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| **Title:** The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 | Post Implementation Review |
| **PIR No: 2013/1582** | **Date: 29/11/2018** |
| **Original IA/RPC No:** DEFRA 1033 | **Type of regulation: Domestic** |
| **Lead department or agency:** Department for Environment Food and Rural Affairs | **Type of review: Statutory** |
| | |
| **Other departments or agencies:** | **Date measure came into force:** **27/06/2013** |
| **Contact for enquiries:** Edmund Beard<br>020 8026 3071<br>Edmund.Beard@defra.gsi.gov.uk | **Recommendation: Amend to maintain** |
| | **RPC Opinion: below threshold** |

**1. What were the policy objectives of the measure?** (Maximum 5 lines)

To help deliver necessary large or complex high-risk infrastructure, such as the Thames Tideway Tunnel, whilst helping to isolate, contain and minimise risk to undertakers, customers and UK taxpayers. The objective was to provide value for money and keep customers bills as low as possible while also promoting innovation within the industry in the financing and delivery of future water and sewerage infrastructure projects.

**2. What evidence has informed the PIR?** (Maximum 5 lines)

Defra policy officials gathered the views of key stakeholders: the water industry's economic regulator, the water consumer champion and the water industry. This legislation has facilitated one infrastructure project to date which is due for completion in 2023. As such evidence of outcomes remains limited. Our review sought the view of stakeholders on possible future use of the regulations.

**3. To what extent have the policy objectives been achieved?** (Maximum 5 lines)

This legislation allowed work to begin on the Thames Tideway Tunnel through the appointment of a separately regulated infrastructure provider. Ring-fencing delivery of this project from Thames Water Utilities Limited and requiring a competitive procurement process, reduced risk to the undertaker and benefited customers by enabling greater value for money.

Sign-off for Post Implementation Review: Chief economist/Head of Analysis and Minister

***I have read the PIR and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.***

Signed: T. Coffey

Date: 29/11/2018

**4. What were the original assumptions?** (Maximum 5 lines)

Best estimated costs of £2.4m per year including extra regulatory effort for Ofwat relating to the regulation of the Infrastructure Provider. One off transitional costs to the undertaker for tendering the projects projected at £17m. Best estimated benefit of £50m per year through the isolation of risk from undertaker and the avoidance of market re-appraisal of the undertaker's credit rating, and increased cost of capital. Benefits also derived through avoidance of diverted management attention from the regular provision of service.

**5. Were there any unintended consequences?** (Maximum 5 lines)

The low cost of capital for Thames Tideway Tunnel was an unexpected positive outcome of these regulations. This resulted from a competitive tension created through the procurement of the Infrastructure Provider. The delivery of the regulatory framework was also more complex than anticipated due to large number of stakeholders. The aligning of the delivery of the project with the wider requirements of the undertaker has been another challenge.

**6. Has the evidence identified any opportunities for reducing the burden on business?** (Maximum 5 lines)

Ofwat indicated that costs could be reduced if the Infrastructure Provider was not required to approach it for waivers of its procurement obligations and instead could apply for the exemptions available to undertakers under the Utility Contract Regulations 2016. It was also suggested that the regulations could be amended to allow for more flexibility in the relationship between the incumbent and the infrastructure provider, in order to deal effectively with new or emerging challenges.

**7. For EU measures, how does the UK's implementation compare with that in other EU member states in terms of costs to business?** (Maximum 5 lines)

This is a domestic measure. The structure of the water industry in England and the use of infrastructure providers is different to EU counterparts and does not allow meaningful or productive comparison.

## Further information

### Overview of the regulations

The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 were introduced to help the delivery of necessary, large or complex water or sewerage infrastructure projects within England. They were designed to help contain, minimise and isolate the risks associated with the delivery of these projects from customers, undertakers and UK taxpayers, while also providing value for money and keeping customer bills as low as possible. The intended effect of these regulations was to create a parallel regulatory regime for delivering large or complex high-risk infrastructure projects which provide value for money for customers and safeguards the ability of undertakers to continue delivering their required level of existing services. These regulations also sought to promote innovation in the financing and delivery of future water and sewerage infrastructure projects within the industry. To date, the Thames Tideway Tunnel is the only project being delivered through this parallel regulatory regime.

