

Regulatory Ring-fencing
Ofwat
Centre City Tower
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Your ref

Our ref

Date
8 January 2019

Contact

Tel: 01903 272775

Dear Sir/Madam

Consultation on strengthening the regulatory ring-fencing framework

Thank you for the opportunity to respond to your consultation on strengthening the regulatory ring-fence and for the helpful discussions we have had on your proposals.

The regulatory ring-fence provides an essential protection for customers and has been proven to be effective. We strongly support a consistent approach to the ring-fence across all companies. Any differences between companies should reflect only specific circumstances, rather than – as now – the companies' history of corporate activity. We therefore welcome the proposals to include the latest set of licence conditions in all companies' licences to ensure that all customers benefit from a similar level of protection.

As you will be aware, Southern Water's licence already contains most of the provisions included in the proposals, albeit with slightly different wording in a number of places. On that basis we have no significant comments to make on the majority of the proposals, which we are happy to support. There are two specific areas where we think further clarity on the proposals would be helpful.

Investment grade credit rating

We note that the proposal is to make the requirement to maintain an investment grade credit rating absolute, rather than subject to "reasonable endeavours". While we acknowledge that this provides clarity on whether a licence breach has occurred, the removal of the reasonable endeavours wording may cause some concern as to the ability of companies to comply in all circumstances. For example, a macro-economic shock could lead to a downgrade of the entire sector, with no change in individual companies' circumstances.

We understand that your response to a breach of the licence in such circumstances would of course recognise the context, and where the company had behaved prudently in managing its credit rating, Ofwat would be unlikely to take any punitive regulatory action in respect of the breach. We think it would be helpful to all stakeholders understanding of the proposals if this were made explicit in the Section 13 legal notice. Without such an explicit reference it is likely that Boards will feel uneasy about agreeing to a licence condition which they cannot be certain of being able to meet.

Notification of significant events

This is a new licence condition which imposes an obligation on companies to inform Ofwat of any circumstances that may materially affect a company's ability to carry out its functions. We support completely the intent behind the condition, and would in any event ensure that Ofwat were informed of significant matters arising. However, there is a risk that different companies will interpret the obligation in different ways, potentially leading to perceived under or over-reporting of events by different companies. Recognising that the inclusion of an exhaustive list would be counter-productive, it would be helpful if the Section 13 notice provided some examples of circumstances where companies would be expected to inform Ofwat and, equally importantly, examples of circumstances that Ofwat would not consider material for the purposes of this condition.

I hope this response is helpful. We would be happy to discuss further any of the issues raised. Note that due to the timing of the consultation, we have not yet consulted with our Board on the proposals and final agreement to the proposals will of course be a matter for them.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Craig Lonie".

Craig Lonie
Director of Strategy & Regulation