

WATER SERVICES REGULATION AUTHORITY

WATER INDUSTRY ACT 1991, SECTION 13(1)

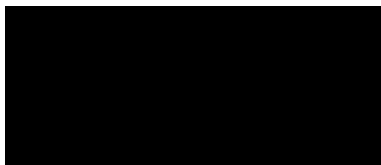
Modification of the Conditions of Appointment of Northumbrian Water Limited

Made on 10 July 2020

The modifications in the Schedule attached hereto will come into effect on 13 July 2020

The Water Services Regulation Authority, in exercise of the power conferred on it by section 13(1) of the Water Industry Act 1991 ("the 1991 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 Northumbrian Water 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

A large black rectangular redaction box covering the signature area.

Aileen Armstrong

Senior Director

Schedule

1. Paragraph 2 of **Condition A** is amended by:

- a. deleting 'and' from the end of subsection (1);
- b. replacing '.' with ';' at the end of subsection (2); and
- c. inserting the following new subsections:

“(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;

(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; and

(5) references to a transfer of any asset or liability includes a part transfer of an asset or liability and, without limitation, there is a part transfer of an asset where an interest or right in or over the asset is created.”

2. Paragraph 3 of **Condition A** is amended by inserting the following definitions in the appropriate place determined alphabetically:

“**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 the corporate group was a single legal entity, where the corporate group is as determined by the relevant Credit Rating Agency;

“**Credit Rating Agency**” means:

- (a) S&P Global Ratings (or any of its affiliates or its successors);
- (b) Moody’s Investors Services, Inc (or any of its affiliates or its successors);
- (c) Fitch Ratings, Inc (or any of its affiliates or its successors); or
- (d) any credit rating agency which has been agreed by Ofwat as having comparable standing to S&P Global Ratings, Moody’s Investors Services, Inc or Fitch Ratings, Inc;

“**Cross-Default Obligation**” means a term of any agreement or arrangement whereby the Appointee's liability to pay or repay any debt or other sum arises or is increased or accelerated by reason of a 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 Ofwat 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:

- (a) an issuer credit rating assigned to the Appointee or any Associated Company which issues corporate debt on its behalf by a Credit Rating Agency;
- (b) a Corporate Family Rating assigned by a Credit Rating Agency to a corporate group of which the Appointee is a member and which has been approved for this purpose by Ofwat; or
- (c) a rating assigned by a Credit Rating Agency to the Appointee or any Associated Company, for so long as Ofwat has determined in writing that this rating sufficiently reflects the creditworthiness of the Appointee;

“Lowest Investment Grade Rating” means:

- (a) an Issuer Credit Rating of BBB- by S&P Global Ratings or Fitch Ratings, Inc or an Issuer Credit Rating of Baa3 by Moody's Investors Services, Inc 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 Ofwat 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) the Appointee has available to it sufficient rights and resources other than financial resources, as required by paragraph P14; and

(d) 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 Ofwat, 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;

3. **Condition I** is deleted in its entirety.

4. **Condition K** is amended by:

- a. deleting the words “Ring-fencing and” from the title.
- b. deleting paragraph 1 and replacing it with:

“1 Introduction

The purpose of this Condition is to ensure that the best price is received from disposals of land to which this Condition applies so as to secure benefits to customers through the application of the proceeds of such disposals to reduce charges as provided in, and subject to the provisions of, Condition B.”

- c. deleting paragraph 3.

5. **Condition P** is deleted in its entirety and replaced with the following new provisions:

“**Condition P: Regulatory ring-fence**

Introduction

This condition requires the Appointee to ensure that it maintains sufficient financial and management resources to enable it to carry out its functions in a sustainable manner, and protects the Appointee from the activities of other group entities. It also requires the Appointee to meet the Board Leadership, Transparency and Governance objectives and procure undertakings from its Ultimate Controller(s).

Conduct of the Appointed Business

P1 The Appointee must, at all times, conduct the Appointed Business as if the Appointed Business were:

P1.1 substantially the Appointee's sole business; and

P1.2 a public limited company separate from any other business carried out by the Appointee.

