
Statement of Reasons: The granting of consent for United Utilities Water Limited to make loans to an associated company

Introduction

Following a period of working level discussions, on 15 April 2016 United Utilities Water Limited (United Utilities) formally requested consent for a period of 5 years to provide working capital through a series of loans (the “Loans”) of no more than £100 million to a joint venture (JV) company in which United Utilities PLC will own 50% of the equity. The JV will be an associated company of United Utilities for the purposes of the conditions of United Utilities’s appointment (licence) as a water and sewerage undertaker. Paragraph 6.11 of licence condition F (Accounts and Accounting Information) states that United Utilities shall not, without consent of the Water Services Regulation Authority (Ofwat), make any loan to any associated company.

On 19 April 2016 we granted consent (for a period of 5 years) pursuant to licence condition F paragraph 6.11 for United Utilities to make Loans to the JV of no more than £100 million.

This notice sets out the reasons why Ofwat has given consent for United Utilities to make the Loans to an associated company and explains the background to this consent.

United Utilities request

United Utilities has announced the creation of a JV with Severn Trent Water Limited (Severn Trent) to combine their non-household retail activities.

United Utilities and Severn Trent (the “appointees”) have explained that the transaction is being entered into in preparation for the opening up of the English non-household retail sector to full competition from April 2017. The JV will have its own management and operate independently of the appointees’ wholesale businesses.

The intention is to create a more efficient organisation focused solely on non-household retail activities and customers.

The appointees have also announced their intention that in due course they will apply to the Secretary of State for consent to exit non-household retail and so be able to fully transfer their non-household retail activities to the JV. Following any retail exit and the opening of the competitive market the JV would seek to retain its existing customers and acquire new customers on the basis of attractive price and service offerings.

As part of the transaction that will create the JV the appointees are seeking to provide Loans to the JV so that it has access to the working capital required for it to provide non-household retail services to customers. These Loans will be on an arm's length basis with the balance of the Loans fluctuating over time reflecting changes in the JV's working capital requirements.

Our duties

In assessing this request we have considered our statutory duties.

In summary, our main statutory duties in relation to water and sewerage undertakers are to:

- further the consumer objective (to protect the interests of consumers, wherever appropriate by promoting competition);
- secure that the relevant companies properly carry out their functions;
- secure that the relevant companies can finance the proper carrying out of their functions; and
- further the resilience objective (to secure long-term resilience).

Subject to those duties, we also have duties to (among other things):

- ensure that consumers are in particular protected by ensuring that transactions with associated companies are carried out at arm's length.

Main considerations

In assessing the request from United Utilities for consent we have considered how customers will be protected, whether the Loans would be consistent with United Utilities's obligations for arm's length trading, the ability of United Utilities to continue

to comply with its licence obligations, the impact of the Loans on the finances of United Utilities and whether a special administrator (if appointed) would be unduly constrained by the grant of the Loans and the transaction more generally.

United Utilities has provided assurances in connection with the grant of the Loans and the transaction more generally that:

- customers will be protected during the transition to the new arrangements with United Utilities having put in place: a customer focused communication plan; measures to protect customer service and track customer satisfaction; and arrangements to effectively and efficiently deal with any customer questions or complaints
- during the period ahead of any retail exit United Utilities will remain responsible for complying with all its licence obligations in respect of the provision of services to its non-household customers, and it will ensure that the JV complies with United Utilities's price control arrangements
- it has acted consistently with its obligations in respect of arm's length trading, including in respect of the transfer of assets, making of the Loans and other commercial arrangements with the JV
- the purpose of the Loans are only to provide the new JV with the working capital required for it to provide non-household retail services to customers. As the JV becomes properly established the intention is that the Loan balances will fluctuate in line with the JV's working capital requirements reflecting its non-household retail activities and the revenues deriving from its participation in the non-household retail market
- the Loans will be no more than £100 million at any time during the 5 year period of this consent. This compares to a regulatory capital value of the United Utilities's business of approximately £10 billion, and
- the Loans and the transaction more generally will be consistent with the requirements of any special administrator and so with the longer-term provision of resilient services across the sector, in particular, in the circumstances of any special administration United Utilities would be able to continue meet its obligations to non-household retail customers (ahead of any retail exit) and the transaction would not obstruct the ability of a special administrator to transfer regulated activities to another company.

The transaction is also subject to merger control procedures and a phase 1 investigation by the Competition and Markets Authority (CMA) under the Enterprise Act 2002 is currently underway. Our consideration of United Utilities's request for consent to the Loans is without prejudice to the outcome of the CMA's review of the impact of the transaction on competition.

Other matters

The other party to the JV is Severn Trent. Its licence does not contain a full set of financial ring fencing conditions and so it does not require formal consent to make loans from its appointed business to the JV. Nonetheless, it has provided similar assurances to those given by United Utilities in relation to customer protection, competition, licence compliance, financing and resilience. Therefore, we would have been prepared to grant such consent had it been formally required. It is also subject to the same licence obligation to ensure that every transaction with an associated company is at arm's length, so that neither gives to nor receives any cross-subsidy.

Conclusion

We have considered the specific circumstances of this transaction (which include the provisions of the Water Act 2014 that will allow non-household retail exit and that it will be necessary for the JV to have access to working capital) and the assurances that United Utilities have given (as finalised on 15 April 2016), including in relation to:

- customers being properly protected, in particular during the transition to the new arrangements
- that the Loans and other aspects of the transaction are consistent with the requirements in the licence for arm's length trading with associated companies
- in the period ahead of any retail exit that United Utilities will remain responsible for compliance with licence conditions and other legal obligations relating to the provision of non-household retail services to its customers
- in the circumstances of the appointment of a special administrator the arrangements associated with the transaction would not obstruct the ability of a special administrator to carry out its functions, including if necessary the transfer of the regulated business and its responsibilities to another company, and
- the licensee retaining adequate financial and management resources to discharge its regulated activities and obligations.

United Utilities will also continue to have an obligation under its licence to ensure that every transaction with an associated company is at arm's length, so that neither gives to nor receives from the other any cross-subsidy (paragraph 6.11 of Condition F).

Bearing in mind both the specific circumstances of the transaction and the assurances that United Utilities have given, we granted consent on 19 April 2016 for a period of 5 years (that will end 19 April 2021) for Loans from United Utilities to the

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JV of no more than £100 million, as formally requested by United Utilities on 15 April 2016.