

Modification of the Conditions of Appointment of Thames Water Utilities Limited

**Made on 20 November 2018
Coming into effect on 21 November 2018**

The Water Services Regulation Authority, in exercise of the power conferred on it by section 13(1) of the Water Industry Act 1991 (the "Act"), after giving notice as required by section 13(2) of the Act, hereby makes the modifications described in the Schedule attached hereto to the Conditions of the Appointments of Thames Water Utilities Limited (the "Appointee") as a water and sewerage undertaker under Chapter 1 of Part II of the Act, the Appointee having consented to these modifications.

**Signed for and on behalf of the
Water Services Regulation Authority**



**Aileen Armstrong
Senior Director, Finance and Governance**

Schedule

Condition A

Condition A is modified as follows:

1. In paragraph 2, after sub-paragraph (2) insert the following new sub-paragraphs:

- “(3) references to a liability shall be taken to include the creation of any mortgage, charge, pledge, lien or other form of security or encumbrance, the making of a loan and the taking on of a debt; and
- (4) references to a loan shall be taken to include the transfer or lending, by any means, of any sum of money or rights in respect of such sum.”

2. In paragraph 3 the following new definitions are inserted at the appropriate place:

“**Corporate Family Rating**” means a credit rating assigned by a Credit Rating Agency, to reflect its opinion of the ability of a corporate group to honour all of its financial obligations, as if there was a single class of debt and a single consolidated legal entity structure, where the corporate group is as determined by the relevant Credit Rating Agency, and the Water Services Regulation Authority has approved in writing to the Appointee that such corporate group can be used for this purpose.

“**Credit Rating Agency**” means:

- (a) Standard and Poor’s Ratings Financial Services LLC (or any of its subsidiaries);
- (b) Moody’s Investors Services Incorporated (or any of its subsidiaries);
- (c) Fitch Ratings Limited; or
- (d) any reputable credit rating agency which has been notified to the Appointee by the Water Services Regulation Authority as having comparable standing to Standard & Poor’s Ratings Group, Moody’s Investors Services Incorporated and Fitch Ratings Limited in both the United Kingdom and the United States of America;

“**Cross-Default Obligation**” means a legal obligation contained in an agreement or arrangement where the Appointee’s liability to pay or repay any

debt or other sum arises or is increased or accelerated due to the default of any person other than the Appointee;

“Financing Subsidiary” means a subsidiary company of the Appointee:

- (1) (a) which is wholly owned by the Appointee; and

(b) the sole purpose of which, as reflected in the company’s articles of association, is to raise finance on behalf of the Appointee for the purposes of the Regulated Activities; or
- (2) Which the Water Services Regulation Authority has agreed in writing will be considered a Financing Subsidiary.

“Holding Company” has the meaning set out in section 1159 of the Companies Act 2006;

“Investment Grade Rating” means an Issuer Credit Rating recognised as investment grade by a Credit Rating Agency;

“Issuer Credit Rating” means, either:

- (a) an issuer credit rating assigned to an issuer of corporate debt by a Credit Rating Agency; or
- (b) a Corporate Family Rating assigned by a Credit Rating Agency to the Appointee for so long as the Appointee continues to be a member of a corporate group approved for this purpose by the Water Services Regulation Authority.

“Lowest Investment Grade Rating” means:

- (a) an Issuer Credit Rating of BBB- by Standard & Poor’s Ratings Financial Services LLC or Fitch Ratings Limited or an Issuer Credit Rating of Baa3 by Moody’s Investors Services Incorporated or such Issuer Credit Rating as may be specified from time to time by any of these credit rating agencies as the lowest Investment Grade Rating; or
- (b) an equivalent rating from any other Credit Rating Agency;

“Ring-fencing Certificate” means a certificate, submitted to the Water Services Regulation Authority by the Appointee, which states that, in the opinion of the Board of the Appointee:

- (a) the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out the Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted;
- (b) the Appointee will have available to it sufficient management resources and systems of planning and internal control to enable it to carry out the Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted; and
- (c) all contracts entered into between the Appointee and any Associated Company include the necessary provisions and requirements in respect of the standard of service to be supplied to the Appointee, to ensure that it is able to carry out the Regulated Activities;

“subsidiary” has the meaning set out in section 1159 of the Companies Act 2006;

“Ultimate Controller” means any person which, whether alone or jointly and whether directly or indirectly, is, in the reasonable determination of the Water Services Regulation Authority, in a position to control or in a position to materially influence the policy or affairs of the Appointee or any Holding Company of the Appointee;

