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By email and post

██████████
██████████
Wessex Water Services Limited
Claverton Down Road,
Claverton Down, Bath
BA2 7WW

7 February 2020

Dear ██████,

CONSENT TO FINANCING ARRANGEMENTS PURSUANT TO CONDITION I PARAGRAPH 8.1

1 Introduction

- 1.1 Wessex Water Services Limited (“**Wessex Water**”) is the holder of an instrument of appointment granted under sections 11 and 14 of the Water Act 1989 (the “**Appointment**”). Words and expressions defined in the Appointment shall have the same meaning in this letter unless the context otherwise requires.
- 1.2 Condition I in Wessex Water’s Appointment contains regulatory ring-fencing provisions which amongst other things, prohibit Wessex Water from giving any guarantee in relation to any liability of an Associated Company (paragraph 8.1 of Condition I, “**Condition I8.1**”) without Ofwat’s consent.
- 1.3 Wessex Water accesses the debt capital markets through a separate wholly owned financing subsidiary, Wessex Water Services Finance Plc, company number 03704265 (“**WWSFPLC**”), which issues financial instruments, normally bonds (the “**Financial Instruments**”), into the debt capital markets on its behalf.
- 1.4 The Financial Instruments are guaranteed by Wessex Water.

1.5 In a letter dated 30 January 2020 (the “**Consent Request Letter**”, included as an Appendix to this letter), Wessex Water requested consent from Ofwat in relation to Condition I8.1 of their Instrument of Appointment. Wessex Water is seeking consent for the provision of guarantees by Wessex Water in connection with the Financial Instruments issued by WWSFPLC.

1.6 We have not been provided with copies of all the documents setting out the relevant financing arrangements. In our consideration of the request for consent we have relied on the information and assurances contained in the Consent Request Letter. Ofwat’s consent is provided on the basis that the material facts described in the Consent Request Letter are accurate.

1.7 The purpose of this letter is to record Ofwat’s agreement to the request for consent made by Wessex Water in its Consent Request Letter and to set out the conditions of that consent.

2 Nature of Consents Sought

2.1 The Consent Request Letter requests the following:

“a general consent is required in relation to Condition I8.1 of the Instrument of Appointment to cover any guarantees that are in place at the time your consent is granted along with any guarantees that arise as a result of any future transactions that the company enters into.”

2.2 Condition I8.1 of the Appointment states that “The Appointee shall not, without the consent of Ofwat: give any guarantee of any liability of any Associated Company”. That is, the guarantees that are required pursuant to the Financial Instruments are prohibited without the consent of Ofwat under Condition I8.1 of the Appointment

3 Ofwat’s Consent

3.1 In accordance with, and for the purposes of Condition I8.1, and subject to paragraph 3.2 of this letter, as of the date of this letter, Ofwat consents to the existing and future guarantee arrangements that are given by Wessex Water in respect of the Financial Instruments issued by WWSFPLC. The list of current Financial Instruments as at the date of this letter are in Appendix 2.

3.2 This Consent is subject to the following conditions:

- a) WWSFPLC continues to be wholly-owned and controlled by Wessex Water and the sole purpose of WWSFPLC is to raise finance on behalf of Wessex Water and

- b) All funds raised by WWSFPLC are passed on to Wessex Water less relevant administrative expenses at WWSFPLC; and
- c) there shall be no material changes, without Wessex Water first obtaining Ofwat's further consent, to the terms of existing guarantee arrangements provided by Wessex Water on Financial Instruments issued by WWSFPLC; and
- d) the terms of any future guarantee arrangements, provided by Wessex Water on Financial Instruments issued by WWSFPLC, shall be materially similar in substance to the terms of the existing guarantee arrangements.

