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# Consultation on change of ownership for Southern Water Services Limited

Ofwat

## About this document

This document is a consultation on whether any issues arise out of the recent change of control of Southern Water Services Limited (“Southern Water”). A change of control occurs when there is any change in who can materially influence the direction, strategy, or activities of a business. We do not limit our definition of change of control to a situation in which shares in a company<sup>1</sup> are transferred to another party.

Our assessment has been undertaken in accordance with the approach we have set out on our approach to changes in control<sup>2</sup>. In carrying out our assessment we reviewed information provided by the new owners and we separately carried out our own investigations on the new corporate structure using publicly available information.

Specifically, this document sets out:

- Our assessment of the ownership structure.
- Our assessment of the new owners identified as an Ultimate Controller as well as their capacity to be an owner of a regulated water company.
- Our understanding of how the governance arrangements, which are relevant considerations in identifying the new Ultimate Controllers of Southern Water, have changed following the change of control.
- Our considerations in identifying the new Ultimate Controllers of Southern Water

We ask for views on our assessment of the incoming owners of Southern Water, whether any additional steps need to be taken at the regulated company in light of the change of ownership and the entities identified as Ultimate Controllers.

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

<sup>2</sup> Our policy approach is as set out in section 2 of [Change of control - general policy](#)

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## 1. Introduction

Owners of water companies have an important role to play by, among other things, holding the regulated company's board and senior management to account for performance and ensuring the company has the operational and financial resources to maintain resilience over the long term and is focused on delivering a high quality service to customers.

Any party who, alone or jointly and whether directly or indirectly, is in the position to control or materially influence the policy or affairs of the regulated company, or one of its holding companies, is considered to be an Ultimate Controller under the terms of each water company's licence. As for other companies, Southern Water's licence requires that any entity that is assessed to be an Ultimate Controller must provide undertakings in favour of the Appointee.

These undertakings require that the entity providing the undertaking, and its subsidiaries, provide to the Appointee such information as is necessary to enable the Appointee to comply with its obligations under the Water Industry Act 1991 or its licence; and do not take any action which may cause the Appointee to breach any of its obligations under the Water Industry Act 1991 or under its licence.

While we do not have formal powers to approve new owners, in the interests of customers we aim to assess the operational and financial capability of any Ultimate Controller to run such an essential public service as a water and sewerage company. As a consequence, it is important that we assess changes in the ownership of the companies we regulate and, where appropriate, consider whether it is necessary to strengthen licence conditions if we believe that customers need additional protection. A summary of the current ring-fencing licence conditions is set out in Appendix 1.

In this document, we set out the specific regulatory considerations arising from the recent change in control of Southern Water following the acquisition of a controlling stake by Macquarie Super Core Infrastructure Fund SCSp (MSCIF). We set out details of the entities identified as Ultimate Controllers following the transaction and our assessment of the capability of the new owners to be responsible owners of a regulated water company.

The principles we apply in assessing a change of control mean we do not carry out change of control consultations in all instances. In this instance, our consultation reflects the complexities associated with identification of the Ultimate Controllers and our long-standing concerns with Southern Water's performance.

We last made changes to the ring-fencing provisions within Southern Water's [licence](#)<sup>3</sup> in July 2020 which brought Southern Water's ring-fencing licence conditions into line with the current industry-leading standard<sup>4</sup>. We do not propose any further licence modifications as a direct consequence of this change of control.

However, as part of an ongoing programme of work, in December 2021, we published [Financial resilience in the water sector: a discussion paper](#). The discussion paper set out concerns about financial resilience in the sector, including in relation to Southern Water. It also set out options to strengthen customer protections associated with the financial resilience of all companies, including the potential to strengthen existing licence conditions.

In July 2022 we published a [Consultation on proposed modifications to strengthen the ring-fencing licence conditions of the largest undertakers](#) and that document sets out changes that we are proposing to make to the licences of all companies, including Southern Water.

