

November 17, 2014

**Consultation : Thames Tideway Tunnel ["TTT"]:
Modification to Condition B of TW's Licence**

I wish to contribute some comment to the above Consultation.

Preface:

- 1 This Consultation has been represented as independent of the Consultation for the IP, undertaken recently by OFWAT. Yet the two are interdependent. These two Consultations should have been combined.
- 2 Given that: "Thames Water is responsible for the operation of the overall integrated sewerage network comprising the Thames Tideway Tunnel and its surrounding sewerage system" [ref. Para 2.2, p. 9 of the Consultation], it is a corporate, legal, and administrative charade to implement TTT as a separate and so-called independent IP. The result is a regulated monopoly water utility operating within a regulated monopoly water utility!
- 3 Given this structure, it will indeed be a challenge for OFWAT to achieve its stated aim to "increase transparency" and "facilitate specific uncertainty mechanisms for activities with separate and different risk profiles" [ref. p.6], - whatever the latter means! Complexity is being increased by these proposals at the expense of transparency.
- 4 As a result, the proposed legal and regulatory structure for TW/TTT is a corporate dinosaur. It will keep lawyers in business for years, just interpreting the regulatory texts underpinning the services delivered. It defies common sense and the norms of infrastructure project financing. It removes the main risks from the private water utility back onto customers. It turns the clock of privatisation back 25 years.

Customer value for money is a myth under such a scheme, and the Regulator has subordinated public interest to that of private investors.

- 5 It is time to face the facts. Furthermore, it is the duty of the Regulator to reflect that in its actions. To date, the 'TW customer in the street' is unaware of the costs and implications of TTT.

6 The Facts, as reported:

- TTT will cost £4.2bn. @ 2011 prices, and take 7 years to build. Fixed price contracts are not available over such a period. Hence, TTT is exposed to very high cost over-runs. Who pays? TW customers, of course.

TTT is a high-risk venture, and should only be attempted when other, lower risk options are not available, - a test which has not been undertaken in recent years.

- Since 2004, two years before TW was taken over by a Luxemburg-based, Macquarie Fund, the financial position of TW has deteriorated significantly:-

TW Balance Sheet data:

2004: Equity Capital = £1.57bn. Long-Term Debt = £1.81bn
2014: Equity Capital = £1.39bn. Long-Term Debt = £9.53bn

- In addition to TW's 2014 Long-Term Debt, as above, TW owes, as a deferred tax liability, **HMRC £880mn (= 63% of Equity Capital)**.

Arguably, TW, a privately-owned, public service monopoly, has only £459mn equity capital to prop up a debt mountain of £9.5bn.

- Of this £9.5bn debt, around **£7.6bn has been raised via Cayman Is.** companies. Prima facie, this seems to be in conflict with current Government and G20 initiatives on the use of tax-havens.
- **In 2004, TW's debt/equity ratio was 54/46. Today that ratio is 87/13**, i.e. TW's debt has risen by almost a multiple of 6 during the period 2004 -14, whilst equity capital has remained static.

Meanwhile, shareholders have received over £2.5bn of dividends 2004-14, with OFWAT as a passive observer.

[In reality, TW could probably have funded TTT as a corporate/utility funding in 2005/6, if it had not been so profligate with its financing over the last 10 years.]

- As of October 2014, Standard & Poor's affirmed their 'A-' rating for TW's Class A debt, and a 'BBB' rating, - two notches above 'junk bond' status, - for Class B debt, with the latter (£7.6bn) on 'negative outlook'.

Given the requirement under TW's Licence to maintain an Investment Grade rating, TW have little headroom to meet unexpected events. TTT financiers will note TW's precarious financial position, when assessing TW's ability to fund and execute its participation in TTT.

- TW customers and OFWAT should question the (lack of) transparency of TW operations, not least as the G20 governments are taking initiatives to improve the transparency of multinationals' corporate structures.

In this context, there are 7 corporate layers between TWUL, the licenced utility, and TW's shareholders in Luxemburg.

- **TW have paid no UK corporation tax over the last 4 years (2011-14), whereas they have paid shareholders over £1bn in dividends.**
- TW's Financial Advisor on TTT, UBS, has been subject to a number of reprimands and fines in recent times:-
 - *US \$780mn (£500mn equiv.)* for supporting tax evasion mechanisms in the USA: (2009);
 - *US \$180mn (£110mn equiv.)* for municipal bond market rigging in the USA (2011);
 - *US \$1.5bn (£960mn equiv.)* for LIBOR rigging: (2012):
 - *US \$885mn (£566mn equiv.)* for mis-selling mortgage-backed securities: (2013):
 - *US \$799mn (£511mn equiv.)* for foreign exchange rate rigging: (Nov 2014);
 - Both UBS and the Macquarie Group, the Ultimate Controller of TW under Condition P of TW's Licence, in the last 2 weeks have both been cited in the alleged tax avoidance arrangements made with the Luxemburg tax authorities;
 - it is understood that investigations are being undertaken by French, German and Belgian tax authorities into UBS activities in their countries;
 - UBS (via their UK predecessor, SBC Warburg) were closely involved with the structuring and financing of Eurotunnel, an economic and technical success, but a financial disaster; it never repaid its debts and had to be restructured and re-financed in 2006; and
 - UBS was also Financial Advisor to the UK Channel Tunnel Rail Link ("CTRL"); another financial disaster, which required a UK Government bail out.

