Title:	Impact Assessment (IA)
Regulation on the Provision for special water and sewerage infrastructure projects in England **Lead department or agency:** Defra **Other departments or agencies:** Ofwat	**IA No:** Defra 1033 **Date: 07/08/10** **Stage:** Consultation **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** David S Jones (020 7238 5989)

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Climate change and population growth are anticipated to increase the stress on UK water resources and the associated water and sewerage infrastructure. Addressing these situations is likely to require larger and more complex infrastructure than the existing regulatory regime was designed to provide for. Government intervention is necessary because the existing regulatory regime arises from statute that protects the industry from competition in the procurement and/or provision of infrastructure. Greater competition in delivering such infrastructure could reduce the customer-borne costs and/or risks associated with these infrastructure projects.

What are the policy objectives and the intended effects?

The policy aims to facilitate the delivery of required but large and/or complex infrastructure, while minimising the risks associated with such delivery. Because customers ultimately fund the industry's capital programmes, minimising these risks should provide better value for customers' money while still delivering the required or desired level of service. The main effect of the policy is the creation of a parallel regulatory regime that will ensure that large high risk infrastructure projects implemented under the Regulations provide value for money for the customer whilst safeguarding the ability of an undertaker to provide services to its customers. Another effect of the policy is to promote innovation in the delivery of potentially high-risk water and sewerage infrastructure projects.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

In developing Part 2A of the Water Industry Act 1991, we considered several options for implementing the underlying policy described above. Now that the Flood and Water Management Act 2010 has been passed, it remains solely for us to commence Part 2A. Thus, the only options considered at this point are: 1) No change - under the no change scenario , all water and sewerage infrastructure would continue to be delivered under the existing regulatory regime, which provides undertakers with a regional monopoly in their appointed service areas, including with respect to delivering infrastructure. 2) the preferred option - taking the measure forward (i.e., developing the regulations provided for in Part 2A)

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed 04/2013
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	No

SELECT SIGNATORY Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY:..... Date:.....

Summary: Analysis and Evidence

Policy Option 2

Description: The requirement for certain water and sewerage infrastructure projects to be put out to competitive tender.

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate: N/A**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**£2.7m**
High	Optional		Optional	**£4.5m**
Best Estimate				**£3.6m**

Description and scale of key monetised costs by 'main affected groups' The main affected groups are Government (including Ofwat) and undertakers. The Government expects to delegate most decisions to Ofwat. The estimated costs of implementing the first project likely to be captured under the new regime (the Thames Tunnel) are likely to be between £3-5m for Ofwat – this will include developing guidance (which may evolve over time, the two stage designation process and regulation (where necessary). At this stage we have no idea how many infrastructure projects are likely to be implemented under the new regime and indeed how many will require direct regulation (which could last for a number of years) so it is very difficult to give meaningful figures.

Other key non-monetised costs by 'main affected groups'

Undertakers will bear monetised costs only for the few projects that will qualify under the regime related to tender costs (approximately 1% of the total cost of the project) although in practise much of these costs will have to have been borne by an undertaker anyway had the project been implemented under the existing regime.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

The main affected groups are Government (including Ofwat), undertakers, competing bidders and water customers. There are no quantifiable monetised benefits associated with the new regime. However, if the new regime is invoked because a project is proposed, competing bidders may realise a benefit from delivering the infrastructure, and customers may realise a benefit from the fact that the new regime will provide value for money vs. the existing regime.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5%

The key assumption is that the regulations, once delivered, will capture the infrastructure projects that the policy is intended to capture: very large or very complex works for which a competitive tender can deliver value for money. The first main risk underlying this assumption is that the first-stage "gateway test" and/or the second-stage "criteria" for determining project function incorrectly or are challenged successfully by an unwilling undertaker. The second main risk is that the ex-ante assessment of the competitive tender shows value for money, but the actual delivery under that model does not produce value for money, either because the assessment was flawed or because the tender was implemented poorly.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB: 0	**AB savings:** 0	**Net:** 0	**Policy cost savings:** 0	No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			England		
From what date will the policy be implemented?			06/04/2011		
Which organisation(s) will enforce the policy?			Ofwat		
What is the annual change in enforcement cost (£m)?			0		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:** 0	**Benefits:** 0	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	10
Economic impacts		
Competition Competition Assessment Impact Test guidance	Possibly	6
Small firms Small Firms Impact Test guidance	No	10
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	Possibly	10
Wider environmental issues Wider Environmental Issues Impact Test guidance	Possibly	10
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	N/R	10
Human rights Human Rights Impact Test guidance	N/R	10
Justice system Justice Impact Test guidance	N/R	10
Rural proofing Rural Proofing Impact Test guidance	N/R	10
Sustainable development Sustainable Development Impact Test guidance	Possibly	10