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<sup>3</sup> A copy of Southern Water's Instrument of Appointment (licence) can be seen here <https://www.ofwat.gov.uk/wp-content/uploads/2020/04/Southern-Water-Consolidated-Appointment-amended-March-2021.pdf>

<sup>4</sup> Details of the changes made to companies licences are set out in <https://www.ofwat.gov.uk/consultation/consultation-under-section-13-of-the-water-industry-act-1991-on-proposed-modification-to-the-largest-undertakers-licences-for-ring-fencing/#Outcome>

## 2. Responding to this consultation

We would welcome any comments on this document. Please email them to [financial.resilience@ofwat.gov.uk](mailto:financial.resilience@ofwat.gov.uk) or post them to:

Change of Ownership for Southern Water Services Limited Consultation response, Ofwat Centre City Tower, 7 Hill Street, Birmingham, B5 4UA.

The closing date for this consultation is 14 September 2022. If you wish to discuss any aspect of this consultation, please contact Elinor Mathieson on 0121 644 7814 or by email at [elinor.mathieson@ofwat.gov.uk](mailto:elinor.mathieson@ofwat.gov.uk).

We intend to publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk). Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our privacy policy<sup>5</sup> explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

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<sup>5</sup> [Ofwat's privacy policy](#)

## Consultation questions

We welcome responses to the following questions.

- 1) Do you have any views on our commentary about the incoming owners?
- 2) Do you agree that it is not necessary to place additional requirements in the licence of Southern Water in respect of the change of control?
- 3) What are your views on our identification of the Ultimate Controllers?

### **3. Changes in Southern Water's ownership**

In this section we set out an overview of recent changes to the ownership of Southern Water.

#### **3.1 Summary of the transaction**

On 9 August 2021 Southern Water announced that a fund managed by Macquarie Asset Management (MAM) had agreed to acquire a majority stake in Greensands Holdings Limited (Greensands), the ultimate parent company of Southern Water. The acquisition would take the form of the subscription for newly issued shares in Greensands and would introduce fresh capital to the group.

The transaction completed in September 2021 and saw Macquarie Supercore Infrastructure Fund SCSp (MSCIF) provide an injection of c.£1.073 billion of new equity into Greensands. This included c.£530 million invested as new equity into Southern Water with the remaining investment used to strengthen the financial resilience of other companies within the Greensands group. From this date MSCIF became the entity with legal control over Greensands and therefore Southern Water.

Since 2007, Greensands had been owned by a consortium of investors with the main investors being funds managed by JP Morgan Asset Management (39.8%), funds managed by UBS Asset Management (21.9%) and Hermes Infrastructure Funds (21.0%) alongside other investors with smaller stakes.

Following the investment by MSCIF the previous consortium of investors' interest has been diluted to a minority share in Greensands, such that the combined equity interest of the previous shareholders is now less than 38%.

All funds invested by MSCIF were invested within the Greensands group with the existing shareholders receiving none of the proceeds.

Southern Water has been facing significant challenges to its operational performance for a number of years. Ofwat believed that an equity injection was necessary to improve the company's financial resilience and to finance the delivery of a transformation plan to deliver necessary service improvements.

#### **3.2 Ownership structure**

Following completion of the transaction, approximately 62% of the shares in Greensands Holdings were owned by MSCIF (indirectly through Wight Ventures S.à r.l and MSCIF Bidco



Limited, each being indirect subsidiaries of MSCIF). Subsequent to completion of the transaction, in November 2021, MSCIF syndicated part of its equity interest (by disposing of a portion of its indirect shareholding in Wight Ventures S.à r.l) to funds managed by AMF Pensionförsäkring AB (11.45% interest in Wight Ventures S.à r.l), MR Ergo (6.97% interest in Wight Ventures) and Retail Employees Superannuation Pty Limited as the trustee for Retail Employees Superannuation Trust (13.28% interest in Wight Ventures S.à r.l) (together the Co-Investors). MSCIF has retained full control over the affairs of Wight Ventures S.à r.l,

MSCIF is a Luxembourg registered limited partnership. It is an investment fund, which we understand has c.50 investors - comprising long-term institutional investors such as pension funds and insurance companies. The holdings of these investors are diverse and no individual investor has overall control. The individual investors do not have a day to day role in the management of MSCIF.

MSCIF is part of a portfolio of funds which are managed by entities within the Macquarie Asset Management division of the Macquarie Group. MSCIF does not have a separate legal personality and is unable to enter into contracts in its own right. It is therefore supported by a General Partner and Manager as outlined below.

