EXPLANATORY MEMORANDUM TO

THE DRAFT WATER INDUSTRY (SPECIFIED INFRASTRUCTURE PROJECTS) (ENGLISH UNDERTAKERS) (AMENDMENT) REGULATIONS 2014

1. This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Water Industry (Specified Infrastructure Projects) (English Undertakers) (Amendment) Regulations 2014 ("the SIP Amendment Regulations") amend the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013.

2.2 The SIP Amendment Regulations affect Infrastructure Providers (IPs) which are independent companies licensed by the Water Services Regulation Authority (Ofwat) to finance and deliver large or complex projects, like the Thames Tideway Tunnel.

2.3 The SIP Amendment Regulations allow Ofwat to include conditions in an IP's project licence which give an IP the right to ask Ofwat to refer certain questions or matters arising under its licence to the Competition and Markets Authority. Water and sewerage undertakers (companies) already have an equivalent right.

2.4 Without the SIP Amendment Regulations, the only way an IP could challenge Ofwat price control decisions is by seeking judicial review before the High Court. This is a time consuming and expensive process, the costs of which are ultimately met by customers.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Background & Legislative Context

4.1 The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 ("the SIP Regulations") came into force on 28 June 2013. They enable the creation of IPs regulated by Ofwat to finance and deliver large or complex high-risk water or sewerage infrastructure projects. The SIP Regulations implement Part 2A of the Water Industry Act 1991 (as inserted by the Flood and Water Management Act 2010) in relation to water and sewerage undertakers whose appointment areas are wholly or mainly in England.

4.2 The SIP Regulations provide for the procuring, licensing and regulating of an IP that is separate from a water or sewerage undertaker. They also lay out the circumstances in which the Secretary of State and/or Ofwat may exercise the power to 'specify' an infrastructure project and 'designate' the company which is to become an IP licensed and regulated by Ofwat to finance and deliver the specified infrastructure project.

4.3 The SIP Regulations are generic and apply to all water and sewerage undertakers and large infrastructure projects that meet certain criteria. They can be found online with corresponding Explanatory Memorandum and Impact Assessment at: http://www.legislation.gov.uk/uksi/2013/1582/contents/made.

4.4 The powers in the SIP Regulations have been used in relation to the Thames Tideway Tunnel which is a Top 40 Priority Infrastructure Investment in the National Infrastructure Plan 2013. On 4 June 2014, the Thames Tideway Tunnel Project Specification Notice, Thames Tideway Tunnel Project Preparatory Work Notice and two Reasons Notices giving the rationale for making the specification notice and the preparatory work notice were made under the SIP Regulations. All four notices are available online at the GovUK website: https://www.gov.uk/government/publications/thames-tideway-tunnel-project-specification-and-preparatory-work-notices.

4.5 By virtue of the Thames Tideway Tunnel being specified, the incumbent undertaker, Thames Water Utilities Ltd, is under a duty to procure competitively an IP to finance, deliver and operate the project. This IP procurement exercise began with the publication of a contract notice in the Official Journal of the European Union on 10 June 2014.

5. Territorial Extent and Application

This instrument applies to the provision of infrastructure for use by any undertaker whose area is wholly or mainly in England, and forms part of the law of England and Wales.

6. European Convention on Human Rights

6.1 Lord de Mauley, Parliamentary Under Secretary of State for Environment, Food and Rural Affairs, has made the following statement regarding Human Rights:

6.2 In my view the provisions of the Water Industry (Specified Infrastructure Projects) (English Undertakers) (Amendment) Regulations 2014 are compatible with the Convention rights.

7. Policy background

What is being done and why?

7.1 The SIP Regulations give effect to various provisions governing project licences as if they were inserted in the Water Industry Act 1991 (the WIA). To a large extent, these provisions were modelled around the regime which applies to the licensing of water suppliers, rather than the provisions that regulate undertakers.

