

Date: 25 June 2020

Ofwat
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By e-mail: OfwatPandO@Ofwat.gov.uk

Dear Sir or Madam

CONSULTATION UNDER SECTION 13 OF THE WATER INDUSTRY ACT 1991 ON PROPOSED MODIFICATION TO THE LARGEST UNDERTAKERS' LICENCES FOR RING-FENCING

This is South West Water's response to Ofwat's consultation under section 13 of the Water Industry Act 1991 on proposed modification to the largest undertakers' licences for ring-fencing.

We note the intention of this consultation is to bring company licences up to the industry-leading standard, including upgrading older-style ring-fence conditions to the most up to date wording except where that would entail a change in policy that Ofwat have not previously consulted upon. Additionally, Ofwat are proposing to apply the formatting and numbering changes and simplified wording that was applied to other conditions in the Licence Simplification Project in December 2018.

With that in mind we have reviewed the revised proposed modification and make the following observations:

- The numbering issues we have previously highlighted are now correct, with the exception that Paragraph P29 should refer to compliance with Paragraph P26, rather than P27 as follows:

P29 Where Ofwat has agreed that the Appointee is not required to comply with paragraph P25, the "Cash Lock-Up" provisions set out in paragraph P28 apply in any circumstances where the Appointee has not complied with paragraph ~~P27~~ **P26** (and in those circumstances the references in paragraph P28 to paragraph P27 have effect as if they were references to this paragraph) and do not apply in any other circumstances.

- We note and accept the proposed modifications to the definition of the issuer credit rating and Paragraph P27 'cash lock up provisions' and support the ongoing simplification of licence text.

I can therefore confirm that South West Water consents to the proposed licence modification, subject to the correction of Paragraph 29.

Finally, we note in section 2.2.1 Ofwat's observation that the provision in the licence exempting South West Water from the requirement to maintain an investment grade credit rating is felt to warrant further consideration.

I would like to re-iterate that as it stands Condition P 7.3 remains in the best interests of our customers.

Prior to South West Water migrating to a new Licence post the acquisition of Bournemouth Water in 2016, we discussed with Ofwat the approach that could be adopted by South West Water as an alternative to maintaining a public credit rating. The principles behind an alternative to the public credit rating were:

- that the Directors undertake an assessment that considers the company's ability to service its debt obligations, and at any time if the Director's believe the assessment of the Appointee's ability will or would be likely to materially adversely change it would inform Ofwat; and
- there were no material benefits to the Appointee of having an Issuer credit rating

In effect the 2016 Licence modification expanded the assessment of whether a company could service its debt obligation and placed the accountability with Directors for both annual certification and ongoing monitoring. South West Water migrated to the new Licence in 2016 and adopted the approach under paragraph 7.3 of Condition P.

South West Water has not to date required a credit rating to access efficient debt finance to support its operations. South West Water has a diversified portfolio of floating rate, fixed and index linked debt instruments. We have a range of counterparties, and South West Water has developed a number of bilateral relationships since privatisation to raise efficient debt funding.

South West Water has been an infrequent issuer into the debt capital markets as the size of required tranches of debt funding has been traditionally lower than 'benchmark'. Where we have had debt capital issuances, we have not required a credit rating to access the market. Given our overall efficient financial position and the cost of maintaining a credit rating, we believe it is not in the interests of customers and stakeholders of South West Water to obtain a public rating.

We believe the benefits of Director Certification which takes into account internal as well as external assessments, are robust and have an extended remit (over and above reliance on a credit rating) in supporting the position that South West Water can service its debt obligations.

If you have any questions, please do not hesitate to contact me.

Yours faithfully



Sally Mills
Regulatory Director

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