

# Strategic Resource Options Assumptions

---

Anglian Water  
October 2023

---

## **Purpose of this paper**

This annex paper is intended to provide further detail supporting the underlying assumptions in our Strategic Resource Options (SRO) Enhancement expenditure case which sets out the rationale and detail of our proposed expenditure in AMP8 to support the development of the Lincolnshire Reservoir (LR) and Fens Reservoir (FR).

The aim of this paper is to provide an overview of the key assumptions made for the purpose of the PR24 business plan submission.

## **Executive summary**

The key assumptions and decision points are listed below with the preferred option in bold:

- 1) Delivery model options – **SIPR** vs DPC vs In-house
- 2) Tender point – **late** or early
- 3) Procurement model – Integrated or **split**
- 4) Regulatory framework – within the Water Resource price control or **separate price control**
- 5) Scope of IP activity – Reservoir only or **abstraction to distribution**

These assumptions materially affect the progression and direction the LR and FR projects. Further stakeholder and market engagement is needed to confirm underlying assumptions for the procurement model and project timings as the projects move into a more defined stage post-Development Consent Order (DCO).

## **1) Delivery model – DPC, SIPR or in-house**

Direct Procurement for Customers (DPC) was established by Ofwat at PR19 as an alternative delivery approach for large capital schemes. It involves the procurement of a Competitively Appointed Provider (CAP) to Design, Build, Finance, Operate and Maintain (DBFOM) the required infrastructure. The standard length of a DPC contract is around 25 years and after this period the assets are brought back in-house, the CAP is paid through a fixed payment mechanism much like under Private Finance Initiative (PFI) contracts.

The Specified Infrastructure Project Regulations (SIPR) was introduced in 2013 to allow the competitive delivery of the Thames Tideway Tunnel (TTT). Under this model an Infrastructure Provider (IP) develops the asset and owns it for the duration of the asset life, remunerated under a regulatory model. SIPR establishes a new named party for regulatory and legal purposes.

Due to the projects' size and complexity, and the potential for the projects to otherwise threaten Anglian's ability to provide services for customers, it has been considered that the projects are unlikely to be effectively delivered in-house or under DPC. and so **SIPR is the most appropriate model**. An initial suitability case was presented to Ofwat in Autumn 2022 with an updated versions for both FR and LR submitted as part of the PR24 business plan. Legal review is also currently in process, along with discussions with various stakeholders, including Ofwat, to determine how license obligations can be transferred to the IP under SIPR.

## **2) Tender point – early (pre-DCO submission) or late (post-DCO award)**

The defining difference between an early and late tender model lies in the timing of the IP licence award (i.e., project handover). This IP award refers to the transition of responsibilities and deliverables from the procuring authority to the IP, however the timing and context of this handover differ significantly.

In an early tender model, the IP is awarded prior to the completion of surveys, Development Consent Order (DCO) submission or award and detailed design works. During the tender, the Appointee would set minimum specifications and deliverables that the IP must achieve, but the IP has a degree of flexibility in how these are met. Once key development activities are complete, the IP would engage in procurement activities, raising finance, construction, and Operation & Maintenance of the project.

Our assessment is that pursuing an early model at this stage would lead to a 3-to-5-year delay of the project as all current efforts would need to be paused until the tender had been awarded.

Moreover, the tender framework would not be able to be launched until the projects were specified under SIPR, which is not likely occur until at least 2025. Because of these delays, pursuing an early tender model would likely change the best value plan within the WRMP24 and potentially lead to other options such as desalination projects being preferred. These would likely be delivered in-house or via DPC and would come at a greater cost per MI to AWS and customers.

In a late tender model, the IP is awarded at a later stage once the Appointee has obtained all key planning permits, post-DCO award, and asset design has progressed. Key aspects such as scope, requirements, and specifications have been finalised and the IP is primarily responsible for progressing the detailed design, financing, construction and operation & maintenance of the asset. This was used for Thames Tideway (TTT) and for other DPC and Public-Private Partnership (PPP) projects and is therefore established as the market precedent.

**The late tender model is the most common precedent for a comparable project and the assumption being made for LR & FR.**

The main benefit for using the late tender model is that it allows the Appointees involvement in the development of the project to manage risk. The late tender model will also allow for the concurrent development of design and DCO submission alongside commercial and procurement design which optimises the timing of delivery. The late model also more appropriately allows us to set our ambition and strategic objectives for LR & FR and increases our control in the development phase.