MSCIF Luxembourg GP S.à r.l (the GP) acts as General Partner to MSCIF and is responsible for ensuring that the MSCIF's investment portfolio is managed appropriately and on a discretionary basis. The new investors have informed us that the GP is part of the MAM division but is required to act independently and in the best interests of MSCIF. Its Board currently has four members with three being Macquarie Group employees and one being an independent Luxembourg based director.

Macquarie Asset Management Europe S.à r.l (MAMES) has been appointed as Manager to manage the investments of MSCIF under the supervision of the GP. MAMES is part of the Macquarie Group and has no subsidiaries.

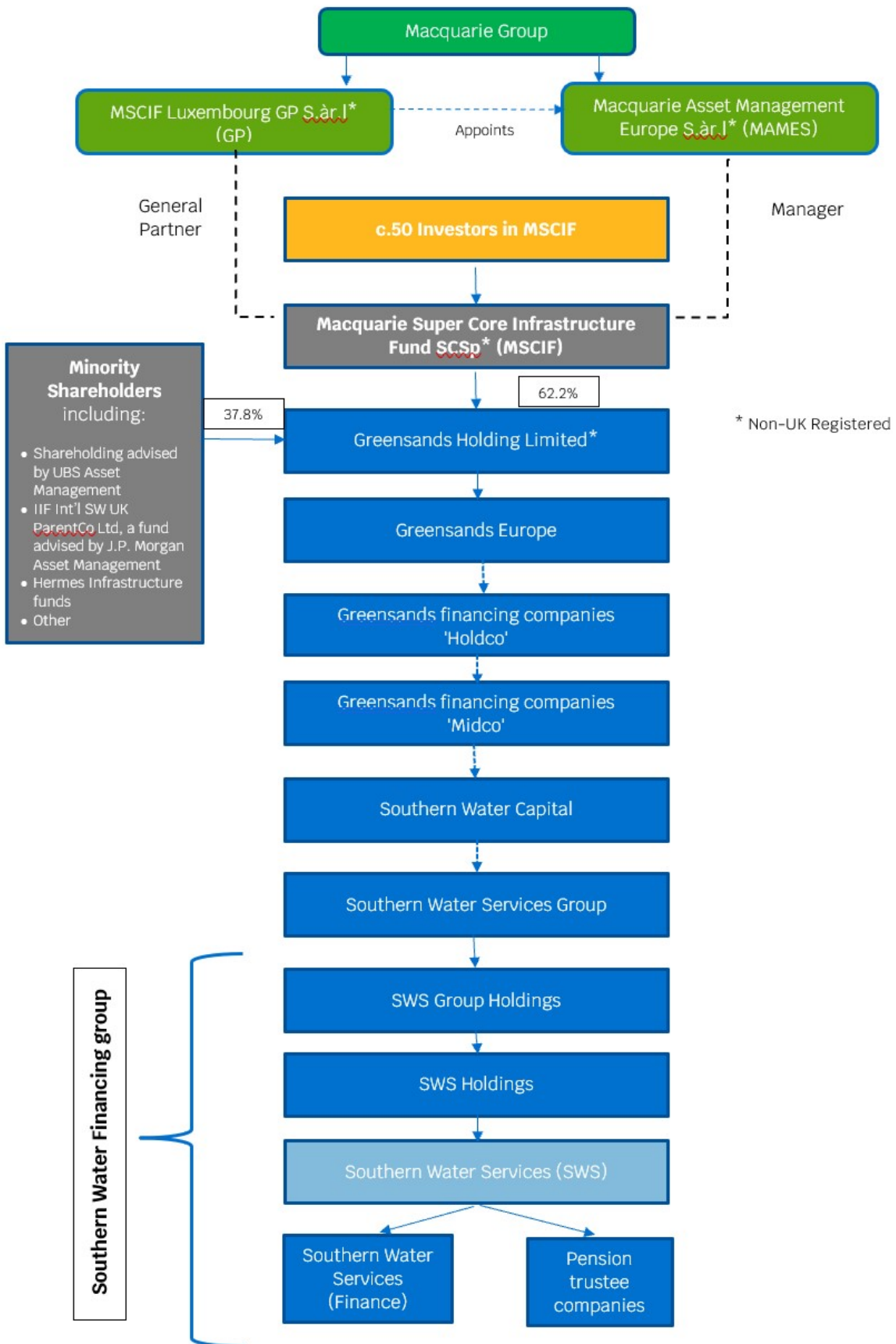
MAMES has no interest in the shares of Greensands. It acts on behalf of MSCIF; it is ultimately responsible (either directly or via delegation arrangements with other entities within the Macquarie Group) for identifying and entering into investment-related agreements for MSCIF, for evaluating the performance of those investments and for exercising all rights conferred on MSCIF as an investor. It is also ultimately responsible (either directly or via delegation arrangements with other entities within the Macquarie Group) for liaising with the companies in which MSCIF invests, in this case Southern Water, and to provide any assistance that may be required. It also monitors the performance, and nominates directors, of MSCIF's investments.