P2 The Appointee must:

P2.1 meet the objectives on board leadership, transparency and governance set out in paragraph P3, and

P2.2 explain in a manner that is effective, accessible and clear how it is meeting the objectives set out in paragraph P3.

P3 The objectives are:

P3.1 The Board of the Appointee establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

P3.2 The Appointee has an effective Board with full responsibility for all aspects of the Appointee's business for the long term.

P3.3 The Board of the Appointee's leadership and approach to transparency and governance engenders trust in the Appointee and ensures accountability for their actions.

P3.4 The Board of the Appointee and its committees are competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that address diverse customer and stakeholder needs.

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

P4 The Appointee must ensure that, at all times:

P4.1 there is an undertaking in place which is given by the Ultimate Controller of the Appointee in favour of the Appointee; and

P4.2 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.

P5 The Appointee must ensure that any undertaking given pursuant to paragraph P4 provides that the person giving the undertaking must, and must procure that each of its subsidiaries other than the Appointee and its subsidiaries:

P5.1 provides to the Appointee such information as is necessary to enable the Appointee to comply with its obligations under the Water Industry Act 1991 or under these Conditions; and

P5.2 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.

P6 In the circumstances set out in P7, the Appointee may only enter into any new contract or arrangement with a person who is required to give an undertaking under paragraph P4 or the subsidiaries of such a person other than subsidiaries of the Appointee, with the prior written approval of Ofwat.

P7 The circumstances referred to in P6 are:

P7.1 where an undertaking required to be given by a person in accordance with paragraph P4 is not in place; or

P7.2 where 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.

P8 The Appointee must provide to Ofwat such certified copies of any undertaking given pursuant to paragraph P4 as are requested by Ofwat.

P9 The Appointee must immediately inform Ofwat in writing if the Appointee becomes aware that:

P9.1 an undertaking given by a person pursuant to paragraph P4 has ceased to be legally enforceable; or

P9.2 there has been a breach of the terms of such an undertaking by the person that gave it.

P10 The Appointee must inform Ofwat as soon as reasonably practicable if the Appointee becomes aware that:

P10.1 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

P10.2 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

P10.3 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.

P11 The Appointee must comply with any direction given by Ofwat to the Appointee to enforce the terms of an undertaking given to it pursuant to paragraph P4.

Assets, rights and resources

P12 To enable it to carry out the Regulated Activities The Appointee must, at all times, act in a manner which is best calculated to ensure that it has in place adequate:

P12.1 financial resources and facilities;

P12.2 management resources; and

P12.3 systems of planning and internal control,

P13 The requirements set out in paragraph P12 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.

P14 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.

P15 For the purposes of paragraph P14, 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.

P16 Where rights and resources which are required to be made available pursuant to paragraph P14 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 P14.

Listing of financial instruments

P17 The Appointee shall maintain the listing of a financial instrument and shall use all reasonable endeavours to retain the listing of that financial instrument, whose market price reacts to the financial position of the Appointee's Appointed Business, on the London Stock Exchange, or another exchange of similar standing.

P18 The obligation in paragraph P17 applies unless the Appointee satisfies Ofwat that market conditions make it inappropriate for the Appointee to maintain such a financial instrument.

Transfer pricing and Cross-Default Obligations

P19 In accordance with Regulatory Accounting Guideline 5 (Transfer Pricing in the Water and Sewerage Industry) published by Ofwat and revised from time to time, the Appointee must ensure that:

P19.1 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

P19.2 the Appointed Business neither gives nor receives any cross-subsidy from any other business or activity of the Appointee.

P20 The Appointee must provide Ofwat with any information about the costs of an Associated Company which provides services to the Appointee which Ofwat reasonably requires. For the purposes of this paragraph P20, reference to the provision of services includes references to anything (including the services of any employee) being made available.

P21 The Appointee must not, without the prior approval of Ofwat:

P21.1 give a guarantee in relation to any liability of an Associated Company;

P21.2 make a loan to an Associated Company; or

P21.3 enter into an agreement or other legal instrument incorporating a Cross-Default Obligation.