### **3) Procurement model – split or integrated**

The integrated procurement model is the default approach to tendering DBFOM contracts. It has been used globally for PPP deals and in the UK, it has been applied within Private Finance Initiative (PFI) contracts, Mutual Investment Models (MIM) and the DPC model. It is a well understood and market tested procurement model.

The split procurement model has been successfully implemented for TTT but has not been directly replicated elsewhere. The procuring authority takes on a much greater role in the IP setup, setting the target threshold and procuring key contracts than under the integrated model. Under the split model the procuring authority procures the main works and other key contracts rather than the bidder/IP.

The key difference between the two models is that under the split model we will be required to set up a project company prior to tender and there will be at least two procurements. Whereas under the integrated model this is not required which reduces the need for vendor due diligence, however it will require bidders to form consortia with financing to participate in the tender.

An initial view of the costs associated with each model have been developed internally by the project team with the support from various external advisors. Due to the current stage of the project, these costs reflect only current assumptions and contain a degree of uncertainty. Additionally, until market engagement activities commence and feedback on how a split model could be utilised it is not possible to quantify the benefits of the split model and how those benefits would compare to the costs.

**The current assumption is a split procurement model** due to the greater level of control it offers.

Depending on the outcome of discussions with stakeholders over the coming months, a reconsideration of the procurement model may be required, with associated re-costing of development expenditure.

#### **4) Regulatory treatment of development costs - Separate price control vs Water Resource control**

The parameters of the Water Resource control reflect the portfolio risk of our whole network, inclusive of capex and opex requirements. As the development costs of the reservoirs would be substantial and have a significantly different risk profile to the rest of the Water Resource control, adding the development expenditure to our price control would distort the risk profile and require material amendments to the regulatory parameters.

If development costs were included, this would materially change Anglian's risk profile. This could lead to higher costs of equity and a potentially significant impact on customer bills. Additionally, under this approach we would have difficulty separating non-reservoir activities from SRO development costs, leading to difficulty comparing non-reservoir costs with other companies. Furthermore, many activities which will be carried out in respect of the reservoirs have a degree of uncertainty which may not be sufficiently captured in the current risk and return framework. All of the reasons given here are consistent with the rationale for the introduction of a separate price control for TTT as well as the Havant Thicket Reservoir.

The alternative approach would be to pursue a separate price control framework. This is the precedent used for TTT and would be a more appropriate outcome and more accurately reflect the risk profile of the projects. This approach would also solve the issues which arise from attempting to include the projects in our Water Resource control. Given Ofwat's preference for a separate price control in the case of the TTT and Havant Thicket precedent, it is assumed that the same approach for the LR & FR should be taken (e.g., transparent reporting, appropriate balance of risk, efficient cost allocation).

Given the above, **a separate price control is the preferred assumption**. To reflect the remaining risks with respect to development and enabling activities, **we propose differential cost sharing rates for the new price control**, to reflect the substantial difference in risk exposure to ourselves and South Staffs Water. Our current assumption for these are that cost sharing would be on a 90:10 basis. In addition to the differential cost sharing rate, a bespoke Interim Determination (IDoK) mechanism may be required as adopted on TTT. For this reason we request that the SROs are a Notified Item at PR24 Final Determination. We will continue to work with Ofwat as details of the delivery arrangements evolve over the coming months and may alter our requested totex after the Draft Determination in 2024.

## 5) Scope of IP activity – Reservoir only or abstraction to distribution

The boundary of works assigned to the IP within the SIPR arrangements will materially affect the degree of risk held by the IP, and significantly affect totex requirements for Anglian. This also affects the legislative changes required to place liability with the correct party.

**We have assumed that the full end-to-end asset system is within the boundary of delivery under the SIPR for the purposes of our business plan.** This includes raw water abstraction and transfer, storage, treatment and transfer of potable water into downstream distribution systems. Breaking up the scope of the project would raise further questions about suitability of sub-elements for DPC and introduce further complexity. However, there are risks to this approach and even in this arrangement there will need to be strict controls built into the commercial agreements as production of water for supply will not be constant, and will need daily communication to optimise water resources in the wider system. Similarly abstraction for the reservoirs is from waterbodies that are already heavily controlled by other parties such as the Environment Agency and Drainage boards as part of upstream water management systems such as river transfer schemes.

This assumption is also dependent on legislative changes which enables the pass down of legal powers and responsibilities from the undertakers to the IP. If these changes are not able to be made then assumed scope will need to be revisited. If this underlying assumption changes as market engagement and stakeholder opinion evolves over time it will have significant impacts on other aspects of the approach, not least the impact on capitalisation of totex for the Sponsors.