The terms under which both the GP and MAMES act on behalf of MSCIF and its investors are governed by a partnership agreement and a management agreement, and these documents

also set out the terms under which these entities can be removed or replaced by the investors in MSCIF.

Macquarie Asset Management (MAM) is the asset management business of Macquarie Group. MAM is a full-service asset manager offering a diverse range of products to its clients, including securities investment management, infrastructure and real asset management, and fund and equity-based structured products. MAM is comprised of two groups, Private Markets and Public Investments. The GP and MAMES are part of the Private Market business of MAM and focus on Infrastructure and Real Assets.

The corporate structure following the acquisition by MSCIF is as set out below:



## **4. Assessment of the incoming equity investors**

### **4.1 Assessment of owners and their capacity to own a regulated water company**

When a change of control happens, we consider the relevant experience an owner has in delivering, managing or investing in the infrastructure sector along with their capacity to finance their investment. We do this to gain insight into a new owner's knowledge and capabilities in running a regulated entity.

We also want to be satisfied that any change of control does not compromise the effective management of Southern Water. To help with this, we ask for relevant information to satisfy us that a new owner has the experience and capacity both operational and financial, to assume the role of running a water company with a view to considering whether additional licence protections are required at the regulated company to protect customers.

#### **4.1.1 The incoming equity investors**

##### **MSCIF – a new owner with a stake of 62.24% in Southern Water**

MSCIF is part of a portfolio of funds which are managed by entities within the portfolio of MAM, an established investment manager with a number of worldwide infrastructure investments. The fund comprises long-term institutional investors such as pension funds and insurance companies.

MSCIF's mandate is to invest in regulated network infrastructure, and it is managed by MAMES.

MSCIF has confirmed that it intends to provide the focus required to realise the transformation in Southern Water and to adopt a long-term approach to its holding. MSCIF recognises the need for Southern Water to significantly improve its performance, financial resilience, and relationship with customers. MSCIF expects that by strengthening the capital structure, together with certain governance changes and renewing management's focus on generating positive customer and environmental outcomes, Southern Water will be given a platform to deliver sustained performance improvements for customers over time.

The incoming investors have stated that they are able to provide expertise in business turnaround situations and will seek to bring in additional operational and financial expertise as required to enable Southern Water to improve its performance and to improve its financial resilience over time.

Southern Water is facing a number of challenges which the company and its new owners need to address. Prior to the completion of the transaction, we engaged with both the company and the new investors to ensure that they understood the extent of what was required. We are continuing to engage with the company and investors regularly and are closely monitoring the progress of the turnaround of the business and we will be holding them to account for delivery against their commitments.

The intention of the investors is that performance will be back on target by the end of the current price review period (2025) although it may be that the turnaround is not complete until early in AMP8.

Medium term, cash flows for Southern Water are supported by the reprofiling of interest payments via swap arrangements carried out prior to MSCIF's investment. MSCIF has confirmed its intention to deter Southern Water from entering into speculative swaps or swaps with mandatory breaks materially before their maturity date.

Under the new ownership, steps are also being taken by Southern Water and its investors to simplify and strengthen its financial structure. For example, a historical loan from Southern Water to one of its parent companies has been removed and the former Cayman Islands registered financing companies are being removed from the group and replaced with UK registered financing companies. We see both of these actions as positive steps to improving the transparency of the financial arrangements that are in place and a step towards reducing the risks to the financial resilience of Southern Water.