[1] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	http://www.defra.gov.uk/environment/flooding/documents/policy/fwmb/fwmialarge-infrastruc.pdf (IA at introduction of the Flood & Water Management Bill into Parliament, October 2009)
2	
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Total costs for Ofwat in implementing the new regime could be in the region of £3-5m [undiscounted] . Production of guidance would be minimal and the majority of costs would be realised during the two stage designation process, the tender evaluation stage and regulation of the IP if required.

Evidence Base (for summary sheets)

Problem under consideration

Climate change and population growth are anticipated to increase the stress on UK water resources and the associated water and sewerage infrastructure. Addressing these situations is likely to require larger and more complex infrastructure than the existing regulatory regime was designed to provide for. For example, changing rainfall patterns are expected to result in wetter winters and drier summers, and to aggravate both water-surplus conditions in the north and in Wales, and water-scarcity conditions in the south and the east. This may lead to an increased requirement for surface-water storage, including potentially complex arrangements for transporting this water. Moreover, heavy-rainfall events are likely to become more frequent. In London, such events would further strain an already-overtaxed sewerage system, leading to more discharges of untreated sewage into the Thames. The Thames Tunnel element of Thames Water's "London Tideway Improvements" scheme is currently being designed with a significant reduction of these discharges in mind. However, such a project is very large and requires engineering and construction skills that have been rarely, if ever, deployed by UK water and sewerage undertakers. It is projects such as these that might be better suited for delivery under the new regulations versus under the existing regulatory regime.

Please note that, throughout this Impact Assessment, the "delivery" of infrastructure may mean the design, financing, construction and/or maintenance of such projects; in some instances, it may also include the operation of such projects.

Rationale for intervention

Government intervention is necessary because the existing regulatory regime arises from statute that protects the industry from competition in the procurement and/or provision of infrastructure. In short, without a change in the law, the undertakers will continue to have a statutory monopoly on delivering infrastructure in their appointed areas. In contrast, this new regulatory regime will allow for Government to require the competitive tendering of very large or complex infrastructure. Greater competition in delivering such infrastructure could reduce the customer-borne costs and/or risks associated with these infrastructure projects.

For example, a competitive tender process could lead to a lower expected cost (*i.e.*, the cost quoted at the outset of the project) for delivering infrastructure, compared to an undertaker's expected cost for delivering the same infrastructure.

Alternatively, a competitive tender might not lead to a lower *expected* cost, but might produce a lower actual cost (*i.e.*, the cost calculated at the completion of the project) by reducing water customers' exposure to cost overruns. (Under the existing regulatory regime, if undertakers can demonstrate that a cost overrun has been validly incurred, they can ultimately recover it from customers, regardless of the "expected cost" projection that they provided at the beginning of the project.) Under the new regime, it is possible that a bidder will agree to assume all or part of the risk of cost overruns, thus shielding customers from bearing at least some of the risk of delivery problems. This could result in an actual cost *to customers* that is far closer to the expected cost than under the existing regime.

Importantly, this additional Government intervention in the delivery of infrastructure will be limited along two crucial dimensions. **First,** this intervention will apply only to very large or complex projects, with eligibility determined by a two-stage assessment that is described in the "Description of Options" section below. To provide further detail on the assessment criteria, Ofwat has committed to publish additional guidance for the benefit of potentially interested and/or affected stakeholders, not yet available.

Second, this Government intervention will not extend to actual project management, no matter how large or complex the project might be. In accepting their Ofwat-granted appointments to serve as water and/or sewerage undertakers, companies have a statutory duty to ensure that they comply with the law regarding the provision of water and/or sewerage services. This includes delivering the infrastructure necessary for such provision. As such, Government intervention at the project-management level is unnecessary, and could even be construed to interfere with their compliance with this statutory duty. In short, even for very large or complex projects, Government will rely on the undertakers' strong motivation

to retain their appointments to ensure that they manage the contractual relationship with the winning bidder so as to ensure the successful delivery of infrastructure.

Provision is made for this new regime in Part 2A of the Water Industry Act 1991. We are currently drafting regulations for laying before Parliament in the early weeks of 2011. The goal is to commence the regulations on 6 April 2011, or as soon as possible thereafter.