7.2 Whereas Ofwat can include a licence condition in the appointment of water and sewerage undertakers allowing for any question or matter, including disputes as to its determinations, to be referred to the Competition and Markets Authority (CMA), it cannot do the same in respect of an IP's project licence. This is because section 17HA of WIA, as inserted and given effect by Schedule 1 of the SIP Regulations, only allows for conditions to be included in the IP project licence which provide for referrals to the Secretary of State, Ofwat or the relevant quality regulator. Accordingly, it is not possible for a licensed IP to be given the right to require Ofwat to refer a dispute regarding a determination, such as a price control decision, to the CMA.

7.3 By contrast, section 12 of the WIA which applies to water and sewerage undertakers provides that conditions included in an appointment may provide for the reference by Ofwat to the CMA and the determination by the CMA of such questions arising under the appointment and of such other matters, including (in the case of references to the CMA) disputes as to determinations by Ofwat, as are specified in the appointment or are of a description so specified.

7.4 The purpose behind the SIP Amendment Regulations is therefore to bring Ofwat's power to include conditions in an IP's project licence into line with that which exists for a water and sewerage undertaker. Should such a condition be included in the project licence, Ofwat would be able to refer any disputes on price determinations to the CMA on request by the licensed IP, in the same way that a water and sewerage undertaker already can. In the absence of such a condition, the only route of challenge against an Ofwat price determination, for instance, would be by way of an application for judicial review to the High Court on a point of law. This is a more limited form of appeal and is likely to be a lengthy process with corresponding associated costs.

7.5 The SIP Amendment Regulations also make amendments to the SIP Regulations which are consequential upon the CMA taking over the functions of the Competition Commission from 1 April 2014. They amend the SIP Regulations so that references in Schedule 1 to the "Competition Commission" become "CMA".

7.6 Government therefore considers that the SIP Amendment Regulations will:

i) keep the cost of procuring a proposed IP as low as possible, as the risk of the investment would likely be seen as greater without a referral to the CMA being explicit during the IP procurement;
ii) remove any disincentive to invest in a proposed IP at an acceptable cost; and
iii) enable any potential future disputes to be resolved promptly, minimising the time to resolve them and correspondingly helping to minimise any associated costs being passed onto customers.

Consolidation

7.7 There is no consolidation associated with this instrument.

8. Consultation outcome

8.1 A public consultation ran for 6 weeks between 28 July and 8 September 2014. Its purpose was to inform stakeholders who represented interests likely to be affected about taking the proposals forward and included a draft of the SIP Amendment Regulations. It was issued by email to 324 contact addresses including:

- CMA,
- Ofwat,
- Water and Sewerage companies in England,
- Consumer Council for Water,
- EFRA Committee MPs,
- London local authorities,
- MPs within the Thames Water region, and
- Mayor of London;

8.2 Five responses were received and a summary published on 11 November 2014, available online at https://www.gov.uk/government/consultations/water-industry-changing-the-specified-infrastructure-projects-regulations and a copy of which is attached to this memorandum.

8.3 The breakdown of respondents to the consultation is as follows:

Organisation Type	**Number of Respondents**
MPs/Lords	1
Water & Sewerage Companies	1
Public Bodies	3
Total	*5*

8.4 The five respondents provided views and comments on the proposed legislation along with a range of other issues related to the proposed Thames Tideway Tunnel project. Although the points raised on aspects of the Tunnel project itself were not relevant to the consultation, for the sake of completeness they are included in the summary below:

Supportive of the draft SIP Amendment Regulations

- Agree with the proposal to bring Ofwat's power to include conditions in an IP's project licence into line with that which exists for water and sewerage undertakers.

- Referring disputes to the CMA is preferable to applications for judicial review, the costs of which might be passed on to consumers.

- CMA engagement with key stakeholders in the event of a dispute provides reassurance to consumers that an objective decision would be reached taking their best interests into account.