### **MSCIF's capacity to be owners of an appointed water company**

MSCIF's investment has been helpful to strengthen the financial resilience of Southern Water and its holding companies. However, Southern Water retains a credit rating at the minimum of investment grade with Moody's. We do not consider it appropriate for regulated companies to maintain a credit rating at this level over the long term and expect Southern Water, with the support of its investors, to be acting to improve its credit rating. Any improvement in credit rating is likely to require improvements to Southern Water's operational delivery as well as maintaining a robust financial structure, and MSCIF has noted that the Moody's credit rating is unlikely to change until AMP8. The investment into the Group by MSCIF includes £230 million (2019/20 average prices) to support and drive the turnaround of Southern Water's performance. MSCIF has told us that since taking its controlling stake in the company, there has been a focus on improving systems of reporting and control and MSCIF has been working with the company to develop further its transformation plan and to ensure new investment is targeted at delivering necessary service improvements for customers and the environment.

The turnaround in performance is expected to take time to deliver and so it is necessary that the new owner has the capacity and expertise to support the turnaround of the business.

Southern Water remains responsible for delivering improvements in its performance and the levels of performance will impact on investor returns.

As part of its engagement with us, MSCIF suggested that it has created capacity via its equity injection for dividend distributions to be made by Southern Water in AMP7. MSCIF has confirmed that dividends will not be paid unless there is clear evidence that Southern Water's performance is on an improving track, and in any case distributions during AMP7 will be below a 4% return on actual equity.

### **MAM's experience in the infrastructure sector**

Funds managed by MAM have been active investors worldwide since 1980. As at 31 March 2021 MAM had \$A562.2bn assets under management. MAM has in excess of 1,900 staff operating in 22 markets.

The incoming investors have confirmed that through MAM, there are current investments in 150 portfolio businesses including the following examples of infrastructure businesses within the UK and across Europe:

#### **Cadent Gas**

A MAM fund has a material investment in Cadent Gas (formerly known as National Grid Gas Distribution Limited) which operates and maintains the largest natural gas distribution network in the United Kingdom, transporting gas to 11 million homes and businesses across the West Midlands, North West England, East of England and North London.

Cadent Limited is responsible for the safe and efficient transportation of gas to the end consumer, on behalf of the chosen supplier and is regulated by Ofgem.

#### **KCOM Group**

A MAM fund is the owner of KCOM Group, a UK communications and IT services provider based in Yorkshire which delivers services in Hull, Cottingham and Beverley. The business is regulated by Ofcom.

#### **Arqiva**

MAM funds also have a material interest in Arqiva, a telecommunications company which provides infrastructure, broadcast transmission and smart meter facilities in the UK. Arqiva is regulated by Ofcom.

#### **AGS Airports**

AGS Airports Limited is the United Kingdom-based owner of Aberdeen, Glasgow and Southampton Airports. The company was formed in 2014 by Ferrovial and a fund managed by Macquarie with each owning a 50% stake. The company acquired Aberdeen, Glasgow and Southampton Airports in December 2014 from Heathrow Airport Holdings (formerly BAA).

AGS Airports Limited is regulated by the Civil Aviation Authority (“CAA”), Department for Transport (“DfT”), and the European Aviation Safety Agency (“EASA”).

## Previous investments

A fund managed by MAM was a significant investor in Thames Water between 2006 and 2017.

Thames Water is the largest of the water and wastewater companies regulated by Ofwat (by reference to RCV). Thames Water provides services to most of Greater London, Luton, the Thames Valley, Surrey, Gloucestershire, north Wiltshire, far west Kent, as well as some other parts of England

There was significant public criticism of the way in which Thames Water was being managed during Macquarie's ownership, both at the time and since. For example, there were concerns about the stewardship of the business, concerns about underinvestment in maintenance resulting in pollution of the River Thames, and the company was subject to enforcement action by both the Environment Agency and Ofwat. The business also performed poorly across a number of other metrics and concerns were raised about the business's financial management.

We have made clear to MAM our expectations of companies and investors as custodians of essential public infrastructure. We have also highlighted the steps we have taken to strengthen the regulatory ring fence protections since the Thames Water investment was sold. MAM has confirmed that it recognises the high expectations that are placed by customers and other stakeholders on water companies as providers of essential water and wastewater services to local communities. MAM has also acknowledged the significant changes we have made to the way in which the sector is regulated since the period of its ownership of Thames Water, including the introduction of our Board Leadership Transparency and Governance principles alongside objectives in company licences, and expectations we have placed on companies on a range of issues that include financial resilience, dividend policies and performance related executive pay.