4 Reasons for Consent

- 4.1 Wessex Water sets out in the Consent Request Letter that it is necessary for Wessex Water to access the Sterling bond markets to deliver the required larger size and longer maturity of funding it needs. Wessex Water was advised that as a private limited company it could not access the Sterling bond markets directly because the bonds need to be listed on a recognised exchange. Wessex Water was advised that the established practice in order to be able to issue bonds was to establish a financing subsidiary that was a public limited company as this vehicle would be able to issue the bonds and then qualify for listing.
- 4.2 The Consent Request Letter says that Wessex Water did not consider alternatives as it was advised that there were no other suitable solutions when it came to accessing the Sterling bond markets.
- 4.3 To deliver a successful bond issue, the financing subsidiary needs sufficient credit strength to issue investment grade bonds. To achieve this, Wessex Water says it has to fully guarantee all the payment obligations of the financing subsidiary; Wessex Water says this makes sense because the regulated business is the exclusive user of the resultant proceeds. Without the guarantee investors "would simply not buy the bonds, or if they did, at an exorbitant price."
- 4.4 Wessex Water says there has been no increase in risk to customers as result of this structure and describes the arrangement as being purely mechanical in that it allows Wessex Water to secure indirect access to the Sterling bond markets through WWSFPLC.
- 4.5 We recognise that there is an established market practice of setting up dedicated financing subsidiaries. We note Wessex Water's assessment that the guarantees provided do not increase customer risk more than if the funds had been issued directly by Wessex Water. In addition, Wessex Water has set out that the guarantee arrangements are in the interests of customers because Wessex Water considers that they provide them with access to deeper pools of capital at a lower

cost than would be the case without the guarantee arrangements in place and that this extra capital is necessary to meet their growing financing needs.

4.6 Taking account of the reasons set out above, Ofwat considers that the Consent provided in section 3 above should be granted because in the circumstances, and from the information provided, Ofwat is satisfied that the granting of consent is consistent with our statutory duties.

Yours sincerely

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Appendix 1 - Consent Request Letter

Please see the attached letter from [REDACTED] dated 30 January 2020.

[REDACTED]
Finance and Governance
Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

30 January 2020

Dear [REDACTED]

General Consent Required for Wessex Water Services Limited (“WWSL”) to guarantee all the financial obligations of Wessex Water Services Finance Plc (“WWSFPLC”)

WWSFPLC is a 100% wholly owned subsidiary of WWSL. It is the only subsidiary company of WWSL. Its sole purpose is to issue bonds on behalf of WWSL and on-lend the proceeds to WWSL with a 100% back to back arrangement.

WWSFPLC was established in 1999 to execute the inaugural bond issue of WWSL. At that time WWSL had been used to accessing other financial markets but given the ever growing size of the company’s capital expenditure programme, designed amongst other things to improve customer services and improve environmental standards, it became necessary for WWSL to access the Sterling bond markets which is a market able to deliver size and maturity.

In general terms WWSL’s financing strategy is to access bank markets for short term and smaller working capital needs, specialist infrastructure lenders such as the The European Investment Bank for medium financing needs in respect of size and duration and the Sterling bond markets for larger and longer transactions. Furthermore the Board of WWSL has agreed for a long time that financing needs of WWSL would be a mixture of fixed and floating rate as well as index-linked. The Board has agreed that floating rate would not be more than a certain percentage of the company’s total debt at any time.

However WWSL has been a private limited company since 1998. Following detailed discussions with WWSL’s lawyers and banks definitive advice was received by WWSL that a private limited company was unable to access the Sterling bond markets directly as the bonds had to be listed on a recognised exchange. The way around this, according to the advice received and a common established practice, was to establish a financing subsidiary which would be a public limited company that itself would be able to issue the bonds and then qualify for listing. Other alternatives were not considered in detail as it was advised to the company that there was no other suitable solutions when it came to accessing Sterling bond markets. Not going to the Sterling bond markets, but relying on other financing sources instead, would not have met the company’s financing needs which were ever growing at the time..

The issue then become one of creditworthiness of the financing subsidiary as it had no assets in its own name. To deliver a successful outcome from any bond issue it had to be the case that WWSL would need to guarantee all the payment obligations of the financing

subsidiary which actually made sense given it would be WWSL that used the resultant proceeds.

Therefore all bonds issued to date have been fully guaranteed by WWSL. If there was no guarantee investors would simply not buy the bonds, or if they did at an exorbitant price. In summary this structure is necessary as WWSFPLC, as a standalone company, would not have sufficient credit strength to issue investment grade bonds without a suitable guarantee from the regulated water and sewerage undertaker.