Although Ofwat's guidance has not yet been published, we expect that the Thames Tunnel element of Thames Water's London Tideway Improvements scheme will be specified by Ofwat, whereupon it will be subjected to a two-stage eligibility assessment provided for in the regulations (and described below). We expect the intervention in this case to be justified because it is likely to be of a size or complexity that threatens the undertaker's ability to provide services to its customers. The specification of the Thames Tunnel element as a potentially eligible project is supported by the current management team of Thames Water.

We do not expect to apply the regulations' proposed assessment process to any other infrastructure project that will take place during "Asset Management Period 5 (AMP5)".

Policy objective

The policy aims to facilitate the delivery of required but large and/or complex infrastructure, while minimising the risks associated with such delivery. Because customers ultimately fund the industry's capital programmes, minimising these risks should provide value for customers' money while still delivering the required or desired level of service. Another objective of the policy is to promote innovation in the delivery of potentially high-risk water and sewerage infrastructure projects. To achieve these objectives, the policy gives Government the power to require a water and/or sewerage undertaker to put certain large and/or complex infrastructure projects out to competitive tender. Competition may encourage new entrants to pursue opportunities to deliver water and sewerage infrastructure more cheaply and/or more innovatively than the existing, monopolistic system. However, the proposed regulations will only affect competition for exceptionally large projects which will be very few so there will not be any immediate widespread impact on competition as a result of introducing the new regime.

The main effect of the policy is the creation of a parallel regulatory regime that can be used to deliver infrastructure of a size or complexity that would threaten the ability of an undertaker to provide services to customers if it had to deliver this infrastructure under the existing regime.

Description of options considered (including do nothing)

The main option considered is the implementation of these regulations. The reasons for considering this option are discussed in the summary at the end of this section.

The Flood and Water Management Act 2010 provides for new regulations that will enforce the competitive procurement of water and sewerage infrastructure under certain circumstances.

Option 1 -No change

Besides implementing the regulations, the other policy option that has been considered is a do-nothing scenario. Under the do-nothing scenario, all water and sewerage infrastructure would continue to be delivered under the existing regulatory regime. This regime provides undertakers with a protected monopoly in their appointed service areas, including with respect to delivering infrastructure. The regime has enabled undertakers to attract enough capital to fund nearly £85 billion of infrastructure (in today's money) since privatisation in 1989. For the great majority of future infrastructure projects, the existing regime will suffice. However, there may be particularly large or complex infrastructure projects that would benefit from the ability to procure them competitively.

Option 2 - Preferred Option - new regime

<u>Two stage assessment</u>

The regulations themselves will create a two-stage assessment process to determine which projects fall under this regime, that is, whether or not the project will have to be put out to competitive tender. The

first stage requires the Minister's opinion (or Ofwat's opinion, if so delegated) as to whether the size and/or complexity of the project threaten the undertaker's ability to provide services to its customers..

The second stage requires the project to satisfy eligibility criteria .The key eligibility criterion will be whether competitively tendering for the specified infrastructure is likely to produce value for money for customers, relative to delivering the infrastructure under the existing regulatory regime. The exact implementation of this value-for-money exercise (as well as the other eligibility criteria) will be made in consultation with an undertaker- and on a project-specific basis, and will depend significantly on guidance that Ofwat will produce before the regulations are commenced.

Tender Process

Infrastructure projects that satisfy the eligibility criteria will then be competitively tendered. The competitive tender will be for the delivery of an infrastructure project, which will include the design, construction, ownership and financing activities associated with a project and might also include the operation and maintenance activities.

It is important to distinguish the existing regime for procuring infrastructure from the new regime. Currently, undertakers already put many infrastructure projects out to competitive tender. However, they do so merely with respect to project construction (or possibly design and construction); responsibility for all other aspects of the project delivery is retained by the undertaker. As a result, under the existing regime, the undertaker always owns the infrastructure, and its shareholders benefit directly (from a regulatory perspective) from the regulatory capital value assigned to that infrastructure.

Under the new regime's tender process, the range of activities for which the winning bidder (rather than the undertaker) is responsible is broader, and—crucially—includes the financing of the project. Financing and ownership typically go hand-in-hand. Thus, the winning bidder would own the works, at least until construction is completed, and bear the risks and/or enjoy the rewards that come with owning the infrastructure.