In a public letter to Ofwat MAM has confirmed it will recognise "the need for Southern Water to significantly improve its financial resilience and enhance its operational performance and relationship with its customers. In undertaking this investment, the Fund, on behalf of its underlying investors, will be a responsible long-term steward of Southern Water and believes it can help the Company deliver the transformation it requires. These intentions and

commitments are designed to enable Southern Water to fundamentally become a better company for the benefit of all its stakeholders, customers, and the environment".

We continue to closely monitor Southern Water and continue to hold it to account in delivering its performance transformation. We expect both the company and its investors to recognise the importance of their roles in the provision of an essential public service and to be accountable for their actions. When setting executive pay and declaring dividends, we have been clear that we expect the company to consider the performance of the business against its commitments and the delivery of its turnaround plan. In addition to the statements about dividends noted above, MSCIF has confirmed it will continue considering and reporting executives' pay in line with Ofwat's published expectations and its governance principles and appropriate to the Company's performance, including against its transformation plans.

#### **4.1.2 Corporate governance and management of Southern Water**

MSCIF has recognised that it is a licence requirement for Southern Water to meet the four objectives of Ofwat's [Board Leadership Transparency and Governance Principles](#) (BLTG principles) and will adhere to the Principles.

MSCIF has highlighted the sentencing remarks in a [judgement in July 2021](#) against Southern Water challenging investors to take a more active role in making sure that companies fulfil their duties, which we agree applies particularly in a business turnaround. MSCIF has reserved the right to put in place certain time-limited arrangements to reflect this where more active investor engagement may be called for as outlined below.

Since the investment by MSCIF, the board of Southern Water now comprises:

- an independent chair
- 2 executive directors (CEO and CFO)
- 6 independent non-executive directors (iNEDs)
- 3 investor directors appointed by Greensands

MSCIF has explained that as part of Southern Water's transformation plan, an independent review of the Board structure has been carried out to assess the effectiveness of the Board and to identify any additional skills which may be required. The Southern Water Board is currently considering the outcome of that review and any changes they consider necessary. We have been informed by MSCIF that following any changes the composition of the board will remain in line with the BLTG principles, with the independent directors remaining as the single largest group on the board.



MSCIF has confirmed that appointments of independent non-executive directors would conform to governance norms in terms of tenure including three-year terms and no non-executive serving more than three terms, with a bias to no more than two terms.

### **4.1.3 Economic and financial standing**

MSCIF is a closed ended investment fund.

Where water companies are owned by closed end investment funds, this has the potential to introduce challenges where additional equity is required to strengthen the financial resilience of the regulated company or finance investment programmes. MSCIF has explained that it is a long term investor and has already taken steps to simplify the capital structure of the group.

### **4.1.4 Conflicts of interest**

MSCIF has stated that it has no direct or indirect equity interest in any undertakers or water supply licensees in England and Wales, therefore MSCIF does not believe that there is any actual or potential conflict of interest. In addition, MSCIF has confirmed that there are also no conflicts relating to the activities of the GP or MAMES. MAM has no other equity investments in other regulated water companies in England and Wales.

Macquarie has invested in the debt of other regulated water companies, however those investments do not confer control or influence over the entities concerned and would not provide access to any confidential information which we consider would lead to there being a conflict of interest.

## **4.2 Strengthening customer protections and licence conditions**

Our financial resilience discussion paper set out our concerns regarding the financial resilience of some companies in the sector. The paper referenced the case study of Southern Water, setting out the challenges to its financial resilience (and its operational performance) in the period prior to MSCIF's investment. We set out a range of options that could be taken to strengthen the customer protections, including licence modifications to strengthen the regulatory ring-fence.

In their engagement on the issues we set out, some commentators have referenced that the injection of equity by MSCIF is evidence that the issues faced by Southern Water were addressed by the market. However, we consider that the poor financial resilience which

ultimately required new investors to make a substantial equity injection to enable continued operation of the company - in the wake of poor operational performance and fines - underlines the need to ensure that customers of all companies are protected against inadequate financial resilience.

