



Change of control - general policy and its application to Thames Water

1. Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage customers in England and Wales. CWater has four regional committees in England and a committee for Wales.
- 1.2 We welcome the opportunity to respond to Ofwat's consultation on the issues arising out of the change of control of Thames Water, as well as how companies' licences can be reformed to help ensure that water companies put customers' interests at the heart of what they do.

2. Executive Summary

- 2.1 CWater recognises that the corporate behaviour of some companies, along with significant service failures, can damage customers' trust in the water sector. Therefore we support the first steps Ofwat is taking to improve the regulatory regime to address this by reforming companies' licences.
- 2.2 When company ownership structures change, this carries the risk of shareholders having a different and material influence over how a company operates, so we support Ofwat's proposed licence change to ensure any change of control is reported and any risk(s) identified and addressed.
- 2.3 Further to this, identifying the parties in the ownership structure who are Ultimate Controllers is important because as well as providing transparency about which parties have influence in how the appointed company is run, it can inform the ring fencing arrangement that helps ensure the company is independent and subject to governance principles that focus on delivering for customers.
- 2.4 Consistently applied ring fencing arrangements would ensure customers of all companies receive the same level of protection. The additional ring fencing arrangements should cover 'cash lock up' requirements if the company has issues with its credit rating, and notifying Ofwat of shareholders that may have a conflict of interest. We support the inclusion of Ofwat's Board Leadership, Transparency and Governance (BLTG) principles as an additional new ring fencing requirement, but would like to see these principles reviewed as 'good practice' governance may have evolved since Ofwat set the principles in 2014.
- 2.5 We support the application of these proposals to Thames Water's licence in light of changes to its ownership structure, and Ofwat's assessment of their new shareholders fitness to invest in the sector. We note that Thames is now renewing its governance arrangements. This should at least reflect the current BLTG principles, and we look forward to seeing the result of this in due course.
- 2.6 We look forward to Ofwat holding discussions and consultations on additional proposals for principles-based licence conditions that will further enhance the requirement for companies to focus on the needs and expectations of their customers.

3. Responses to consultation questions

Q1: What are your views on the introduction of notification requirements on change of control into the licence information requirements?

We agree that Ofwat needs to identify and address any regulatory issues arising from a change of control at an appointed water company, and make any required licence changes in a timely manner. We also agree that a consistent approach to all appointed companies would help ensure any changes of control are identified and addressed fully.

Therefore, we support a new licence condition that requires the appointed company to inform Ofwat when it becomes aware of a change that could be a change of control¹.

Q2: What are your views on the proposed obligation to provide us with information?

In order to fully explore the implications of a change of control, we agree that Ofwat will require a range of information to assess whether the new structure will enable the appointed company to carry out its functions and commitments. This obligation is currently lacking in company licence requirements.

Q3: What are your views on the information that may be helpful for our assessment of change of control?

Ofwat's proposed range of information as set out in Appendix A2 of the consultation paper would give a detailed profile of the corporate and organisational structure of an appointed company and its owners, along with their economic, technical, and professional capacity to run a regulated water utility.

The range of information also includes possible conflicts of interest, any legal issues or investigations the owners or controller(s) are subject to, and a demonstration of their willingness and ability to comply with the regulatory environment they will be operating in.

We think this is a suitably comprehensive range of information which should either give Ofwat an assurance that the change of control will protect customers' interests or prompt Ofwat to investigate further and challenge if necessary. Licence changes should not be approved if an appointee fails to comply with these requirements.

Q4: What are your views on the proposed obligation to require the Appointee to comply with any direction from Ofwat to enforce an Ultimate Controller's undertaking?

Firstly, Ofwat needs to ensure an appointed company has identified and informed the regulator of who is the Ultimate Controller (i.e. the party that has a controlling interest and/or can materially influence the appointee's board). This is important as some of the more complex ownership structures do not always show clearly who the Ultimate Controller is.

Secondly, the role of the Ultimate Controller should be clear in the appointed company's governance arrangements.

¹ This should include a submission for merger clearance to the Competition and Markets Authority and/or the European Commission.

