



Ein cyf/Our ref: JJ/PO/121/2023

Huw Irranca-Davies MS
Chair of the Legislation, Justice
and Constitution Committee

17 April 2023

Dear Huw,

Thank you for your letter of 31 March, regarding the Committee's scrutiny of the Construction Contracts (Exclusion) (Wales) Order 2023.

The purpose of this Order is to allow DPC projects to sit outside some of the requirements of Part 2 of the Housing Grants Construction and Regeneration Act 1996 ('the Act'). The exclusion would cover the agreements between water companies and Competitively Appointed Providers (the CAP) and the construction contracts between the CAP and the first-tier supply chain. The exclusion would not apply to second and third tier supply chain parties – these will remain subject to the provisions of the Act.

DPC projects will be structured in a way which is similar to the Welsh Government Mutual Investment Model (MIM). Water companies are purchasing a service from the CAP – which includes the design, build, finance, and (in some cases) operations and maintenance of an asset or programme/system of assets. The CAP will be paid a CAP Charge over the life of the DPC project similar to the Annual Service Payment in MIM.

As a result, it is expected the CAP will not receive payment until construction of the project (or part of the project) is complete and capable of providing a service. This may include, for example, payment only at the end of the construction of the project, but also stage payments for when parts of DPC projects are complete and providing a service.

The Act requires payment to be made for construction activity as it progresses and not on completion of the construction activity at the end of the construction period or in staged payments which reflect phases of construction activity. The DPC project structure cannot operate unless there is an exemption from the application of these aspects of the Construction Act. Therefore, the relevant contracts have to come within the scope (i.e. the definitions) of Part 2 of the Act before being excluded from the effect of those provisions by means of this Order. It is an Exclusion Order. It can be understood as a two stage process; (i) the contract coming within the scope of Part 2 of the Act and then (ii) being excluded from the effects of Part 2. Therefore, there is not in fact a contradiction between the Order and the Explanatory Memorandum.

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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding.

Example of DPC in action

Furthermore, the Ofwat scheme can be operated with some flexibility which allows a degree of staged payments provided that the part of the project which has been completed is operational and providing a service. The key objective of this Exclusion Order (and of a parallel Order already made in England) is to exclude the rigid provisions of Part 2 of the Act which would otherwise apply.

For example, the Haweswater Aqueduct Resilience Project (HARP) project in England which is currently being procured by United Utilities for delivery via DPC, includes the replacement of six tunnel sections of the existing aqueduct. The DPC project is structured to enable stage payments on completion and operation of each of the tunnel sections. The payment at each stage is determined in part with reference to the actual cost of construction operations. For the HARP project this approach is possible because when each tunnel segment is complete it will provide a benefit to customers.

The total cost of the HARP project is in excess of £1bn and the nature of the tunnelling work is complex. Staged completion aids the financing of the project.

Ofwat's guidance for DPC projects anticipates that different approaches may be required on different projects and requires companies to consider the specific characteristics of their projects and how timing of payments can be structured to offer best value for customers.

With regards to article 3(d) of the Welsh Order 2023, the intention is to provide sufficient detail that allows relevant contracts to be identified and exempt from Part 2 of the Act, but without dictating payment arrangements and permitting some flexibility for water companies to take account of their project specific arrangements. Therefore, the wording in article 3(d) includes a reference to regular payments that are determined in part by reference to the actual cost of construction operations and become payable after at least one part of construction operations is completed and is capable of performing a service.

In terms of the Ofwat process in relation to the procurement and award of DPC projects, DPC is given effect through a condition in water companies' Instruments of Appointment ("licences"). Before a project can be put out to tender, the DPC project must be designated by Ofwat under the licence, and the water company must get Ofwat's consent to launch a tender process. The water company must also gain Ofwat's consent prior to entering into an agreement with a prospective CAP at the end of the procurement process.

In reaching a decision on whether to withhold consent, amongst other things, Ofwat takes into account the proposed commercial arrangements for the project and how they deliver value for money for customers, this includes the timing of any payments to the CAP.

Yours sincerely,



Julie James AS/MS

Y Gweinidog Newid Hinsawdd
Minister for Climate Change