In the years prior to MSCIF's investment, Southern Water and its owners entered into a number of financing arrangements which supported short-term covenanted financial ratios, including a debt restructuring at both the regulated and holding companies and a restructuring of the swap portfolio. Credit rating agencies signalled the actions taken on the swaps portfolio as challenging the credit risk of the company; and ultimately the auditors of Greensands Holdings Limited (a holding company of Southern Water) referenced a material uncertainty related to going concern.<sup>6</sup> We do not consider this is a sound basis to finance the operation of a regulated monopoly provider of essential services. Throughout that period, customers continued to suffer the consequences of poor operational performance and we are considering whether there are additional regulatory protections that could be put in place across the industry that might encourage investors to take steps sooner to strengthen financial resilience and deliver finance, where it is necessary, to deliver necessary service improvements for customers.

We are continuing our programme of work and engagement with stakeholders to consider the possible steps we could take to strengthen the customer protections. This work is ongoing, and Southern Water has the benefit of the licence modifications that were made in 2021 to bring the ring-fencing licence conditions of all companies up to the current industry-leading standard. In July 2022 we published a [consultation](#) on changes we are proposing to make to strengthen the regulatory ring fence licence conditions of the largest undertakers, including Southern Water. That consultation is open for comment until 29 September 2022. As a result, we do not propose further amendments to Southern Water's licence in this document.

### 4.3 Conclusion

Our assessment shows that MAM has significant investments and experience as an owner of assets in the infrastructure structure, including in the water sector in England. MAMES is part of the MAM group and can draw on the experience of the wider MAM group when providing services as Manager to MSCIF and its investment in Southern Water.

There have been significant changes to the way in which the water sector is regulated since Macquarie's ownership interest in Thames Water, and Southern Water and its owners will

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The auditors stated 'the liquidity available to pay interest on ... debt at the Greensands Group parent company is scheduled to be exhausted by October 2021' and 'a material uncertainty exists that may cast significant doubt on the group's and the parent's ability to continue as a going concern', Greensands Holdings Limited, [Annual report and financial statements for the year ended 31 March 2021](#), page 110.

need to comply with the current licence requirements and their behaviours will need to take account of the current expectations for the sector.

MSCIF has acknowledged the importance of its role as an owner of an essential service provider. It recognises the necessary transformation that is required to the services provided to Southern Water's customers and this has underpinned the significant injection of equity to Southern Water to strengthen financial resilience and to fund necessary service improvements. We will continue to hold Southern Water and its investors to account for the delivery against the PR19 final determination. Failure to deliver in line with the expectations set out at PR19 will impact on investor returns and hence its investors will bear the pain where service performance falls short.

Southern Water has the licence modifications that were made in 2021 to bring the ring-fencing licence conditions of all companies up to the current industry-leading standard and we are consulting separately on further modifications to the licences of all companies, including Southern Water to strengthen the regulatory ring fence and to ensure that there are adequate protections for customers. Taking account of all of the factors above, we do not consider it necessary to place additional requirements in the licence of Southern Water in response to MSCIF's investment.

### **Questions:**

- Do you have any views on our commentary about the incoming owners?
- Do you agree that it is not necessary to place additional requirements in the licence of Southern Water in respect of the change of control?

## 5. Identification of Ultimate Controllers of Southern Water

In this section we consider the identification of the Ultimate Controller(s) of Southern Water under the new ownership structure.

Southern Water's licence requires that an Ultimate Controller undertaking be obtained from any party 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.

In July 2008, Greensands Europe Limited (company number 06366236), which is the highest UK registered holding company in the group structure, provided an Ultimate Controller undertaking. This undertaking remains in place.

Following the new investment, MSCIF is considered to have control over Southern Water. The remaining shareholders in Greensands each have shareholdings of less than 15% of the total equity and so do not have control over the activities of Southern Water. MSCIF have also confirmed that no individual investor, either acting alone or with others, is able to have significant influence over the activities of Southern Water.

MSCIF acting through the GP has given an Ultimate Controller undertaking to Southern Water, a copy of which has been provided to Ofwat. As a Luxembourg registered partnership MSCIF does not have a legal personality separate to that of its limited partners and so cannot provide an Ultimate Controller undertaking in its own right. The terms of appointment of the GP require it to act independently on behalf of MSCIF, not on behalf of the wider Macquarie Group and therefore we do not consider that there is a need for further undertakings to be provided by any parent company of the GP.

