



**Water Industry Act 1991, Section 13**

**Proposals by the Director General of Water Services for the Modification of the Conditions of Appointment of Bristol Water Plc as a Water Undertaker**

**The process**

Any representations about, or objections to, these proposals must be sent in writing to the Director General of Water Services, Centre City Tower, 7 Hill Street, Birmingham B5 4UA (fax, 0121 625 3606 or e-mail [keith.mason@ofwat.gsi.gov.uk]) to be received no later than 5.00pm on 16 January 2004. Please quote reference LEG34/2(A).

**The Proposed Modifications and the reasons for them**

In May 2003 Bristol Water plc (Bristol Water) finalised new financing arrangements. The new arrangements will increase the level of debt of the appointed business.

Ofwat proposes to make the following licence modifications to bring Bristol Water's licence into line with water companies that have restructured their finances.

Bristol Water has agreed in principle to the making of these modifications.

**Ring-fencing of Bristol Water**

The Director wishes to ensure that Bristol Water's regulated business is ring-fenced from the other activities of Bristol Water Group (the Group). Bristol Water (the Company) must not, whether through its involvement in those other activities or by its dividend policy, put at risk its ability either to carry out its functions as a water undertaker or to finance them. Licence modifications will therefore:

- (1) prohibit the transfer of any asset from the Company to any Associated Company except with the Director's consent;
- (2) require the Company to maintain an investment-grade corporate credit rating;
- (3) prohibit the Company from giving a guarantee of any liability or making any loan to any other company within the Group except with the Director's consent;
- (4) prohibit it from entering into or continuing any commitment which includes a 'cross-default obligation' (whereby its financial liabilities are increased or accelerated because of a default elsewhere within the group) except with the Director's consent; and
- (5) require the Company to declare or pay dividends only in accordance with a dividend policy which has been approved by its Board and will not impair its ability to finance its functions.

The Company's Directors are already required to certify annually to Ofwat that it has adequate financial and management resources. Further modifications will therefore require:

- (6) (i) the Directors to certify their opinion that any contracts with Associated Companies include all provisions necessary for the Company to meet its obligations as a water undertaker;
- (ii) the certificate to include the main factors which the Directors took into account in giving the certificate;
- (iii) the Company to inform the Director if the Board becomes aware of any circumstances which might mean that the Company's most recent certificate could not be repeated; and
- (iv) the annual certificate to be accompanied by a report to the Director from the Company's Auditors, detailing any inconsistencies between the certificate and the statements submitted with it or the findings of their own audit.

**Management of Bristol Water**

Although the Company is a subsidiary, it has its own duties as the water undertaker for its area. A further licence modification will:

- (7) require the Company, in carrying out those functions, to behave as if they were substantially its sole business and it were a separate public limited company. In doing so it will be required to have particular regard to the following:
  - (i) the composition of the Board should allow it to act independently of the parent company or controlling shareholder, and exclusively in the interests of the Company;
  - (ii) the Board must ensure that each of its directors discloses any conflicts of interest between their duties to the Company and other duties, both to the Board and to the Director;
  - (iii) where potential conflicts exist between the interests of the Company and other companies in the Group, the Board must ensure that it has regard exclusively to its interests as a water undertaker;
  - (iv) no director of the Company should vote on any matter where they have an interest by virtue of other directorships;
  - (v) the Company should inform the Director of any important changes in the composition of the Board or the responsibilities of any director;
  - (vi) the company's dividend policy; and
  - (vii) the principles of corporate governance which are from time to time recognised by the Listing Rules of the Financial Services Authority.
- (8) A further licence modification will require the Company to publish the financial information that would be required if it was subject to the Listing Rules of the Financial Services Authority.

**Maintenance of comparisons with other water undertakers**

The Director considers that Bristol Water's core business should be transparent to regulation.

To that end, the Director proposes modifications of the Company's licence, which will require it to operate at arm's length from its Group. The modifications will:

- (9) (i) ensure that payment for any services provided by any Associated Company does not exceed prices obtained by market testing, or where this is not appropriate, an appropriate proportion of the Associated Company's costs, as agreed by the Director; and
- (ii) require the Company to obtain from the Associated Company information required by the Director about the latter's costs.


**The role of the Company's owners**

The Company should have the active co-operation of its owners in carrying out its functions as a water undertaker and complying with the conditions of its appointment. Further modifications will:

- (10) (i) require the Company to obtain from the Group legally enforceable undertakings, applicable to all other companies in the Group, that each of them will:
  - (a) give the Company all information it requires to comply with its licence;
  - (b) refrain from any action which would be likely to cause or require the Company to breach any of its obligations under the Water Industry Act 1991 or its licence as a water undertaker; and
  - (c) ensure that the Company's board contains not less than three independent non-executive directors.
- (ii) require the Company to inform the Director immediately in writing, if it becomes aware that the undertaking has ceased to be legally enforceable, or that there has been any breach of its terms; and
- (11) prohibit the Company (except with the Director's consent) from making any contract with a member of the Group which is not one of the Company's subsidiaries, for so long as the above undertakings have not been given or there is an unremedied breach of any of them.

**Office of Water Services**

**December 2003.**

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