“United Kingdom Holding Company” means a Holding Company which is registered in the United Kingdom and which is not a subsidiary of any company registered in the United Kingdom;”

Condition P

Condition P is deleted in its entirety and replaced with the following new condition:

“Condition P: Regulatory ring-fence

1 Introduction

1.1 The purpose of this Condition is to ensure that:

- (a) the Appointed Business is conducted as if it is substantially the Appointee’s sole business and it is a public limited company separate from any other business carried out by the Appointee;

- (b) the Appointee retains sufficient rights and assets and has in place adequate financial resources and facilities, management resources and systems of planning and internal controls;
 - (c) any transfers or transactions entered into by the Appointee do not adversely affect the Appointee's ability to carry out the Regulated Activities;
- and
- (d) the Appointee demonstrates that it is complying with the requirements of this Condition.

2 Conduct of the Appointed Business

- 2.1 The Appointee must, at all times, conduct the Appointed Business as if the Appointed Business were:
 - (a) substantially the Appointee's sole business; and
 - (b) a public limited company separate from any other business carried out by the Appointee.
- 2.2 The Appointee must meet the corporate governance principles issued by the Water Services Regulation Authority and revised from time to time.
- 2.3 The Appointee will demonstrate, in an appropriate manner, how it is meeting the principles referred to in paragraph 2.2.

3 The Role of the company's Ultimate Controller and United Kingdom Holding Company

- 3.1 The Appointee must ensure that, at all times:
 - (a) there is an undertaking in place which is given by the Ultimate Controller of the Appointee in favour of the Appointee; and
 - (b) where the United Kingdom Holding Company of the Appointee is not the Ultimate Controller of the Appointee, there is an undertaking in place which is given by the United Kingdom Holding Company of the Appointee in favour of the Appointee.
- 3.2 The Appointee must ensure that any undertaking given pursuant to paragraph 3.1 provides:

- (a) that the person giving the undertaking must, and must procure that each of its subsidiaries other than the Appointee and its subsidiaries:
 - (i) provides to the Appointee such information as is necessary to enable the Appointee to comply with; and
 - (ii) does not take any action which may cause the Appointee to breach any of,

its obligations under the Water Industry Act 1991 or under these Conditions;
and

3.3 Where:

- (a) an undertaking required to be given by a person in accordance with paragraph 3.1 is not in place; or
- (b) there has been a breach of the terms of such an undertaking by the person that gave it and that breach has not been remedied,

the Appointee must not enter into any new contract or arrangement with such a person or the subsidiaries of such a person other than subsidiaries of the Appointee, without the prior written approval of the Water Services Regulation Authority.

3.4 The Appointee must provide to the Water Services Regulation Authority such certified copies of any undertaking given pursuant to paragraph 3.1 as are requested by the Water Services Regulation Authority.

3.5 The Appointee must immediately inform the Water Services Regulation Authority in writing if the Appointee becomes aware that:

- (a) an undertaking given by a person pursuant to paragraph 3.1 has ceased to be legally enforceable; or
- (b) there has been a breach of the terms of such an undertaking by the person that gave it.

3.6 The Appointee shall inform the Water Services Regulation Authority as soon as reasonably practicable if the Appointee becomes aware that:

- (a) arrangements are in progress or in contemplation which, if carried into effect, may lead to a change to the Ultimate Controller(s) of the Appointee; or

(b) arrangements have been put into effect which might be considered to have led to a change to the Ultimate Controller(s) of the Appointee; or

(c) any person intends to submit a merger control filing to the Competition and Markets Authority or the European Commission with respect to an actual or potential change of control of the Appointee.

3.7 The Appointee must comply with any direction given by the Water Services Regulation Authority to the Appointee to enforce the terms of an undertaking given to it pursuant to paragraph 3.1.

4 Assets, rights and resources

4.1 The Appointee must, at all times, act in a manner which is best calculated to ensure that it has in place adequate:

(a) financial resources and facilities;

(b) management resources; and

(c) systems of planning and internal control,

to enable it to carry out the Regulated Activities. The above requirements must not be dependent upon the discharge by any other person of any obligation under, or arising from, any agreement or arrangement under which that other person has agreed to provide any services to the Appointee in its capacity as a Relevant Undertaker.

4.2 The Appointee must ensure that, as far as reasonably practicable, it has available to it sufficient rights and resources other than financial resources so that if, at any time, a special administration order were to be made in relation to it, the special administrator would be able to manage the affairs, business and property of the Appointee in accordance with the purposes of the special administration order.

4.3 For the purposes of paragraph 4.2, the Appointee is not required to amend the terms of any legal obligation which has been transferred to it in accordance with a scheme made under Schedule 2 to the Water Industry Act 1991.

