

14 July 2020

Conclusions on section 13 of the WIA91 on proposed modification to ring- fencing provisions

About this document

The regulatory ring-fence provides an important protection for companies¹ and their customers. Its purpose is to ensure that the regulated company maintains sufficient financial, management and other resources to enable it to carry out its water and sewerage services in a sustainable manner, and it protects the regulated company from the activities of other entities such as other group companies.

On 20 November 2018 we published a [Consultation on strengthening the regulatory ring-fencing framework](#). Following this, on 9 July 2019, we published our [Conclusions on strengthening the regulatory ring-fencing framework](#) which set out that we would proceed to modify the Instruments of Appointment (**'licences'**) of the 17 largest regulated water companies in England and Wales.

Under section 13 of the Water Industry Act 1991 ('WIA91'), the Water Services Regulation Authority (**'Ofwat'**) may modify the conditions of a water (and/or wastewater) undertaker's licence if the company consents to the modifications. Before making modifications under section 13 of the WIA91, Ofwat must give notice in accordance with that section. On 15 May 2020 we, therefore, published a statutory [Consultation under section 13 of the Water Industry Act 1991 on proposed modification to the largest undertakers' licences for ring-fencing](#). The consultation was a notice under section 13. The statutory consultation closed on 25 June 2020.

In this document, "Conclusions on section 13 of the WIA91 on proposed modification to the largest undertakers' licences for ring-fencing", we set out the comments made in response to the consultation and how we have taken them into account in arriving at our final decision on licence modifications. This document confirms Ofwat has now modified the licences of all companies who have provided consent to the changes (all companies except Wessex Water) and provides our reasons for making the modifications (as required by section 195A of the WIA91). We set out most of the reasons for the modifications in the consultation and still consider those reasons to be valid. In this document we provide additional clarification on specific issues.

We amended the companies' licences on **10 July 2020**, and the amendments came into effect on **13 July 2020**. The notices amending the licences are on our website.

¹ For the purpose of this document, a reference to a water company or company means one of the 17 largest companies holding an appointment as a water and/or sewerage undertaker under the Water Industry Act 1991

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1. Responses to the consultation

Our consultation invited comments on the modifications we proposed to make to the licences of the large water companies. These are:

1. inserting a new requirement to inform us when the regulated company becomes aware of arrangements which may lead to a change of control;
2. inserting a new provision that enables Ofwat to issue a direction to the company requiring it to enforce its Ultimate Controller's undertaking;
3. modifying the requirement to use "reasonable endeavours" to maintain an investment grade credit rating, to a requirement that companies "must ensure" that an investment grade credit rating is "maintained at all times";
4. adjusting the definition of Issuer Credit Rating to clarify which ratings will be used as regulatory markers for the purposes of triggering cash lock-up;
5. updating the cash lock-up provisions, so that the provisions are consistent across companies;
6. updating the requirement and definition for Ring-fencing Certificate, so that the requirement is consistent across companies;
7. inserting a requirement to report any circumstance that might materially affect the company's ability to carry out its Regulated Activities to Ofwat as soon as possible;
8. simplifying some of the wording to be consistent with earlier simplification changes made to licences; and
9. deleting condition F1, which deals with the procurement of services, from the licences of Anglian Water and Welsh Water (Dŵr Cymru).

In addition to the above, for those companies with older licence drafting² the modifications proposed were broader as they included updates to the drafting.

We received 18 responses to the consultation: 17 from the affected companies, and one from the Consumer Council for Water (CCWater). All companies except Wessex Water gave their consent to making the modifications to their licence, in some cases after further engagement on the points they made in response to the consultation. We are [publishing those responses](#) which made substantive comments alongside this document. All other responses contained only a consent to make changes.

² Companies with older licence drafting are: Anglian Water, Bristol Water, Dŵr Cymru, Northumbrian Water, South East Water, South Staffs Water, Southern Water, Sutton and East Surrey Water, United Utilities, Wessex Water and Yorkshire Water. The remaining five (Hafren Dyfrdwy, Portsmouth Water, Severn Trent Water, South West Water and Thames Water) already had a more up to date Condition P.

2. Consultation responses and our view

Given the significant engagement we had with companies, there were relatively few substantive comments on the proposed modifications. Overall, respondents were supportive of the objectives of the modifications but a few issues were raised:

Requirement to maintain an investment grade credit rating

Yorkshire Water said it remains concerned by the absence of a grace period before a breach of the requirement that companies “must ensure” that they maintain an investment grade credit rating. It said that in the absence of that it will rely on the position set out in ‘[Ofwat’s approach to enforcement](#)’ including that, in deciding what action we should take, we will take into account whether circumstances genuinely outside of a company’s control, led, or contributed, to a breach.

South West Water does not maintain a public credit rating; instead, it has a provision allowing it to use an alternative approach to maintain a rating. The company said it considers that this remains in the best interests of its customers. The points raised do not affect our decision to go ahead with the licence modifications.

Relying on other parties to deliver a service to customers

Portsmouth Water asked us to confirm that the existing requirement that a water company, acting in its regulated capacity, cannot rely on another company to ensure it has adequate financial resources and facilities to carry out its regulated functions does not prevent companies from entering arrangements in which they depend on each other to deliver services including cross border company programmes.

Although this point does not refer to a new requirement in the proposed modifications, we confirm that we do not consider that the licence requirement referred to prevents water companies from entering into such agreements. However, any such agreements must comply with the relevant licence obligations. For example, Condition P requires a water company to ensure that sufficient rights and resources would be available to a special administrator if a special administration order were to be made in relation to that company.

Credit ratings to be used as regulatory markers

Separately, we have engaged with companies to confirm the ratings that we use as regulatory markers for the purposes of the cash lock-up provisions. Limb ‘c’ of the

updated definition of Issuer Credit Rating allows us to determine that specific ratings should be used as regulatory markers providing they sufficiently reflect the creditworthiness of the Appointee. We will publish reasons on our website for any such determinations made.

Affinity Water consented to the modifications but said it considered that Fitch's Issuer Default Rating (IDR) is not reflective of the creditworthiness of a company as a whole and as such should not be captured by limb 'a' of the definition of Issuer Credit Rating (which captures all entity-level "issuer" credit ratings). We are satisfied that Fitch's IDR is caught by limb 'a' and was also captured by the previous licence definition of Issuer Credit Rating and are engaging with the company directly as this does not affect the decision on making the modifications.

Non-acceptance

Wessex Water has responded that it does not consent to the modifications because it does not agree that it is necessary to have inflexible or pre-scripted solutions to deal with concerns regarding a company's financial resilience. It says it has been the practice of the Board of YTL to withhold dividend payments where that could lead to a credit rating downgrade; and that this demonstrates that the protections and assurances that Ofwat seeks to obtain through licence modification are already in place through the basics of good governance and stewardship.

We believe that having protections in the licence is an important safeguard for customers, and we are disappointed that Wessex Water has not given its consent. We will consider how to proceed, but in the meantime are pleased that these protections have been adopted across the rest of the sector.

Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

July 2020

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