Thirdly, we support an additional licence provision which will require the appointed company to comply with any direction from Ofwat to enforce an undertaking required by the Ultimate Controller. We note that while licence conditions currently require appointed companies to procure required undertakings from the Ultimate Controller, the appointee cannot enforce them. By adding the ability to enforce an undertaking, Ofwat is helping to protect the integrity of the appointed company in customers' interests.

Q5: What are your views on bringing all the licences up to the same standards, including introducing a requirement to meet the Board Leadership Transparency and Governance (BLTG) principles?

Customers of all appointed companies will benefit from consistent ring fencing standards set in company licences, as it will help ensure the regulated utility is protected. As Ofwat notes, current ring fencing conditions currently vary, and we agree with the move to make them more consistent.

We also support an extension to the ring fencing conditions to require companies to comply with the BLTG principles. This should give customers greater assurance that companies are complying with high standards of governance and leadership.

Q6: Are there aspects of the most up to date provisions which you think we need to revisit or amend?

As the BLTG principles were published, following consultation, in January 2014, we think these should be reviewed to ensure they remain fit for purpose. The 2014 principles were designed to ensure appointed companies act independently, and have corporate governance standards commensurate with those of companies listed on the London Stock Exchange.

As over four years have passed since the principles were set, it may be beneficial to review to what extent to which the world of corporate governance has changed and how this should be reflected in the BLTG principles.

Q7: What are your views on how the ring fencing conditions need to be further updated?

The ring fencing conditions could apply consistent standards in the following areas, where licence conditions currently vary:

- The requirement for appointees to have a 'cash lock up' if it is placed on a negative watch by the credit rating agencies. Consistency here would help protect customers from any failures as the appointees would not be able to release funds to the holding company without Ofwat's consent, in this scenario.
- An obligation for Appointees to inform Ofwat of any circumstances that materially affect its ability to carry out its regulated activities, for example changes in financial structures or significant changes in investors. Appointees could be required to inform Ofwat before the change takes effect, to allow for Ofwat intervention if needed.
- If the appointee has a shareholder who holds shares in multiple utilities. The ring fencing conditions could require companies to alert Ofwat of such scenarios to allow a review of whether it presents a conflict of interest.

Additionally, we support the current ring fencing conditions that state that appointees should operate the business as if it is their sole business (independent of the holding company) to standards commensurate with a publicly listed company.

To ensure this is understood and implemented, Ofwat could add a licence condition that requires appointees to periodically demonstrate to Ofwat how it is adhering to this

requirement. Much of Ofwat's regulation focuses on compliance statements rather than demonstrating adherence, so this may be an opportunity for Ofwat to require companies to demonstrate how they apply required principles.

Q8: Do you agree with our assessment of the incoming investors of Thames Water?

Q9: What are your views on the ability of the new investors of Thames Water to run a regulated water utility?

Q10: Do you have any concerns with the new investors of Thames Water that might affect the ability of Thames Water to fulfil its statutory duties and obligations under its licence?

The consultation paper details the structures and relationship with Thames Water, of OMERS, Kuwait Investment Authority, and the Universities Superannuation Scheme. This includes a look at their experience in water and other regulated sectors and governance arrangements.

As CCWater only has access to limited information about these investors, in response to all three questions, it would not be appropriate for us to comment on their ability to run a regulated water company or Ofwat's assessment.

Q11: What are your views on the proposed modifications of Thames Water's licence?

We agree with the proposed modifications because they are in line with the more consistent licence conditions Ofwat is proposing for all company licences, including providing information in the context of change of control, identifying the Ultimate Controller and reinforcing the ring fencing arrangements.

Q12: What are your views on our assessment of the Ultimate Controllers under the current arrangements?

Table F on page 26 of the consultation paper lists the seven Ultimate Controllers Ofwat has identified as having a material influence on how Thames Water operates, based on the percentage of shares in the company. Ofwat's assessment has been applied methodically in line with the principles set out in the consultation proposals that apply to all companies.

However, Ofwat will need to ensure that this is reviewed if Thames notifies of any changes, and ensure that Thames' governance arrangements (currently under review) comply with current BLTG principles. This will have to be revisited as and when the BLTG principles are reviewed and updated, as we suggest in response to Question 6.

Enquiries

Enquiries about this consultation response and requests for further information should be addressed to:

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