

April 2024

# **Direct Procurement for Customers – Ofwat’s reasons for modifying the conditions of appointment of six water companies.**

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## 1. About this document

This is a notice under section 12A(9) of the Water Industry Act 1991 (**the Act**), providing reasons for our decision to modify the licences of six companies to give effect to Ofwat’s Direct Procurement for Customers (**DPC**) initiative.

On 6 February 2024, we commenced [a consultation](#) to amend the conditions of appointment of five water and sewerage companies and one water only company (referred to collectively below, as **water companies**). The purpose of the modifications is to facilitate delivery of large infrastructure schemes through DPC.

We had five responses to the consultation; these were from five of the companies whose licences are being amended. No response was received from the sixth company, but they did respond to an earlier informal consultation, and we took their one drafting comment into account in issuing the statutory consultation. Following the responses from the five companies, we have made one minor change to the wording of the amendments.

We have now amended the conditions of appointment for all six companies. In accordance with section 12A(9) of the Act, this document:

- confirms the decisions and sets out the modifications made;
- states the effect of the modifications;
- states how we have taken account of representations made; and
- states the reason for differences between the modifications made and the modifications we consulted on.

## 2. Background

Background information on DPC is set out in the consultation document and is summarised briefly below.

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

DPC was introduced before the 2019 price review. The [2019 price review \(PR19\) methodology](#) set out that we expected water company business plans to consider DPC for large infrastructure projects where this was likely to deliver the greatest value for customers. Our [2024 price review methodology](#) continued with the DPC model and stated that water companies should use DPC by default for any discrete projects with a whole life totex over £200m. There has been a significant increase from PR19 to PR24, in the number of major projects in the water sector that have been proposed to be delivered by DPC.

In 2021 we amended the conditions of appointment (licences) of five water companies. The purpose of the modified provisions was to enable DPC delivery. We have now introduced those new DPC provisions into the licences of the following six companies:

- [Severn Trent Water Limited](#)
- [South East Water Limited](#)
- [South West Water Limited](#)
- [Thames Water Utilities Limited](#)
- [Wessex Water Services Limited](#)
- [Yorkshire Water Services Limited](#)

### 3. The modifications

The licence modifications were set out in full in Annex 1 of the consultation document. In summary there are three categories of changes which are all required to enable water companies to deliver large infrastructure projects via DPC.

#### ***Licence Change 1 – new Condition U***

The first licence change is a new condition which enables Ofwat to regulate DPC projects. Amongst other things, the new condition will specify the process which companies must follow in carrying out a DPC procurement and sets out Ofwat's role during a DPC procurement.

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

The second licence change will allow a water company to recover from its customers, outside of price controls, the designated charges that the water company must pay to the CAP for services.

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

The third licence change is an amendment to the interim determination provisions in Condition B of the relevant companies’ licences allowing for a bespoke DPC interim determination. The triggers for this bespoke interim determination include when a project is brought back in house for delivery by the water company rather than by the CAP.

## **4. The effect of the modifications**

These modifications enable a competitive procurement process for delivering major projects. It is expected that this will promote innovation and achieve better value for money for customers. Ofwat will not directly regulate the third-party provider (CAP) but the licence provisions enable us to indirectly regulate the project via the water company by setting out provisions that must be in the project agreement between the water company and the CAP; by requiring the appointment of an independent technical assessor for each project; and by giving Ofwat consent rights in respect of various project gateways.

The license modifications will allow companies to charge customers for the costs associated with the appointed CAP. These charges will be set via the competitive process rather than via price controls.

The license amendments introduce a new interim determination. This provides companies with the assurance of funding should a DPC project be bought back in-house, whether partially or completely.

## **5. Reasons for modifications**

In the February 2024 consultation document, we provided our reasons for our proposal to modify the licence conditions of the affected companies.

In summary our reasons for making the changes are:

- to protect customers, the new condition U puts appropriate controls in place, giving Ofwat oversight and approval rights in respect of aspects of a DPC project;
- Ofwat consent is required before a project can be put out to tender and before the water company enters into a project agreement with the successful bidder. This enables Ofwat to check best value for customers is being achieved;
- the licence changes are necessary as they provide the mechanism for companies to charge customers for the charges of the appointed CAP;

- the licence amendments introduce a new interim determination which will provide companies with certainty that they will be funded if a DPC project is brought back in-house in full or in part.

## 6. Responses to the consultation

We received five responses to the consultation all from water companies whose licences have been modified.

Two of those companies accepted the modifications with no further changes; two of the companies suggested minor drafting changes; and one company accepted the changes but questioned whether the timing was right for the changes to be brought into effect given that the price review had not yet confirmed which projects should be delivered via DPC. The earlier response from the sixth company also requested a minor drafting change, for clarification.

We have made one minor change to the modifications following the consultation. One of the companies that responded pointed out a potential ambiguity in the revisions to the drafting of paragraph 9.4(1)<sup>1</sup> of condition B, and we have amended the paragraph to remove the ambiguity.

We have also engaged with the one company about timing and clarified that we are expecting all companies that are likely to start delivering DPC projects in the next five-year period to have these provisions in place prior to final price review determinations being made. This is in order to provide a legal basis for Ofwat agreeing to fund the company its development costs in the next price review but not the costs of delivering these projects in-house.

The five responses were from: Thames Water, Severn Trent Water, South East Water, Yorkshire Water and South West Water.

## 7. When the modifications will come into effect

Under section 12A of the Act modifications take effect on a date specified by Ofwat, which date must be at least 56 days after the modification was made.

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<sup>1</sup> This paragraph is 9.4.1 for the five water and sewerage companies, and is paragraph 8.4(1) for South East Water, the water only company.

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The modifications were made on **23 April 2024** and will come into effect on **21 June 2024**.

**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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