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FAQ Document for RAPID Investor Workshop 2022

Throughout the RAPID investor workshop, there was open Q&A on Slido. Below are the completed responses from Ofwat and RAPID to the questions that were asked throughout the day.

RAPID schemes

Q: How much certainty is there in the planned construction dates?

A: Certainty of planned construction dates will vary by project according to where the project is in its development phase. For example, there is a high degree of certainty around the dates for the HARP project which is currently out to procurement. Other projects such as those currently going through the RAPID process (e.g., the Hampshire Water Transfer and Water Recycling scheme) are earlier in the development phase and therefore dates may be subject to change.

Q: How will the deals be staggered to ensure that not too many come through at once, but equally there is momentum behind it?

A: We will consider how the pipeline of projects going to market can be staggered, however, we do need to be mindful that the projects will be driven by companies' specific needs e.g., to address a future water supply deficit. This could limit how much the pipeline can be staggered. We also expect companies to be exploring this issue in their market engagement with investors and the supply chain, and companies should be seeking to understand market capacity to bid for and deliver the projects, and how the procurement timetable may need to be flexed to get a better response from the market.

DPC and SIPR

Q: Why is DPC or SIPR better than in-house delivery?

A: Both SIPR and DPC can deliver greater benefits for customers through increased investment in water infrastructure. These competitive models for infrastructure delivery can open the market to new participants and they have the potential to drive lower costs, develop greater innovation and build resilience.

While Ofwat's regulatory regime is successful at challenging monopoly companies' performance and efficiency – however, in some areas, such as the delivery of major infrastructure projects, competition can deliver greater benefits for customers.

It is also the case that the current mechanisms available in price controls may need to develop bespoke regulatory settlements for these types of projects as we set out in the [PR24 Draft Methodology](#) (Page 79).

Additionally, where there are no recent precedents/benchmarks for large projects, it can be difficult for a regulator to effectively challenge companies' proposed costs. DPC and SIPR addresses this issue through setting customers' bills based on actual market-tested financing and delivery costs, rather than based on companies' estimates.

Q: How do you ensure that the in-house knowledge and capability of the water companies is not side-lined in DPC?

A: Delivery through DPC has the ability to enhance companies' skills rather than detract from them. The size and complexity of the schemes delivered under DPC are of a scale that most companies do not have recent experience in delivering, and in the case of the RAPID projects, companies may not have delivered similar schemes since privatisation. A third-party provider, who is better equipped and experienced in the delivery of major infrastructure, offers benefits to the company as well as customers e.g., through allowing the company to focus on provision of core services and reducing the risk to the core business from management distraction. We expect companies and the industry more generally will benefit from the introduction of new participants and the innovation and best practice they will bring with them.

Q: Who decides between SIPR and DPC?

A: Where companies consider SIPR may be more appropriate, we expect them to engage with us on the drivers for using SIPR over DPC, including whether it meets the current legislative requirements to using SIPR and whether it can offer best value for money for customers. As Ofwat has a formal role in specifying projects under the Water Industry (Specified Infrastructure Projects) (English Undertaker) Regulations 2013, we would need to agree with the company's analysis before proceeding to specify a project for delivery under SIPR.

Q: Does Ofwat expect SIPR to replace DPC or run in parallel with it?

A: We expect them to exist in parallel and DPC and SIPR can offer significant benefits over in-house delivery. SIPR, however, generally has higher set up costs as well as regulatory costs over the life of the asset. Therefore, we expect most projects to be delivered by DPC, and SIPR to only be used for the larger more complex projects (including where direct regulation may offer advantages) and where the potential benefits offset the higher costs.

Q: For DPCs, does this mean Ofwat are expected to be a licence holder and in future be regulated?

A: Under DPC, we are not able to licence competitively appointed providers (CAPs) and they will not be regulated directly by Ofwat. Under SIPR, we will directly regulate the

infrastructure provider and the project, and we will licence the infrastructure provider – the current example of this is Tideway for the Thames Tideway Tunnel.

Q: The recent DPC guidance is noted. How far away do you think standardised documentation is?

A: Standardised documentation is not likely to be developed in the short-term given the model is still in its nascent phase – one project is out to procurement, and another is expected to be tendered next year – and that a variety of different projects and asset types are being developed for delivery under DPC. However, as more projects go out to tender and reach financial close, we will look for where we can develop greater standardisation, including whether standardised parts of documents/agreements can be developed. It should be noted however that we expect the market to drive standardisation alongside our DPC guidance and it is likely that future projects will look to the pathfinder projects when developing their individual project documentation.

Q: Ofwat referred to 'legislative threshold' for using SIPR. Please can more explanation of this threshold be provided?

A: The Water Industry Act 1991 and the Water Industry (Specified Infrastructure Projects) (English Undertaker) Regulations 2013 provide that the Secretary of State or Ofwat may only require a company to put an infrastructure project out for delivery under "SIPR" where:

- the infrastructure project is of a size and complexity that threatens the incumbent water company's ability to provide services to its customers; and
- specifying the project is likely to result in better value for money for customers than would the case if the infrastructure project were not specified.