The regulations will also provide the Secretary of State or Ofwat with the discretion to decide whether to regulate the winning bidder directly. We anticipate that the tender process will not take place until the Secretary of State or Ofwat has made a decision as to whether to regulate the winning bidder. If Ofwat decides to do this, the winning bidder becomes a designated Infrastructure Provider (IP), and the regulations will specify how this new IP will be regulated.

While these regulations can oblige an undertaker to tender out a project, they do not necessarily require the resulting IP to be directly regulated. Ofwat might, instead, rely on its existing regulatory regime for the undertaker who will contracting the winning bidder i.e. "indirect regulation" of the winning consortium.

The tender process itself will be conducted by the undertaker whose customers will ultimately benefit from the delivery of the infrastructure. Moreover, section 36B(5)(c) of the Water Industry Act 1991 (as amended) requires the regulations to specify that the undertaker will choose which bid to accept... Although the regulations will guide this choice through specifying factors to be considered, and although the undertaker will be required to consult the Secretary of State or Ofwat on how it will conduct the tender process, ultimately the undertaker will be responsible for selecting the winning bidder. The reason for this is that the undertaker is ultimately responsible for the successful delivery of the infrastructure, under the conditions of its appointment by Ofwat. If a third party (*e.g.*, Ofwat) were to select the winning bidder, and the winning bidder failed in delivering the infrastructure, the undertaker for whom the project was being built could sue the third party for breach of contract.

Other options

There were no other options considered. The existing regime's basis in statute means that further statute is required to make changes. An alternative to secondary legislation would have been primary legislation. However, making the change in primary legislation was not feasible with respect to the Bill that became the Flood and Water Management Act 2010, and we are likely to need this new regime to be in place before the next primary-legislative opportunity will become available.

Costs and benefits of each option

Option 1 – No change

By definition, the do-nothing scenario has no (additional) costs or benefits.

Option 2 – Preferred Option

Costs

The new regulations will oblige the Secretary of State or Ofwat to give notice of a proposal to make a designation. This notice must state the reasons why the designation is being made. This assessment will likely require an expense which may be borne by the Secretary of State or Ofwat or by the relevant undertaker. However, the completion of this assessment is an important aspect of the policy because it is designed to ensure that customers receive value for money through the procurement process.

Ofwat

At this stage it is very difficult to give accurate figures on costs likely to be incurred by Ofwat in implementing the new regime as we don't know how many projects will be designated, how large they will be and whether they will require direct regulation. However, the first large infrastructure project that might be captured under the new regime is the Thames Tunnel - this is a substantial, complex and high risk infrastructure project currently estimated to cost £3.6bn. The estimated costs for Ofwat in dealing with this project under the new regime are in the region of £3-5m – this will include development of the guidance for designation of projects (which will evolve over time), the two stage designation process, overview of the tender evaluation process and possibly regulation. For other subsequent projects that may be designated, we consider that Ofwat's costs would be lower as not only will the guidance have been produced but Ofwat will have had experience of operating the new regime and procedures can be more streamlined (but much will depend on the nature and size of a project being considered).

As regards timing of the above costs it is difficult to be precise but we have been advised that approximately 10% of the £3-5m (undiscounted) is likely to be incurred in the pre-tender phase i.e developing guidance and designating the project, 70% will be realised during the tender phase and up to the award of the contract, 10% ongoing monitoring during construction phase and 10% after construction – depending on whether regulation is required and for how long. The present value of costs on this basis would be between £2.7m - £4.5m discounted at 3.5%.

Based on £5m

2010-2011 Guidance and designation	2012 - 2014 Pre-tender	2015-2020 Award of contract – construction phase Monitoring or will this solely be role of undertaker	2021 onwards (50 years)? Regulation by Ofwat if required
500,000	3,500,000	500,000	500,000 (total)

Undertakers

Undertakers may incur some additional costs arising from the new regime that would ultimately be recoverable from customers. Tendering costs are likely to make up around 1% of the total costs of undertaking the project, but these costs are unlikely to be materially different than if the project was not designated unless the undertaker had in-house capacity or an associate within its group that would be able to deliver the infrastructure. If the project is put out to full tender following designation under the regulations they will need to conduct lengthy and detailed legal negotiations with not only the winning bidder but also the other participants in the bid, because the ultimate legal relationship between winning bidder and undertaker will be an important determinant of the quoted cost and cannot be left to decide post-bid. The magnitude of these costs will depend on the number of bid participants. Undertakers will also incur costs of managing the contract with the winning bidder. However, in tendering out the project, they will avoid some costs associated with delivering the project themselves. As such, the relationship between costs under the existing regime and those under the new regime will be project-specific and thus difficult for us to establish in this impact assessment.