In summary, all bonds issued since 1999 have followed this format and WWSFPLC has never undertaken any other activity other than to issue bonds on behalf of WWSL. There has been no increase in risk to customers by following this format. It is one of purely mechanics whereby WWSL is incapable of securing direct access to bond markets so the format that needs to be followed is one whereby WWSL has, in effect, indirect access to the markets.

A general consent is required please in relation to Condition 18.1 of the Instrument of Appointment to cover any guarantees that are in place at the time your consent is granted along with any guarantees that arise as a result of any future transactions that the company enters into.

To aid the decision from Ofwat an extract is below from the Trust Deed of a very recent transaction which shows the nature of the guarantee being given by WWSL in respect of WWSFPLC's obligations under a transaction of this type.

GUARANTEE

(A) THE Guarantor hereby irrevocably and unconditionally guarantees to the Trustee the due and punctual payment in accordance with the provisions of these presents of the principal of and premium (if any) and interest on the Securities and of any other amounts payable by the Issuer under these presents.

(B) If the Issuer fails for any reason whatsoever to pay when due and payable any such principal, premium, interest or other amount, the Guarantor shall cause each and every such payment to be made as if the Guarantor instead of the Issuer were expressed to be the primary obligor under these presents and not merely a surety (but without affecting the nature of the Issuer's obligations) to the intent that the holder of the relevant Security or Coupon or the Trustee (as the case may be) shall receive the same amounts in respect of principal, premium, interest or such other amount as would have been receivable had such payments been made by the Issuer.

(C) If any payment received by the Trustee or any Holder or Couponholder under the provisions of these presents shall (whether on the subsequent bankruptcy, insolvency or corporate reorganisation of the Issuer or, without limitation, on any other event) be avoided or set aside for any reason, such payment shall not be considered as discharging or diminishing the liability of the Guarantor and this guarantee shall continue to apply as if such payment had at all times remained owing by the Issuer and the Guarantor shall indemnify the Trustee and the Holders and/or Couponholders (as the case may be) in respect thereof PROVIDED THAT the obligations of the Issuer and/or the Guarantor under this sub-clause shall, as regards each payment made to the Trustee or any Holder or Couponholder which is avoided or set aside, be contingent upon such payment being reimbursed to the Issuer or other persons entitled through the Issuer.

(D) The Guarantor hereby agrees that its obligations under this Clause shall be unconditional and that the Guarantor shall be fully liable irrespective of the validity, regularity, legality or enforceability against the Issuer of, or of any defence or counter-claim whatsoever available to the Issuer in relation to, its obligations under these presents, whether or not any action has

been taken to enforce the same or any judgment obtained against the Issuer, whether or not any of the other provisions of these presents have been modified, whether or not any time, indulgence, waiver, authorisation or consent has been granted to the Issuer by or on behalf of the Holders or the Couponholders or the Trustee, whether or not any determination has been made by the Trustee pursuant to Clause 18(A), whether or not there have been any dealings or transactions between the Issuer, any of the Holders or Couponholders or the Trustee, whether or not the Issuer has been dissolved, liquidated, merged, consolidated, bankrupted or has changed its status, functions, control or ownership, whether or not the Issuer has been prevented from making payment by foreign exchange provisions applicable at its place of registration or incorporation and whether or not any other circumstances have occurred which might otherwise constitute a legal or equitable discharge of or defence to a guarantor. Accordingly the validity of this guarantee shall not be affected by reason of any invalidity, irregularity, illegality or unenforceability of all or any of the obligations of the Issuer under these presents and this guarantee shall not be discharged nor shall the liability of the Guarantor under these presents be affected by any act, thing or omission or means whatever whereby its liability would not have been discharged if it had been the principal debtor.

(E) Without prejudice to the provisions of Clause 9(A) the Trustee may determine from time to time whether or not it will enforce this guarantee which it may do without making any demand of or taking any proceedings against the Issuer and may from time to time make any arrangement or compromise with the Guarantor in relation to this guarantee which the Trustee may in its discretion consider expedient in the interests of the Holders.