- Project costs should be kept lower by reducing perceived project risks without CMA involvement, thus reducing rates of return sought by investors and resulting in lower customer bill impacts.

- Minor textual drafting amendments were suggested to improve clarity.

Neutral on the draft SIP Amendment Regulations

- Draft proposed amendments to the SIP Regulations are outside the remit of the organisation, therefore no substantive comments to make.

Need for the Thames Tideway Tunnel project questioned (outside the remit of the consultation)

- The problem of Combined Sewer Overflows (CSOs) not quite as bad as portrayed insofar as the spills are untreated sewage diluted with surface rainwater runoff.

- Upgrades to London Sewage Treatment Works should significantly reduce the likelihood of fish kills, rather than the Tunnel preventing CSO spills.

- The Tunnel will make little difference to the visual appearance of the river due to its natural turbidity.

- Health benefits for river users relatively small.

- Increased costs of the Tunnel project render it incompatible with the EU Urban Waste Water Treatment Directive compliance using Best Technical Knowledge Not Entailing Excessive Cost.
- Cost-benefit analysis deeply flawed, and concerns about £80 increase on customer bills hitting the poorest hardest.

- Other alternatives are available for addressing the issue of sewage discharges.

8.5 We have noted the views and comments received from respondents on the draft SIP Amendment Regulations. Other comments relating to the merits of the Thames Tideway Tunnel project itself were also noted, although these are outside the scope of the consultation. The purpose of the consultation was not to review the merits of the Tunnel but to consider proposed amendments to the SIP Regulations that would (i) bring Ofwat's powers to include conditions in a project licence which allow for certain questions or matters to be referred to, and determined by, the CMA into line with those already available in relation to water and sewerage undertakers, and (ii) to update the SIP Regulations so that references in Schedule 1 to the "Competition Commission" become "CMA".

8.6 The case for a tunnel has already been addressed in the Government's National Policy Statement for Waste Water which was debated and approved by Parliament in March 2012. It is available online at https://www.gov.uk/government/publications/national-policy-statement-for-waste-water. The Government supports a tunnel-based solution as the most cost-effective, timely and comprehensive response to the problem of significant sewage pollution in the River Thames in London. It also complies with the judgment of the Court of Justice of the European Union in October 2012 that the UK was in breach of the Urban Waste Water Treatment Directive in respect of London. A Development Consent Order to build and operate the Thames Tideway Tunnel was made on 12 September 2014.

8.7 In light of consultation, and views received on the proposals, Government has decided to proceed with laying the draft SIP Amendment Regulations before Parliament for the reasons stated in paragraphs 7.1 to 7.6 above.

9. Guidance

9.1 Defra will announce the SIP Amendment Regulations coming into effect in the following ways:

- Press Release or announcing on social networks (such as Twitter),
- an email to all the original consultees, and
- on the GovUK website.

9.2 As the instrument amends the SIP Regulations which largely apply the Water Industry Act 1991 to business with neither a net cost nor a requirement for enforcement, there is no need for specific guidance.

10. Impact

10.1 There is no separate Impact Assessment for the SIP Amendment Regulations additional to the original Impact Assessment for the SIP Regulations. This is because the legislation would have no foreseen cost impact to either the private or voluntary sectors.

10.2 The Impact Assessment for the SIP Regulations is available online at: http://www.legislation.gov.uk/uksi/2013/1582/impacts.

11. Regulating small business

The legislation does not affect small business.

12. Monitoring & review

The SIP Regulations include a duty on the Secretary of State to carry out a review of the regulations and publish a report setting out its conclusions at the end of a period of five years beginning with the day on which the SIP Regulations came into force. This duty will apply to the SIP Regulations as amended by the SIP Amendment Regulations

13. Contact

John Manning (020 7238 2019) or email thamestunnelteam@defra.gsi.gov.uk at the Department for Environment, Food and Rural Affairs to answer any queries regarding the instrument.