Q: You mentioned there is limited scope for SIPR. Can you provide some example potential projects for the use case?

A: The only project to date that has been specified for delivery under SIPR is the Thames Tideway Tunnel. In 2015 we published guidance on the factors we would take into account when assessing whether a project could be specified under the regulations: [Criteria for selecting specified infrastructure projects](#).

Q: How confident are you that SIPR will be reformed?

A: We consider that there is a strong case for amending SIPR, and we are currently engaging with Defra and BEIS on this. However, we expect that any changes to legislation are likely to take considerable time and resources and so are unlikely to be in place in the short term.

Q: What are the rules on water cos and investors in water cos bidding? Is it different if project does / does not serve the water co in question?

A: Under DPC the incumbent water company must not, without the written consent of Ofwat:

- Bid in its own DPC procurement process – including submitting a bid in its own name, being part of any consortium submitting a bid, or being named in any bid as the entity undertaking the DPC project
- Award a CAP agreement to an associate company

There are similar prohibitions in place under SIPR that would prevent the incumbent company and its associates from bidding and delivering a specified infrastructure project within the incumbent's area unless they have the consent of Ofwat or the Secretary of State. In deciding whether to consent, the Secretary of State or Ofwat may only consent if they are of the opinion that the participation of the associated company in the tender process will not have the effect of distorting competition or breaching the principles of non-discrimination or transparency in the process.

The reason for the prohibition on water companies and its associates bidding for and delivering infrastructure projects, is to prevent real or perceived conflicts. Conflicts may relate both to the bidding process (where other interested parties may be dissuaded from bidding, leading to weak competitive pressure and poor value for customers) and to the management of the contract (where the sole focus should be achieving the best outcome on behalf of customers).

Companies can bid for projects out of their area of appointment (i.e., outside of the area covered by their licence) where they are not expected to be a beneficiary of the project but will have to deliver this as non-appointed business.

There is nothing to prevent an investor in a water company bidding in a procurement conducted by that water company unless the investor is an associate company of the water company. Under SIPR and under a water company's licence conditions, an associate company is either a group company or a related company and a related company is any undertaking in which that undertaker has a participating interest.

Q: How is the market responding to HARP?

A: UU has shortlisted bidders to participate in the next stage of the tender process and have provided a link to the press release: [United Utilities shortlists three consortia for next stage of HARP tender process.](#)

Q: Is it the intention that the upcoming DPC projects have an embedded target cost scheme as is the case in HARP?

A: Given market conditions and complexity of infrastructure being procured, it might not be possible or value for money to transfer all the risk of cost overruns to the CAP. Therefore, in our recent draft guidance document on the development of DPC projects, we have said that we expect companies to consider cost incentivisation models such as a target price. We expect companies to demonstrate that any proposed model represents best value for customers.

Q: A highlighted customer benefit of DPC is the uncovering info about the project cost. Would it mean target-cost, or similar open book scheme, will be a standard?

A: Not necessarily, while open book evidence of actual projects costs is helpful, the primary benefit we are referring to is the benefit from basing customer bills on marketed tested costs (including cost of finance). Normally during a price review, we would carry out benchmarking to test the efficiency of companies plans. However, it is difficult to benchmark large projects, particularly where the project is of a type that hasn't been delivered for some time and this can result in customers overpaying. Therefore, customers will benefit from paying market tested prices regardless of whether the project uses a target cost or fixed price approach.

Q: In DPC projects where a DBF scheme is expected, do you think that the interest could be less than in the case of DBFO schemes, and also the competitiveness?

A: It is likely that the interest in DPC will vary between models and projects. For example, DBFOM of a water recycling plant is likely to attract interest from a different range of market participants, than say DBFM of a large, gravity fed water transfer project with relatively little operations and maintenance.

While DBF is an untested model in the UK water industry, variants of the model exist elsewhere internationally, and we consider on the right project that a DBF model underpinned by the DPC framework will be an attractive proposition and attract sufficient interest.

Q: What happens if a competitive BWACC above the regulatory WACC is achieved? Is this politically acceptable?

A: Assessing the value for money (VfM) of DPC to in-house delivery will take into consideration a wide range of assumptions in deriving the benefits and does not solely focus on the bid WACC. There are many different factors that can impact how a project may outturn which will affect the VfM assessment, many of which companies will not be able to estimate with any reasonable level of certainty when it assesses the value for money of bids. For example, we can't easily predict what the allowed WACC will be at future price reviews under in-house delivery, or how the project might outturn in terms of cost performance.

Therefore, the VfM assessment seeks to understand the range of possible outcomes and determine a VfM envelope for the project rather than focus on one element of it.

Q: How have you arrived at a 40% VfM saving against water companies delivery?

A: The 6-40% estimate of potential benefits from a DPC delivery model is based on a range of value for money assessments across a range of different projects. Each project has its own scenario analysis which will result in a broad range of outcomes, and this is what the estimates have been based upon. However, we note these are only desk top studies at this stage.