We have been informed that there are currently c.50 investors in MSCIF. These investors do not have day to day control of MSCIF and the largest holding is an interest of c.12%. Further, subsequent to completion of the transaction, in November 2021, MSCIF syndicated a part of the equity interest in Wight Ventures S.à r.l, (an indirect subsidiary of MSCIF) through the Co-Investors. However MSCIF has retained full control over the affairs of Wight Ventures S.à r.l, with the Co-Investors being given limited minority blocking rights. As a result, there is no individual investor who is able to exert significant influence on MSCIF and who in our view is required to provide an Ultimate Controller undertaking at this time.

MAMES has also provided an Ultimate Controller undertaking in its capacity as Manager. While MAMES does not have a direct interest in the shares of Greensands, its role as Manager, a key adviser to MSCIF, means that it may be able to exert a material level of influence on the activities of Southern Water.

While both the GP and MAMES are part of the MAM Group, their responsibilities are clearly defined by the relevant partnership agreement and management agreement which set out the scope and terms under which they provide services to MSCIF and its investors. As a result, we do not consider that entities which sit higher within the Macquarie group are able to have a level of influence which would lead us to conclude that they should also provide Ultimate Controller undertakings.

After considering the corporate and management structure as set out in section 3.2, we have not identified any further entities that meet the licence definition of Ultimate Controller and, as such, we do not consider that any further Ultimate Controller undertakings are necessary.

**Questions:**

- What are your views on our identification of the Ultimate Controllers?

## Appendix 1 – Evolution of the ring-fence and its key provisions

Companies' licences contain certain conditions that are designed to protect the regulated business, to ensure each company has sufficient access to resources it needs to carry out its functions. The conditions constrain a company's conduct, ensuring its resources are not diverted and that it is not exposed to undue risk. These protections are collectively known as 'the regulatory ring-fence' and they help to limit the extent to which value can be extracted from companies ensuring that sufficient resources are available in all circumstances.

In 2020 we strengthened and aligned the [ring-fencing licence conditions](#)<sup>7</sup> of all companies<sup>8</sup> so that, to the extent reasonable, they are consistent across companies. We also adjusted the definition of Issuer Credit Rating to clarify which ratings will be used as regulatory markers for the purposes of triggering cash lock-up.

In summary, the key provisions of the regulatory ring-fence require each company to:

- Operate as though the Appointed Business were substantially the Appointee's sole business and a public limited company separate from any other business carried out by the Appointee;
- Procure undertakings from its Ultimate Controllers committing them not to take any action which may cause the Appointee to breach its obligations under the licence or the WIA 1991. The Appointee must enforce the undertaking if Ofwat so directs;
- Inform us if the company becomes aware of arrangements which may lead to a change of control;
- Ensure it maintains at least one investment grade credit rating;
- Not to make any payments or transfers other than previously agreed financial and operational payments, if the credit rating falls low enough to trigger cash lock-up<sup>9</sup>;
- Certify to us, annually, that it has sufficient financial resources and facilities, management resources and systems of planning and internal control to carry out the Regulated Activities for at least the following twelve months;
- Maintain at least one listed financial instrument unless Ofwat has agreed otherwise;
- Maintain a dividend policy which rewards efficiency and management of economic risk and does not impair the ability of the company to finance the Appointed business;
- Transact with associated companies on an arm's-length basis; and,
- Report any issues to Ofwat that could materially affect the Appointee's ability to carry out its Regulated Activities as soon as possible.

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<sup>7</sup> [Conclusions on section 13 of the WIA91 on proposed modification to ring-fencing provision](#), 14-Jul-2020

<sup>8</sup> Wessex Water did not agree to the licence modifications we sought in 2020 and retains some differences.

<sup>9</sup> Wessex Water's licence applies a lower threshold to use 'reasonable endeavours' to maintain an investment grade credit rating and does not contain the cash lock-up licence provisions.

The ring-fence also prohibits the following actions without the prior approval of Ofwat:

- Guaranteeing the liabilities of an Associated Company;
- Making a loan to an Associated Company;
- Entering into financial agreements that incorporate cross-default obligations; and
- Transferring to any Associated Company any right or asset other than financial resources that a special administrator would require if a special administration order were made.

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

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