These regulations have been amended twice. Once under the Water Industry (Specified Infrastructure Projects) (English Undertakers) (Amendment) Regulations 2014, which gave Ofwat the power to include conditions in an infrastructure provider’s project licence that allow for matters or questions to be referred to the Competition and Markets Authority for determination. This gave infrastructure providers the same right as water and sewerage undertakers to require Ofwat to refer its price control decisions to the Competition and Markets Authority. The second amendment was made by the Public Procurement (Amendments, Repeals and Revocations) Regulations 2016 which altered the Regulations to make them reflective of the Utility Contract Regulations 2016.

Whilst Regulation 11 sets out the requirement for a review, without amendment of Regulation 1(2) no new infrastructure projects will be able to be specified beyond 27 June 2020. However the regulations would continue to apply to any projects designated before that time.

### Review approach

This review assessed the regulations against their objectives, sought opportunities for improvement and tested if there might be any future projects which may benefit from the legislation remaining in place. This legislation supported the financing of the Thames Tideway Tunnel, which is planned for completion in 2023. The project is therefore still underway and will begin to deliver after the review period. Therefore data gathering focused on those with immediate knowledge of progress on the ongoing project and sourcing capital. Defra officials identified and contacted key stakeholders, mainly organisations which had been directly involved with the use of these regulations, to share their views to inform the review. Of eight organisations invited to share their views, five chose to respond to our request in full, with the rest signalling a lack of interest or lack of a valuable contribution to the report.

As these regulations have supported one large ongoing project so far, further economic analysis would not move beyond original assumptions. In-depth analysis of compliance and enforcement would also not be appropriate, as only one organisation falls within this remit and is compliant.

### Key assumptions in this review

The cost and benefit analysis which informs this review comes from the original Impact Assessment (DEFRA 1033) which was based solely on the one project foreseen within the 10 year period from when the regulations were being made. Data on the cost to customer bills in relation to the development of the Thames Tideway Tunnel comes from evidence submitted on behalf of Thames Water Utilities Limited and Ofwat.

**Original Impact Assessment assumptions**

| COSTS (£m) | Total Transition (Constant Price) | Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---|---|---|---|---|
| Low | | 0-1 | 1.9 | 53 |
| High | | | 4.2 | 97 |
| Best Estimate | 17 | | 2.4 | 63 |

| BENEFITS (£m) | Total Transition (Constant Price) | Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---|---|---|---|---|
| Low | | | 25 | 150 |
| High | | | 100 | 600 |
| Best Estimate | | | 50 | 300 |

| Price Base | PV Base | Time Period | Net Benefit (Present Value PV)) (£m) | | |
|---|---|---|---|---|---|
| Year 2010 | Year 2010 | Years 30 | Low: 53 | High: 547 | Best Estimate: 237 |

**Effectiveness of the regulations against policy objectives**

This legislation has been shown to be successful in its objective of facilitating the delivery of large or complex infrastructure projects. Procurement has led to the appointment of a separately regulated infrastructure provider: Bazalgette Tunnel Limited (known publically as Tideway). Tideway has suggested that the regulatory and contractual arrangements facilitated by the legislation has provided a regulated framework that incentivises it to deliver the infrastructure on time and on budget, for the benefit of customers.

The legislation has also allowed the risk associated with the project to be contained, minimised and isolated through the ring-fencing of the project from Thames Water Utilities Limited. Consumer Council for Water and Ofwat stated in their response that appointment of a separate infrastructure provider has provided greater value for money than previously modelled with delivery by Thames Water. Tideway and Thames Water have suggested that competitive procurement increased value for money and lowered impact on customer bills. They also stated that legal separation between Tideway and Thames Water allowed each to focus on their respective roles and service.

It is the view of Tideway, and their investors, that this model of delivery is attractive to debt investors. Private financing of water and sewerage infrastructure is a new and ultimately innovative concept. Tideway believed that this model of delivery was been received warmly by the industry and investors. They asserted that the model would be well received by the infrastructure finance community if extended.

**Unexpected costs and/or unanticipated consequences of the legislation**

Ofwat have described the low cost of capital as an unexpected positive outcome. This contributed to a reduced increase in customer bills compared to original modelling: £20-25 rather than £70-80.