Undertakers are unlikely, however, to incur net costs arising from the new regime that would need to be borne by shareholders, in that to our knowledge, this invocation of the new regulatory regime will not cause any bond or loan covenants to be breached. Nevertheless, covenant packages form a confidential part of agreements between undertakers and their lenders, and we cannot guarantee in advance that undertakers have not already entered into (or will not enter into) agreements with lenders where this new regulatory regime would somehow breach a covenant.

We would not expect any significant impact on an undertakers administration burden as regards understanding the new regime but any potential costs we expect to be covered in the 1% as referred to above.

Benefits

Requiring certain projects to be put out to competitive tender should produce benefits for customers. For example, the competitive tender could deliver infrastructure at a lower price or at lower risk to customers. However, at this stage it is not possible to quantify these benefits . The value-for-money assessment will be designed to prevent this new regime from being invoked in instances where it would not provide value for money to customers.

The assessment relates to the procurement method, not the project itself. Taking the Thames Tunnel as an example of a project that is potentially eligible for the new regulatory regime, the assessment will take it as given that the project must be done. The assessment of the alternative procurement method (*i.e.*, of requiring the project to be tendered out under these regulations) is effectively a comparative assessment relative to procuring the infrastructure under the existing regulatory regime.

The methodology for assessing value-for-money on an ex-ante basis will be developed before the regulations are commenced. However, we illustrate below a possible approach to conducting such an assessment.

For example, the value-for-money assessment might consist of a combined quantitative and qualitative evaluation of the two procurement-method options. Quantitatively, there are two main cost drivers that could differentiate a project delivered under the existing regime from one under the new regime: the cost of capital and the project cost itself.

As for the capital cost, a project delivered under the new regime will very likely be financed by a special-purpose entity (a “special-purpose vehicle” or “SPV”) that exists solely to deliver the project. The SPV may or may not benefit from guarantees or other financial support from the sponsor. Regardless of these guarantees, however, it is very likely to have a higher cost of capital than the undertaker does today, which might significantly raise the overall cost of a project, relative to the existing regime. However, this assessment needs caution. It is inappropriate to assume, for example, that Thames Water would be able to finance the Thames Tunnel at its *current* cost of capital. Rather, it would require both a significant equity injection and significant incremental debt. Given that the cost of capital is, like most commodities, determined by supply and demand, Thames’s significant demand for incremental equity and debt capital would almost undoubtedly *raise* that cost. Therefore the cost of capital achievable by the SPV should be compared with the cost of capital that would be achievable under the existing regime, but not the existing rate the undertaker has faced for smaller loans and capital projects.

As for the project cost, the difference between the existing regime and the new regime will initially be determined by quantitative inspection. However, the project-cost element of the assessment also brings the *qualitative* evaluation into play around protecting customers from risks of an unexpected increase in costs or project overruns. Under the existing regime, validly incurred cost overruns relative to the expected cost quoted at the outset are quite likely to be recovered from customers. Under the new regime, however, there is a possibility that the winner of a competitive tender will, in exchange for a higher expected cost, bear some or all of the risk of the cost overruns. Thus, the project cost as experienced by customers could be lower than the actual magnitude of expense that will have been incurred to deliver the project, if under the new regime the winning bidder has accepted some of the risk of cost overruns.

The two stage tests and specifics of assessing likely value-for-money arising from competition are intended to ensure as far as possible that customers are better off in terms of value for money, and at minimum they are no worse off, than if the current regime were applied.

Risks and assumptions

The chief risk arising from implementing the policy is that the new regulatory regime might create greater uncertainty for the industry and for investors than we currently predict. This uncertainty could result in a higher cost of capital than forecast. For example, investors may be concerned that the new regulatory regime will not produce the same degree of predictability and transparency that the existing regulatory regime holds for them. On the other hand, both Thames Water and a potential investor have indicated that it may not be desirable or possible for Thames Water to deliver the Thames Tunnel under the existing regulatory regime. In other words, the "base case" cost of capital for delivering the Thames Tunnel would be very likely to be higher, in any case, than what it has been.

A second risk is that the industry may be less inclined to propose infrastructure if they believe that their ability to deliver it under the existing framework will be subject to the discretion of the Secretary of State (or Ofwat, if so delegated). This risk is mitigated by the "gateway test" (i.e., that the project's size or complexity must threaten an undertaker's ability to provide services), and by the guidance that Ofwat will publish as to the limited reach of these regulations. Moreover, any decision arising from the gateway test will be subject to appeal through the judicial-review process. Finally, industry participants will still be governed by quality regulations and licence conditions that require them to do what is necessary to deliver appointed services.

