INDUSTRY COMMENT

DPC BY DEFAULT

Omar Clarke urges companies to get on the front foot and embrace Ofwat's heightened PR24 DPC expectations as an opportunity as well as a challenge.

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Post its emergence at PR19, Direct Procurement for Customers (DPC) will play an even stronger role in the PR24 price review process. UK Government, through its latest Strategic Policy Statement, continues to see competition in major infrastructure projects as a pathway to deliver value for customers.

The rhetoric for DPC has progressed from companies being encouraged to consider DPC at PR19 for schemes worth £100m to companies being expected, 'by default', to assess schemes meeting the increased £200m threshold. This stronger stance on DPC at PR24 should come as little surprise. Prior to the PR24 business plan preparations, several of the Strategic Resource Options being progressed by companies through the Regulators Alliance for Progressing Infrastructure Development (RAPID) have been pushed for DPC evaluation.

Technical discreteness

A 'DPC by default' approach alongside the issuing of Ofwat's consultation on the 'Technical Discreteness' test for schemes points towards the need for companies to have a more robust process for evaluating potential options at PR24.

Ofwat's latest guidance provides more light on the core test areas that it expects companies to assess against. The latest consultation also shows that for PR24, Ofwat will be expecting companies to push hard on potential mitigations to keep a scheme in consideration rather than ruling out an option too early.

The discreteness test's proposed areas of focus are the following:

- *Programme scalability – a test of size.*
- *Construction risk – identifying the construction risk and determining if it prevents DPC from being appropriate.*
- *Operations & maintenance risk – the ability to transfer these areas to a Competitively Appointed Provider.*

Ofwat's greater clarity on DPC at PR24, through the draft guidance materials and the discreteness test, which is expected to be finalised in April 2023, is hoped to increase the standardisation across companies' evaluation of schemes. The variability in companies' assessment of schemes was recognised as an area for improvement from Ofwat's PR19 Lessons Learnt recollections and it is clear that the regulator intends to reduce ambiguity for companies going into the AMP8 period.

Heightened expectations on DPC evaluations

There are nuggets in Ofwat's narrative on DPC across the PR24 methodology and supporting documents that aren't to be missed. Typically, at PR19, only stand-alone schemes were put through the test areas for DPC consideration. This will continue at PR24 and may be the most common form.

However, Ofwat expects companies to not fail a project solely because it does not meet the £200m threshold. Instead, to meet the £200m threshold, Ofwat has heightened its expectations for companies to look at similar solutions and assess the potential to club them together and re-assess on that basis.

Beyond this, Ofwat has increased the expectation for companies to consider mitigations or alternative arrangements that could be made to help meet the construction risk test and, if appropriate, the operations & maintenance risk test. Some of the 'pathfinder' DPC projects, for example, United Utilities' Haweswater Aqueduct Resilience Programme, will have pushed ahead the thinking on what can be considered to be appropriate for DPC.

Meeting 'DPC by default' expectations first-time around

With a 'DPC by default' approach, companies should focus on landing their DPC options first-time around. Unsatisfactory assessments of potential schemes run the risk of delaying companies from hitting the ground running at the start of AMP8. The narrative is clear, Ofwat has stated that it will reserve the right to consider schemes as potential DPC options until companies can provide satisfactory evidence otherwise.

The primary focus should be to assess potential DPC schemes against the discreteness tests through to value-for-money assessments between delivering via a CAP or the in-house counterfactual. Beyond this, companies should consider how a scheme going through DPC could aid a wider programme's delivery. For example, companies will be needing to put forward a step-change investment plan to deliver against combined sewer overflow programmes which will require a diversified mix of interventions. DPC may be a vehicle for particular asset types such as new wastewater storage units. Pursuing this solution via DPC may free up the water company to deliver blue-green nature-based solutions faster and more efficiently through in-house delivery models.

DPC has a firm role to play in the PR24 process. Ofwat will be pushing hard to consider incentives for companies when pursuing DPC as well as having its finger on the pulse of investors' receptiveness for the increased opportunities in this space. In the meantime, companies should ensure high-quality assessments are carried out, with an appropriate evidence base.

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