4.4 Where rights and resources which are required to be made available pursuant to paragraph 4.2 are made available by a Group Company, the Appointee must ensure that if, at any time, a special administration order were to be made in relation to it, the rights and resources would be available to the special administrator for the purpose set out in paragraph 4.2.

5 Listing of financial instruments

5.1 If the Ultimate Controller of the Appointee is not listed on the London Stock Exchange or on another exchange that the Water Services Regulation Authority agrees is of similar standing the Appointee must comply with paragraph 5.2.

5.2 The Appointee must use all reasonable endeavours to maintain the listing of a financial instrument, whose market price should reflect the financial position of the Appointed Business, on:

- (a) the London Stock Exchange; or
- (b) with prior agreement of the Water Services Regulation Authority, another exchange of similar standing,

unless the Water Services Regulation Authority, following an application by the Appointee, determines that market conditions are such that it would be inappropriate for the Appointee to maintain the listing of such a financial instrument.

6 Transfer Pricing and Cross-Default Obligations

6.1 The Appointee must ensure that:

- (a) every transaction between the Appointed Business and any Associated Company is at arm's length, so that neither the Appointed Business nor the Associated Company gives a cross-subsidy to the other; and
- (b) the Appointed Business neither gives nor receives any cross-subsidy from any other business or activity of the Appointee.

in accordance with Regulatory Accounting Guideline 5 (Transfer Pricing in the Water and Sewerage Industry) published by the Water Services Regulation Authority and revised from time to time.

6.2 The Appointee must provide the Water Services Regulation Authority with any information about the costs of an Associated Company which provides services to the Appointee which the Water Services Regulation Authority reasonably requires.

6.3 The Appointee must not, without the prior approval of the Water Services Regulation Authority:

- (a) give a guarantee in relation to any liability of an Associated Company;

- (b) make a loan to an Associated Company; or
 - (c) enter into an agreement or other legal instrument incorporating a Cross-Default Obligation.
- 6.4 The Appointee must not continue or permit to remain in effect an agreement or other legal instrument incorporating a Cross-Default Obligation unless:
- (a) prior approval has been given by the Water Services Regulation Authority; or
 - (b) the Cross-Default Obligation would only arise on a default by a subsidiary of the Appointee and the Appointee ensures that:
 - (i) the period for which the Cross-Default Obligation is in effect is not extended;
 - (ii) liability under the Cross-Default Obligation is not increased; and
 - (iii) no change is made to the circumstances in which liability under the Cross-Default Obligation may arise.
- 6.5 The Appointee shall not, without the consent of the Water Services Regulation Authority and otherwise than in compliance with its directions concerning the valuation of the asset and the treatment of the consideration in the Appointee's accounts, transfer to any Associated Company to which paragraph 6.1 applies any right or asset to which paragraph 4.2 applies.

7 Credit Ratings and "Cash Lock-Up"

- 7.1 The Appointee must demonstrate its ability to service its debt obligations by complying with paragraph 7.2
- 7.2 The Appointee must ensure that it and any Associated Company which issues corporate debt on its behalf maintains, at all times, an Issuer Credit Rating which is an Investment Grade Rating.
- 7.3 The "Cash Lock-Up" provisions set out in paragraph 7.4 apply in any circumstances where:
- (a) the Appointee does not hold an Issuer Credit Rating which is an Investment Grade Rating;
 - (b) the Appointee holds more than one Issuer Credit Rating and one or more Issuer Credit Ratings held by it is not an Investment Grade Rating; or

- (c) any Issuer Credit Rating held by the Appointee is the Lowest Investment Grade Rating and:
 - (i) the rating is on review for possible downgrade or is on “Credit Watch” or “Rating Watch” with a negative designation; or
 - (ii) otherwise where the rating outlook of the Appointee as specified by the Credit Rating Agency which has assigned the Lowest Investment Grade Rating has been changed from stable or positive to negative.

