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Change of Control
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By email: FinanceAndGovernance@ofwat.gsi.gov.uk

8 June 2018

Dear Aileen

Response to the consultation: "Change of control - general policy and its application to Thames Water" (the "Consultation")

Thank you for the opportunity to respond to the Consultation.

As a general matter, we have a concern that material issues of broad application across the sector which are contained in the Consultation have not been as broadly flagged and debated as we would have liked given the importance of some features, principally because the Consultation prima facie appeared to be deal with specific change of control issues for Thames Water. Nevertheless, we acknowledge that seeing how the changes apply to a real-life example - Thames Water in this case - is helpful to our understanding.

We have focused on the aspects of the Consultation which have the broadest application and where we have concerns. Hence this letter contains responses only to questions 1-3 and question 5 which are raised in the Consultation, albeit recognising that responses to these questions may also have relevance to other questions raised in the Consultation (such as questions 11-12).

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

We believe that it is appropriate for Ofwat to be informed at a suitable time of a potential change of control, and this would certainly be the case where arrangements have led to a change in Ultimate Controller or another regulatory authority has been advised (i.e. legs 3.6(b) and 3.6(c) of the proposed new Condition P for Thames Water).

However, our view is that issues are raised by the first leg of the test, contained in 3.6(a) of the proposed new Condition P for Thames Water, including that there are no safe harbours or allowance for exercise of judgement on the part of the Appointee's Boards. There are other duties owed and sensitivities which often need to be considered in such situations – for example, the maturity of any proposal or deliberations, the position of other stakeholders (and risks arising therefrom) and the potential implications for both companies and Ofwat by virtue of such information constituting potentially price sensitive information under relevant listing rules.

We would recommend, as an alternative to leg 3.6(a), that a more general principle be followed (and understood by Appointee's Boards) that it is for the Appointee to advise Ofwat of a potential change of control at a time when its Board considers it appropriate having regard for all relevant factors at play. It is noted that Boards of Appointees would be aware of an impending, genuine process, given that access to information and cooperation of the Appointee would be required to facilitate any sale process.

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

We agree with the principle that new owners should engage with Ofwat to provide information.

The question then arises as to what are the potential consequences, including remedies or other measures, in relation to issues that arise from the information that is being requested, particularly given the specificity of the information which is listed in Appendix A2? The Consultation contains limited detail on this aspect but, presumably, it could result in Ofwat seeking changes to the proposed new ownership or financing arrangements.

By introducing this requirement, it should be anticipated that (many) potential owners and interested parties would seek to engage in advance of the acquisition of change of control, in order to gain a firm understanding of Ofwat's position in advance of their commitment. This would obviously have implications for Ofwat and its processes (as well as existing and potential new investors in the sector), including as to how the certainty sought by such parties would be satisfied in advance.

In addition, the implications for the perception of the UK water sector's openness to new sources of capital should be understood – this openness has been important to securing investment to support the sector over many price reviews as well as delivering on a lower cost of capital for the sector and thus lower customers' bills.

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

We note that some of the prescriptive information contained in Appendix A2 may not be available in respect of specific types or classes of owners. For example, information in the strict form requested may not be applicable for institutional funds (such as those advised by iCON Infrastructure). In addition, there appear to be new threshold criteria contained in A2(c) but are not clear how these operate (or how they have been developed). For example, is it intended that a number of water only companies would not satisfy the proposed size criteria so they may not be acceptable buyers of another Appointee? Finally, regulatory investigations and legal claims referred to in A2(d) and (e) are often confidential or have confidential aspects (and legal professional privilege may operate).

In this context, we would encourage that information lists are guides rather than obligatory requirements, and that a flexible "provide" or "explain" type approach is applied by Ofwat.

Q5: What are your views on bringing all the licences up to the same standards, including introducing a requirement to meet the BLTG principles?

As a general matter, we have concerns that changing all licences through this specific consultation appears to be via a less comprehensive approach to consultation to those adopted by Ofwat in recent processes considering proposals to materially change licences.

Specifically, in relation to the Board Leadership and Transparency Guidelines ("***BLTG***") provisions, Clause 2.2 of the proposed Thames Water Condition P contains the obligation that the Appointee "must meet the corporate governance principles issued by the Water Services Regulation Authority and revised from time to time". There are a number of elements of the formulation proposed that we consider to be problematic, including but not limited to the following:

- The BLGT as they stand today have not been drafted with a view to them being obligatory (with licence breach as a consequence of non-compliance), and we do not believe they would be fit for purpose (or would have been adopted) in their current form if they had such force.

- The scope for temporary breaches (for example, because of turnover of independent non-executive directors) or even less transitory breaches (for example, because company specific factors suggested it was in the best interests of the company to have more executive directors) could result in a "technical" licence breach, with all the fundamental issues that such creates for financing arrangements of an Appointee as well as the prospect of regulatory sanctions.

- The approach Ofwat proposes is at variance to the approach embodied in the UK Corporate Governance Code (the "***Code***") which, as stated in the Code, is "widely admired and imitated internationally". The Code is not a rigid set of rules and works on a "comply or explain" approach. We believe that such an approach would also be the preferred one here, and is best suited to accommodate the diverse nature of the UK water sector.

- By requiring Appointees to have governance consistent with a UK publicly listed company (pursuant to 2.1(b) of the proposed Condition P for Thames Water), Appointees would already be required to apply the Main Principles contained in the Code, pursuant to UK Listing Rules.

- The ability of the "principles" to be "revised from time to time" provides the de facto ability to change licences implicitly via a process that is different from the licence change process. In fact, the Consultation explicitly flags Ofwat's intention to revise the BLTG.

Finally on this matter, the proposed source of challenge by companies contained in clause 11 of the proposed Condition P, being appeal to the Competition and Markets Authority (the "***CMA***"), does not prima facie seem like an appropriate forum for disputes of this nature on this subject matter: it is a very expensive and time consuming dispute resolution process and, importantly, it is not clear against what objective criteria would the CMA be expected to determine reasonableness or otherwise of proposed revisions to corporate governance principles.

We also have material concerns in relation to the narrowness of the two principles that are expected to be embodied in companies' dividend policies, as per Clause 8 of the proposed Condition P. From an interpretative perspective, it is unclear whether the two principles are exhaustive and the specific wording in Clause 8.1(b) is not clear. We refer to our letter to Rachel Fletcher dated 16 May 2018 in which we highlighted the multitude of factors which determine dividend policies and levels, including the need to remunerate capital. We would expect that any such provision makes clear that the identified principles are not exhaustive (including specific reference to a dividend policy being able to embody other matters or principles as the Board of the Appointee should consider appropriate) and that 8.1(b) is expressed with greater clarity to enhance the ability of Board members of Appointees to interpret and apply it.

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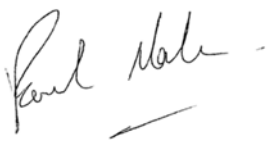
We would be happy to discuss any aspect of your Consultation and our response contained in this letter at your convenience.

Yours sincerely



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