(F) The Guarantor waives diligence, presentment, demand of payment, filing of claims with a court in the event of dissolution, liquidation, merger or bankruptcy of the Issuer, any right to require a proceeding first against the Issuer, protest or notice with respect to these presents or the indebtedness evidenced thereby and all demands whatsoever and covenants that this guarantee shall be a continuing guarantee, shall extend to the ultimate balance of all sums payable and obligations owed by the Issuer under these presents, shall not be discharged except by complete performance of the obligations in these presents and is additional to, and not instead of, any security or other guarantee or indemnity at any time existing in favour of any person, whether from the Guarantor or otherwise.

(G) If any moneys shall become payable by the Guarantor under this guarantee the Guarantor shall not, so long as the same remain unpaid, without the prior written consent of the Trustee: (i) in respect of any amounts paid by it under this guarantee, exercise any rights of subrogation or contribution or, without limitation, any other right or remedy which may accrue to it in respect of or as a result of any such payment; or (ii) in respect of any other moneys for the time being due to the Guarantor by the Issuer, claim payment thereof or exercise any other right or remedy; (including in either case claiming the benefit of any security or right of set-off or, on the liquidation of the Issuer, proving in competition with the Trustee). If, notwithstanding the foregoing, upon the bankruptcy, insolvency or liquidation of the Issuer, any payment or distribution of assets of the Issuer of any kind or character, whether in cash, property or securities, shall be received by the Guarantor before payment in full of all amounts payable under these presents shall have been made to the Holders, the Couponholders and the Trustee, such payment or distribution shall be received by the Guarantor on trust to pay the same over immediately to the Trustee for application in or towards the payment of all sums due and unpaid under these presents in accordance with Clause 10.

(H) The obligations of the Guarantor under these presents are direct, unconditional and, subject to the provisions of Condition 3, unsecured obligations of the Guarantor and, save for such exceptions as may be provided by applicable laws and subject to Condition 3, at all times rank at least equally with all its other outstanding unsecured and unsubordinated obligations, present and future.

Yours sincerely



Wessex Water Services Limited

Appendix 2 – Existing Financial Instruments

The Financial Instruments issued by WWSFPLC and guaranteed by Wessex Water are listed under “Inter-company loan” below.

The Financial Instruments had a carrying amount at 31 March 2019 of £1,625.9m (2018: £1,599.4m) and a face value of £1,400.0m (2018: £1,599.4m) and comprised nine index-linked bonds and four nominal bonds all maturing between 2021 and 2058 as seen below.

17. Other Interest-bearing Loans and Borrowings (continued)

	Currency	Nominal interest rate	Year of maturity	Face value 2019 £m	Carrying amount 2019 £m	Face value 2018 £m	Carrying amount 2018 £m
<i>Bank loans</i>	Sterling		2021-2026	413.7	413.7	275.0	275.0
<i>Inter-company loans</i>							
Bond	Sterling	5.375%	2028	200.0	198.6	200.0	198.5
Bond	Sterling	5.75%	2033	350.0	346.3	350.0	346.1
Bond	Sterling	4.00%	2021	200.0	199.3	200.0	199.1
Bond	Sterling	4.00%	2021	100.0	102.3	100.0	103.2
Index Bond	Linked Sterling	3.52%	2023	50.0	79.9	50.0	77.0
Index Bond	Linked Sterling	2.186%	2039	50.0	66.7	50.0	64.8
Index Bond	Linked Sterling	1.75%	2046	75.0	107.4	75.0	103.5
Index Bond	Linked Sterling	1.75%	2051	75.0	107.4	75.0	103.5
Index Bond	Linked Sterling	1.369%	2057	75.0	107.4	75.0	103.5
Index Bond	Linked Sterling	1.374%	2057	75.0	107.4	75.0	103.6
Index Bond	Linked Sterling	1.489%	2058	50.0	67.7	50.0	65.5
Index Bond	Linked Sterling	1.495%	2058	50.0	67.7	50.0	65.5
Index Bond	Linked Sterling	1.499%	2058	50.0	67.8	50.0	65.6
				<u>1,813.7</u>	<u>2,039.6</u>	<u>1,675.0</u>	<u>1,874.4</u>

Source: note 17 of Wessex Water’s March 2019 Annual Report and Accounts.