modifying the first notice to reflect the more limited scope of the project that is to be delivered via DPC. In accordance with section 195A of the Act, this document sets out the reasons for issuing both notices.

2. Reasons for issuing a designation notice

Following engagement with Anglian Water on the Elsham Transfer and Treatment scheme, we are designating it a DPC Delivered Project under licence condition U1 for the following reasons:

1. **Size:** Anglian has provided sufficient evidence that the project is of a size that means the increased costs of the DPC procurement process are likely to be offset by the benefits from DPC. At PR19, we advised companies to use a threshold of £100m whole-life totex to identify projects that may be suitable for DPC. While not a hard threshold, the value of the total Elsham Transfer and Treatment scheme met this threshold.
2. **Discreteness:** While the project is complex with multiple interfaces, Anglian Water’s PR19 Business Plan submissions provided sufficient evidence that the project is of a suitable level of technical discreteness to allow it to be delivered, owned and operated by a CAP.
3. **Value for Money:** Anglian provided evidence that delivery via DPC was likely to offer better value for money for customers compared to delivery by Anglian Water. Its value for money assessment of the DPC route compared to the in-house counterfactual identified that DPC could provide potential benefits to customers of between £13.8m and £15.9m compared to delivery by Anglian Water.

3. Reasons for modifying the designation notice

Following engagement with Anglian Water and the Environment Agency on the Elsham Transfer and Treatment scheme, we have modified the first designation notice of the Elsham Transfer and Treatment scheme to remove the conditioning plant and transfer pipe from the scope of the designation, leaving the water treatment works component to be delivered by DPC.

Our reasons for modifying the designation are:

1. There is a risk that requiring the conditioning plant and transfer pipe to be delivered by DPC could result in late delivery of the project, with knock on implications for the environment and customers.
2. Delivery via DPC of the remaining component of the scheme, the water treatment works, is still likely to deliver better value for money for customers than in-house delivery.

(1) Risk of late delivery and impact on the environment and customers

Anglian Water has provided evidence that delivery of the full Elsham Transfer and Treatment scheme by DPC mechanisms, may threaten Anglian Water's ability to meet certain statutory environmental obligations by March 2025. The deadline of March 2025 is when Anglian Water will have a number of abstraction licences removed by the Environment Agency. If the Elsham Treatment & Transfer scheme is not in place by this date, Anglian Water will no longer be able to meet the Environment Agency resilience requirements for a 1 in 200 year drought scenario.

Given the complexities of the full scheme and that DPC is a new delivery model, we accept there are risks of late delivery if the transfer pipeline and conditioning plant are delivered by DPC. This could result in Anglian Water being unable to meet its environmental obligations, negatively impacting the environment and customers.

We understand from Anglian Water, that the risk profile of the water treatment works is different from the conditioning plant and transfer pipeline and there is little risk of late delivery if the water treatment works is delivered by DPC.

(2) Delivery of the remaining DPC Delivered Project, the Water Treatment Works, by DPC is likely to continue to deliver better value for money for customers.

While the whole-life totex for the water treatment works only scheme is estimated to be below the £100m whole-life totex benchmark, Anglian has provided evidence that continuing to deliver the water treatment works by DPC is likely to offer better value for money for

customers than delivery by Anglian Water. Its value for money assessment of the DPC route compared to the in-house counterfactual identified that DPC could deliver potential benefits to customers of between £3.3m and £4.3m compared to delivery by Anglian Water.

In addition to value for money, Anglian Water has provided sufficient evidence that the Water Treatment Works is still a suitable level of technical discreteness to allow it to be delivered, owned and operated by a CAP.

Conclusion and next steps

Accordingly, we have issued a designation notice for the whole project, and a subsequent notice reducing the scope of the project so that only the water treatment works will now be delivered via DPC. As delivery of the conditioning plant and transfer pipeline will now be done by Anglian Water, it will submit an application for an interim determination. We anticipate publishing draft determinations on its application by the end of June 2021 with final determinations following by the end of July 2021.

**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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