7.4 Where paragraph 7.3 applies, the Appointee must not, without the prior approval of the Water Services Regulation Authority, transfer, lease, licence or lend any sum, asset, right or benefit to any Associated Company, other than where:

- (a) the Appointee makes a payment to an Associated Company which is:
 - (i) pursuant to an agreement entered into prior to the circumstances referred to in paragraph 7.3 arising, which provides for the goods, services or assets to be provided on an arm’s length basis and on normal commercial terms; and
 - (ii) properly due in respect of the goods, services or assets;
- (b) the Appointee transfers, leases, licenses or lends any sum, asset, right or benefit to any Associated Company (excluding a dividend payment, a distribution out of distributable reserves or a repayment of capital), where:
 - (i) the transaction is on an arm’s length basis on normal commercial terms; and
 - (ii) the value due in respect of the transaction is payable wholly in cash and is paid in full when the transaction is entered into;
- (c) the Appointee makes a repayment of, a payment of interest on or payments in respect of fees, costs or other amounts incurred in respect of:
 - (i) a loan made from a Financing Subsidiary to the Appointee, provided that the Financing Subsidiary continues to be an Associated Company of the Appointee; or

- (ii) a loan made prior to the circumstances referred to in paragraph 7.3 arising which is otherwise in accordance with these Conditions, provided that payment in respect of such a loan is not made earlier than provided for in accordance with its terms;

or

- (d) the Appointee makes a payment for group corporation tax relief or for the surrender of Advance Corporation Tax, calculated on a basis not exceeding the value of the benefit received, provided that the payment is not made before the date on which the amounts of tax subject to the relief would have become due.

8 Dividend Policy

8.1 The Appointee must, at all times, have in place a dividend policy which effectively embodies:

- (a) the principle that dividends declared or paid should not impair the ability of the Appointee to finance the Appointed Business; and
- (b) the principle that dividends should be an incentive which is expected to reward efficiency and the management of economic risk,

and has been approved by the Board of the Appointee.

8.2 The Appointee must ensure that any dividends are declared or paid in accordance with the current dividend policy made in accordance with paragraph 8.1.

9 Ring-fencing Statement and Certificate

9.1 The Appointee must publish with its audited accounts for each twelve month period a statement as to whether or not (as at the end of the period) the Appointee has available to it sufficient rights and resources other than financial resources, as required by paragraph 4.2

9.2 No later than the date on which the Appointee is required to deliver to the Water Services Regulation Authority a copy of each set of accounting statements prepared under Condition F, the Appointee must submit a Ring-fencing Certificate to the Water Services Regulation Authority.

9.3 Where the Board of the Appointee becomes aware of any activity of the Appointee or any Group Company which does not form part of the Regulated

Activities, and which may be material in relation to the Appointee's ability to finance the Regulated Activities, the Appointee must:

- (a) inform the Water Services Regulation Authority; and
- (b) within fourteen days of becoming aware of the activity, submit a new Ring-fencing Certificate to the Water Services Regulation Authority.

9.4 Where the Board of the Appointee becomes aware of any circumstances which would change its opinion such that it would not give the opinion contained in the Ring-fencing Certificate, the Appointee must inform the Water Services Regulation Authority of this in writing.

9.5 Whenever the Appointee submits a Ring-fencing Certificate to the Water Services Regulation Authority, the Appointee must submit a statement of the main factors which the Board of the Appointee has taken into account in giving its opinion for the Ring-fencing Certificate.

9.6 A Ring-fencing Certificate must be:

- (a) signed by all directors of the Appointee on the date of submission; or
- (b) approved at a meeting of the Board of the Appointee, convened in accordance with the Appointee's articles of association, in which case the Ring-fencing Certificate must:
 - (i) be signed by a director of the Appointee or the Appointee's company secretary; and
 - (ii) have appended to it a certified copy of the minutes of the approval.

9.7 Each Ring-fencing Certificate shall be accompanied by a report prepared by the Appointee's Auditors and addressed to the Water Services Regulation Authority, stating whether they are aware of any inconsistencies between that Ring-fencing Certificate and either the statements referred to in sub-paragraph 9.3 of condition F or any information which the Auditors obtained in the course of their work as the Appointee's Auditors and, if so, what they are.

10 Reporting of Material Issues

10.1 Where the Board of the Appointee becomes aware of any circumstance that may materially affect the Appointee's ability to carry out the Regulated Activities

the Appointee must inform the Water Services Regulation Authority as soon as possible.

11 References to Competition and Markets Authority

11.1 The Appointee may notify the Water Services Regulation Authority, within one month of receiving notice that a revision is to be made to the corporate governance principles referred to in paragraph 2.2, that it disputes the revision, and in that case:

(a) the question of whether the revision is appropriate shall (unless the Water Services Regulation Authority withdraws the decision to make it) be referred by the Water Services Regulation Authority to the Competition and Markets Authority for determination; and

(b) the revision shall not take effect unless the Competition and Markets Authority determines that it shall.

Condition F

The following paragraphs and sub-paragraphs are deleted:

1.1(3), 1.1(4), 1.1(4A), 1.1(6), 6.1, 6.8 to 6.12 and 6A

Condition K

Paragraph 3 of Condition K is deleted.