P22 The Appointee must not continue or permit to remain in effect an agreement or other legal instrument incorporating a Cross-Default Obligation unless:

P22.1 prior approval has been given by Ofwat; or

P22.2 the Cross-Default Obligation would only arise on a default by a subsidiary of the Appointee and the Appointee ensures that:

P22.2.1 the period for which the Cross-Default Obligation is in effect is not extended;

P22.2.2 liability under the Cross-Default Obligation is not increased;
and

P22.2.3 no change is made to the circumstances in which liability under the Cross-Default Obligation may arise.

P23 The Appointee must not, without the consent of Ofwat, transfer to any Associated Company any right or asset to which paragraph P14 applies.

P24 In giving consent under paragraph P23, Ofwat may also give a direction to the Appointee on the valuation of the asset and the treatment of the consideration in respect of that asset in the Appointee's accounts.

Credit Ratings and "Cash Lock-Up"

P25 The Appointee must demonstrate its ability to service its debt obligations by complying with paragraph P26.

P26 The Appointee must ensure that it or any Associated Company which issues corporate debt on its behalf maintains, at all times, an Issuer Credit Rating which is an Investment Grade Rating.

P27 The “Cash Lock-Up” provisions set out in paragraph P28 apply in any circumstances:

P27.1 where neither the Appointee or any Associated Company which issues corporate debt on its behalf holds an Issuer Credit Rating which is an Investment Grade Rating; or

P27.2 where the Appointee or any Associated Company which issues corporate debt on its behalf:

P27.2.1 holds one or more Issuer Credit Ratings and one or more such Issuer Credit Ratings is not an Investment Grade Rating; or

P27.2.2 holds an Issuer Credit Rating which is the Lowest Investment Grade Rating and:

P27.2.2.1 the rating is on review for possible downgrade or is on “Credit Watch” or “Rating Watch” with a negative designation; or

P27.2.2.2 otherwise where the rating outlook of the Lowest Investment Grade Rating has been changed from stable or positive to negative.

P28 Where paragraph P27 applies, the Appointee must not, without the prior approval of Ofwat, transfer, lease, licence or lend any sum, asset, right or benefit to any Associated Company, other than where:

P28.1 the Appointee makes a payment to an Associated Company which is:

P28.1.1 pursuant to an agreement entered into prior to the circumstances referred to in paragraph P27 arising, which provides for goods, services or assets to be provided on an arm’s length basis and on normal commercial terms; and

P28.1.2 properly due in respect of the relevant goods, services or assets;

P28.2 the Appointee transfers, leases, licences 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:

P28.2.1 the transaction is on an arm’s length basis on normal commercial terms; and

P28.2.2 the value due in respect of the transaction is payable wholly in cash and is paid in full when the transaction is entered into;

P28.3 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:

P28.3.1 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

P28.3.2 a loan made prior to the circumstances referred to in paragraph P27 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

P28.4 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.

Dividend policy

P29 The Appointee shall declare or pay dividends only in accordance with a dividend policy which has been approved by the Board of Appointee and which complies with the following principles:

P29.1 the dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and

P29.2 under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk.

Ring-fencing Certificate and statement

P30 No later than the date on which the Appointee is required to deliver to Ofwat a copy of each set of regulatory accounting statements prepared under Condition F, the Appointee must submit a Ring-fencing Certificate to Ofwat.

P31 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:

P31.1 inform Ofwat; and

P31.2 within fourteen days of becoming aware of the activity, submit a new Ring-fencing Certificate to Ofwat.

P32 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 Ofwat of this in writing.

P33 Whenever the Appointee submits a Ring-fencing Certificate to Ofwat, 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.

P34 A Ring-fencing Certificate must be:

P34.1 signed by all directors of the Appointee on the date of submission; or

P34.2 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:

P34.2.1 be signed by a director of the Appointee or the Appointee's company secretary; and

P34.2.2 have appended to it a certified copy of the minutes of the approval.

P35 Each Ring-fencing Certificate shall be accompanied by a report prepared by the Appointee's Auditors and addressed to Ofwat, stating whether they are aware of any inconsistencies between that Ring-fencing Certificate and either the statements referred to in Condition F6.1 or any information which the Auditors obtained in the course of their work as the Appointee's Auditors and, if so, what they are.

Reporting of material issues

P36 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 Ofwat as soon as possible.”