- Neither Macquarie, nor TW, are signatories to the UN PRI (Principles of Responsible Investment), and neither Macquarie, nor UBS, are signatories to the Equator Principles.
- In the last 2 months, the Indiana Toll Road (USA) has gone into “Chapter 11”, i.e. bust, and, in the UK, M6 Toll is reportedly teetering on the brink of financial restructuring, both projects being managed by Macquarie/Macquarie Funds, as is TW.
- Conflicts of interest abound, too within the TTT project:-
 - TW has to date been responsible for:-
 - the design, planning and preparatory work for TTT,
 - the choice of who and how companies and investors will be invited to tender for owning, building and operating the TTT project, and
 - the evaluation of the bids and selecting the winner(s),
 whilst supposedly maintaining independence from IP.
 - CH2MHill, TW’s technical advisor for the last 5(?) years on TTT, is expected, - and OFWAT is seemingly supportive, - to be appointed as Project Manager for both IP and TW; and
 - a number of senior TW staff, who were responsible for the development of TTT will transfer over to IP.

Issues of independence and transparency seem to be cast aside.

- In the light of the above, TW customers might rightly question the suitability of the participants in this TW/TTT scenario. It is indeed astonishing, notwithstanding the Chairman of the Public Accounts Committee’s description of TTT as a “big vanity infrastructure project” (ref. Jan 22, 2014, Q109), that nowhere in the Consultation for TTT has either OFWAT, nor Government, seemingly questioned the corporate and financial probity of the participants, never mind issues such as Value for Money, when cheaper, lower risk alternatives are available.
- **It is, indeed, time to draw a line under this whole TTT initiative, before any more TW customer monies are spent.**

Specific Comments on Consultation Document:

- 7 Para. 1.1, 2nd para, p.4: “untreated sewage” may, by some, be deemed as an exaggeration. “Untreated”: yes, but “sewage” is an exaggeration. Such outflows could comprise 95-98% rainwater. The CSO’s arise because of the lack of capacity in the system to cope with excess rainwater. NB. only one fish has been killed in the Thames as a result of such outflows over the last 10 years (official DEFRA data).
- 8 Para 1.1, p.5: (centre page): two-thirds of TTT is to be undertaken by IP, one third by TW. Hence, this description of TTT as being responsible for design, testing, etc. of TTT is incorrect
- 9 Para 1.1, p.5: (lower page): any costs are efficient and continue to represent best value to Thames Water’s customers”: there is no evidence from either TW or OFWAT to support this statement (notwithstanding that it might make OFWAT feel good!).
- 10 Para 1.1, p.5: centre page: TTT has been structured to be built, operated and funded by two, supposedly, financially separate and “independent” utilities, one-third (£1.4bn) TW and two-thirds (£2.8bn) IP.

Yet any such “independence” is a physical and commercial myth. IP will depend on TW to supply untreated water at one end of the Tunnel, and IP will deliver such water back to TW at the other end.

As the ultimate beneficiary of TTT, TW will carry a contingent liability for IP’s performance, et vice versa.

Any financier analysing the proposed structure will note the potential and significant contingent liability carried by TW for IP’s construction and operations.

- 11 Paras 2 & 3: price controls, price time limiting, etc. : RCV for TTT is a misconception. RCV was derived out of RAB, which was established at privatisation to represent the value of an on-going, existing utility delivering a public service.

TTT is unable to provide such service until it is complete. Therefore, its RAB is zero. Hence, RCV becomes meaningless in that scenario.

The use of RCV to establish fees during construction of TTT is pure “Enron economics”.

As to time limiting, etc., it is an established principle of financing infrastructure, - and, indeed, any, - project that the availability of finance is established at the outset. By splitting TTT funding support during construction into two time periods (between AMPs, etc.) goes completely against that principle. It lays the project open to collapse halfway through construction.

Concluding Concern:

These comments repeat much of those stated in the IP Consultation.

12 Notwithstanding perceived weaknesses in the UK Water Regulatory regime, not least the removal by many utilities from the oversight and governance of the London Stock Exchange, OFWAT is still seen, in general, as the ultimate protector of the public interest for customers.

Under the Government's NSIP regime, however, OFWAT has accepted Government instruction to issue a licence(s) for the implementation of TTT, irrespective of the fact that TTT may not be the optimal solution today, nor Value for Money, in overcoming a perceived CSO problem in the Thames.

Further, the Terms of Reference for the Planning Inspectorate, dictated by Government, for their Inquiry into TTT early 2014 precluded any discussion as to the options to resolve the CSO problem, apart from TTT.

TTT was recommended as the answer to the CSO problem in 2005/6. Nine years on, any prudent investor, financier or TW customer, - who ultimately will have to pay for TTT, if implemented, - will question whether that recommendation, - now, 9 years old, - is valid in today's circumstances against other available options.

OFWAT, nevertheless, in the interest of customers should question the validity of that recommendation, as is their responsibility and the integrity of the proposals. **Seemingly, they have not.**

Hence, OFWAT have subordinated customer interest to that of Government, and, in this case, to TW, a private sector, monopoly public service, owned and controlled from a tax-haven.

In the meantime, CCWater and CCG (Customer Challenge Group) are powerless, and arguably fall under the influence of an all-powerful TW; CCG has its administration in TW.

Customer trust has been broken. OFWAT have compromised their independence.

"My priorities (Nov 2012) included getting customers' interest back to the top of the agenda, maintaining trust and confidence in the sector in the eyes of our customers and stakeholders, the sharing of pain and gain more equitably between customers and investors,..." Jonson Cox, City Brief, Aug 2014

"Trust and confidence: hard won and easily lost", Cathryn Ross, CEO, OFWAT, City Brief, Aug 2014.

OFWAT should stand fast to such noble principles. Through their blind support for TTT, however, they will be perceived as bowing to commercial and financial interests at TW customers' expense.