A third risk is that the first-stage "gateway test" and/or the second-stage eligibility criteria function incorrectly or are challenged successfully by an unwilling undertaker.

A fourth risk is that the ex-ante assessment of the competitive tender shows value for money, but the actual delivery under that model does not produce value for money, either because the assessment was flawed or because the tender was implemented poorly.

The post implementation review will eventually consider performance of the new regime against all these risks.

The main assumptions include:

- that the regulations will be found to be applicable to the very large or complex infrastructure projects for which a competitive tender might deliver better value for money;

- that competitive tendering for the delivery of such projects has the potential to produce better value for money for customers than the existing regulatory regime; and

- that sufficient interest will actually exist among third parties to participate meaningfully in such tenders when they occur.

Administrative burden and policy savings calculations

The policy and regulations do not in themselves impose an administrative burden on business.

Specific Impact Tests

Statutory equality duties – the Regulations will have no impact. The main affected groups are Government (including Ofwat) water and sewerage companies and competing bidders.

Competition – the Regulations could act to improve competition (Page 6)

Small Firms – the Regulations will have no impact

Environmental Impacts/ Sustainable development – The introduction of a new licensing regime for large infrastructure projects could enable a more integrated and sustainable approach to the delivery of the capital investment programme.

Social impacts – the Regulation will have no impact.

Wider impacts

There are unlikely to be wider impacts given the very few instances in which we anticipate the regulations will be applied, and the even fewer instances in which we anticipate that projects will actually be specified for competitive tender. (The regulations will capture only those projects that, in the first

instance, meet the “gateway test” of size/complexity; and, in the second instance, demonstrate value-for-money relative to procuring the infrastructure under the existing regime.)

Assuming that Thames Tunnel is successfully specified as a project that must be put out to tender, Thames Water’s cost of capital should not be affected by this for two reasons. First, and most obviously, Thames will not bear the direct risk of the project. Secondly, the unitary charge that Thames will have to pay the provider of infrastructure in order to use such infrastructure will be recovered from customer bills—this much is clear.

Likewise, the rest of the industry should not experience a change to its cost of capital in the event that Thames Tunnel is put out to tender. A project financing of an unusual water/sewerage infrastructure project will likely attract different investors from the usual investors in water/sewerage companies because the risk profile of such a project will be different from the risk profile of an integrated water and/or sewerage company.

Summary

In summary, the preferred option is to create a new regulatory regime that will operate in parallel with the existing regime. For the great majority of future infrastructure projects, the existing regime will suffice. However, there may be particularly large or complex infrastructure projects that would benefit from the ability to procure them competitively. Importantly, the regulations will specify that a project must deliver value for money in order to be eligible for designation under the parallel regime.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; Political commitment to review.
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] Has the application of the regulation approved by Parliament been successful? That is, has the Minister (or Ofwat, if so delegated) taken an opinion on whether the Thames Tunnel threatens Thames Water's ability to provide services to its customers, and-- if so-- has a value-for-money assessment been performed and does it show that the new regime could deliver value-for-money relative to the existing regime? If the regulations have not been applied, what was the rationale for that decision? (Is it, at least, consistent with the two-stage assessment provided for in the regulations?)
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] To review this objective we will need to know whether the regulations were applied and the specific circumstances that followed from this application. This will require reviewing internal documents
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] The baseline position is that there exists a regulatory regime in which undertakers have a statutorily protected monopoly over the provision of water and sewerage infrastructure in their respective service areas.
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] Success in this objective will be assessed by whether regulations produced a better outcome for consumers. If the regulations were applied (including the two-stage assessment described herein), and if that application has resulted in a parallel regime for procuring infrastructure, then the regulations may be judged a success. If the regulations were applied but without resulting in a parallel regime for procuring infrastructure, then it may not be so easy to determine success. For example, were there valid expressions of interest from competing bidders when the tender conducted? Were they ignored or rejected because of a process failure? If the regulations were not applied altogether, then it may be a question of whether Ofwat took the decision as to the ultimate suitability of these generic regulations to the specific case. In all of these instances, internal documents will need to be reviewed.
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] Monitoring will be conducted through a review of the documentation and processes leading to the designation (or not) of large infrastructure projects and Ofwat will conduct ongoing monitoring of their guidance to ensure that it remains fit for purpose.
Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here]

Add annexes here.