T. Martin Blaiklock
Consultant
Infrastructure & Energy Project Finance

[redacted]

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OFWAT Consultation:
"Change of Control – General Policy and its Application to Thames Water"

I wish to comment on the above Consultation.

1. It is now ten years since I first made comment as to OFWAT's regulatory and licensing regime for water Appointees, so I am pleased to see that, at last, some action is being proposed. Furthermore, it is now 25 years or more since the England & Wales water utilities were privatized, so some adjustments to the licensing regime is called for to meet today's circumstances.

   Rather than respond directly to OFWAT's questions, - after all, "consultation" should be a two-way process, - I would like to highlight some of what I see as omissions in OFWAT's proposals.

2. The arrival in the last 10 years of institutional investors and Private Equity Funds as shareholders in water utilities has raised some unforeseen** issues, which have allowed financial excesses to arise, and these need to be addressed.
   [** As to why they were "unforeseen" is a discussion for another day!].

   Overall, however, whilst the privatized utilities are essentially, by law, "private" companies, which normally enjoy a degree of non-disclosure, they are also public service monopolies, so the highest standards of transparency, integrity, accountability and probity are demanded. Hence, OFWAT's proposals are a move in the right direction. Nevertheless, I perceive there to be some gaps.

3. **"Control":** The issue of shareholder "control" is a tricky one, as the proportions of shareholder equity in a company may not necessarily reflect who is in "control". For example, said shareholders may have assigned their ownership/management rights to a third party, as can arise with Private Equity-structured deals. If the latter be the case, then it should be for the Appointee to identify the source of "control", and, if such "controlling" party does not reflect the majority shareholding, the management and commercial/financial arrangements between the shareholders and the "controller" must be disclosed.

With many current Appointees being ultimately owned and controlled through companies domiciled in tax-havens, where arrangements between the parties may be opaque, such disclosure should be mandatory for all Appointees.

4. **Corporate Structure**: many Appointees have adopted complex, "wedding cake" corporate structures, which obfuscate responsibilities and liabilities, and push up the administration costs. They should be outlawed, unless there is a good (i.e. explicit) corporate reason for such structures to be adopted.

5. **Tax-havens****: it has been noted that some Appointees have used tax-haven-domiciled companies, e.g. Cayman Islands, to raise capital. The reasons for this are not very clear, but it raises the questions as to: (a) whose money is being used; (b) where did the money come from; and (c) why is it domiciled in a tax-haven? UK Appointees, should not be allowed to resort to using such sources of capital.

   [** Note: Jersey, Guernsey, IoM, etc, are included in my list of tax-havens]

6. **Change in Shareholders**: notwithstanding that Appointees are "private companies" with many being unquoted on the LSE, when the sale of shares takes place, the amount, value, identity and domicile of the parties to the sale should be publicly disclosed.

   It is understood that this is not normal for unquoted UK enterprises, but Appointees are public service monopolies, where a higher standard of probity is demanded, i.e. "don't go into the kitchen unless you are prepared to cook"!

7. **Ring-fencing**: the service (interest and repayment) of shareholder loans and subordinated debt should be included in the definition of "dividends" under the proposed ring-fencing clauses.

8. **Debt**: the Appointee's licence should include clauses which demand that any debt raised by, or in support of, the Appointee's activities should be raised on an ''arms' length' basis and on commercial terms [cf. OFGEM's standard gas transmission licence terms (ref. Condition 47).

9. **Deferred Liabilities**: since privatization, Government/HMRC have introduced provisions for companies to 'bring forward' depreciation allowances, such that this measure reduces current corporation tax liabilities, albeit creating additional liabilities for tax at a later date, if tax rates stay at the same level as today. This concession by Government/HMRC was introduced to incentivize companies to invest in assets of production.

   However, Appointees need no incentive to invest, as investment programs are pre-determined by their PR tariff / RAB negotiations every 5 years. Hence, this concession is an unnecessary handout at taxpayers' expense. [It also raises the question as to whether OFWAT includes this concession in its RAB calculations?].

   In the case of Thames Water, the potential tax liability is recorded in their Balance Sheet (2017) as £877mn, not an insignificant sum.

Either: (a) Appointees should, in the public/taxpayers' interest, not avail themselves of this concession, or (b) OFWAT should adjust their RAB calculations accordingly when setting tariffs.

10. **Customer Interface:** for those Appointees, who have chosen to remove their shares from the London Stock Exchange, the Directors should arrange an Annual Public Meeting when customers can interface with water company management.

11. **Pension Deficits:** In the year-ending 2017, the TWUL pension deficit went up from £260mn to £379mn. During 2017, TWUL contributed around £60mn to its two pension funds, but paid shareholders a dividend of £157mn. Is this imbalance fair?

    It is recognized that many private companies / Appointees currently carry significant pension deficits in their accounts, but one would hope that Appointees would set the highest standards with respect to supporting their pensioners. Some rebalancing constraint is called for as to how excess profits/dividends are paid in relation to increases in pension deficits. Could this be part of the "ring-fencing" constraint?

12. **Sustainable Development Goals ("SDG"):** in the current international climate, it is essential that Appointees maintain the highest standards with respect to SDG. In response,

    I recommend that:

    - Licensees should be signatories to the UN Principles of Responsible Investment ("UNPRI");

    - Investment projects undertaken by Appointees should comply with The Equator Principles ("EP"): the UK has 'designated status" under the EP, which reflects the judgement that domestic UK SDG-type regulations comply with the Equator Principles. However, history has shown that that is not always the case for some UK infrastructure projects!; and

    - Appointees should achieve "green" status, as and when "green" ratings for bond issuers are introduced, as for credit ratings (S&P, etc.). In any event, Appointees should ensure that their bond issues achieve at least a (S&P) "green" rating.

13. **Conflicts of Interest [CoI"]**: CoI arise in almost every major Appointee's activities and investment projects. However, an event of CoI should always be seen as a perception, or judgement, by a third party, and not a judgement to be made by the conflicted party.

    It should be the responsibility of each Appointee to keep a CoI Register for all Directors and major contractors (value >£250,000). Failure to register a CoI should, possibly, lead to loss of office or contract termination.

14. **The RAB Model**: whilst it may be a task for another day, the RAB Model is "past its sell-by date" and needs revision. At best it reflects a notional value of the enterprise, based on market data 25 years ago, plus some updates on investment values since then.

    There is much to be said for:

    (a) bringing back the enterprise value to more closely reflect the audited value of the Appointees;

    (b) changing the reporting period to less than the current 5 year cycle; and

    (c) under the new "RAB", placing the risks of implementing new investment projects with the Appointees, not with customers (who cannot control such risks).