Infrastructure providers are subject to a regulatory framework and regime. This has been amended a number of times directly and indirectly through alterations to other pieces of legislation. While Tideway have noted that they have the in-house capability to review and manage their regulatory framework and obligations accordingly, Ofwat have suggested that the initial delivery of this framework was significantly more complex and time consuming than originally anticipated, given the number of stakeholders involved.

The Consumer Council for Water felt that the agreement of responsibilities and accountabilities in regards to the handling of customer complaints and queries presented greater challenges than first anticipated and a significant amount of proactive communications was required to educate and inform customers about the project, particularly concerning financing. This activity, the Consumer Council for Water believe, was not originally accurately priced into original assumptions.

Thames Water believe that aligning the clear focus of the infrastructure provider delivering the Thames Tideway Tunnel with the wider ranging requirements of the incumbent has been a challenge, and more complex than first anticipated. While it is their opinion that the two have worked well together through closely integrating their operations, there is potential for greater flexibility for the infrastructure provider to adapt to meet new challenges and/or the changing obligations for the incumbent.

**Opportunities to revise this regulation to reduce burden on businesses**

Ofwat's submission stated that they believed there were to be a number of large infrastructures projects proposed in Price Review 2019 (covering investment from 2020 to 2025), and draft business plans do indicate a number of projects which might be suitable for delivery via a regulated infrastructure provider. Ofwat suggested this legislation should be amended to extend the expiration date or remove the sunset provision to allow other projects to benefit from this delivery model.

Tideway also believe that this legislation should be retained to enable other future projects to be delivered in the same way as the Thames Tideway Tunnel. They make the point that prior to a project being designated, they do not impose a regulatory or administrative burden on any person or business. Tideway also suggest that amending the legislation to extend provision beyond 2020, and therefore allow other projects to be specified and benefit from this delivery model, would represent greater value for money given the costs and resources involved in creating the original regime.

Further to this, Tideway, and its investors, believe that if the legislation was not amended to extend the period of provision beyond 2020 and therefore is allowed to lapse that there creates the risk that a perception could appear that these regulations have not been effective in their initial policy objectives and the delivery of the Thames Tideway Tunnel. This, they believe, could create reputational risks to Tideway and its stakeholders, Thames Water and others.

Thames Water believe that amendments could be made to make the infrastructure provider more clearly accountable to the incumbent. They also suggested that revisions could be made to allow for flexibility when dealing with new or emerging challenges the incumbent is facing.

**Conclusion**

These regulations have been a successful in their policy objectives, and this view is supported by those stakeholders who responded to this review. The regulations have enabled the delivery of the Thames Tideway Tunnel to progress well, contained risk from the incumbent and provided value for money for customers. The main unexpected consequences of this legislation was the reduced cost to customers. This is a positive and supports the objective of providing value for money. The regulations have also provided a new innovative model of delivery for water or sewerage infrastructure within the industry.

Though it was raised by Ofwat that the delivery of the regulatory framework created a greater challenge than first anticipated, this sentiment was not shared by the infrastructure provider or the incumbent. Additionally, the Consumer Council for Water noted that agreeing accountabilities and the level of proactive communications required was not pre-empted and required significant resource. However, once again this concern was not echoed by Tideway or Thames Water, and therefore it could be assumed that this did not really make a huge impact on the key parties involved, hence why they did not consider the need to submit this as a comment.

The concern raised by Thames Water on the challenge of striking the right balance between focus and flexibility may also be more about the delivery and implementation of the legislation, rather than its design, and may resolve itself over time or for future projects due to the value of hindsight and learning from experience.

Stakeholders also overwhelmingly expressed interest for retaining these regulations, with a number suggesting that they should be amended to remove the sunset clause and have the legislation continue indefinitely.

**Recommendation**

This review recommends that this legislation is amended to extend the power to designate projects beyond 2020. This is likely to require the deletion of regulation 1(2) which provides that certain provisions cease to have effect after a specified date. This will allow future infrastructure projects and providers to come forward during the 2020-2025 water company investment period. We consider that further changes should only be considered in light of experience of application to a wider number of projects.