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By email

Paul Kerr  
Group Chief Financial Officer  
Sutton and East Surrey Water Plc (SES Water)  
London Road  
Redhill  
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RH1 1LJ

25 May 2023

Dear Paul,

## **Time-limited consent for SES Water to maintain one Issuer Credit Rating**

Sutton and East Surrey Water Plc (“**SES 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.

In a letter dated 16 May 2023 (the “Consent Request Letter”, included as Appendix 1 to this letter), SES Water requested consent for a time-limited derogation from Ofwat’s regulatory ring-fencing framework in respect of the requirement to maintain investment grade Issuer Credit Ratings with at least two Credit Rating Agencies.

The purpose of this letter is to record our consent to the specific request made by SES Water and to set out any conditions of that consent.

In our consideration of the request for consent, we have relied on the information contained in the Consent Request Letter provided to us by SES Water. The consent provided in this letter is granted on the basis of the information provided by SES Water and our assessment of the specific circumstances of SES Water at the time of the request. Accordingly, the consent provided should not be taken as a statement of Ofwat policy as to the provision of consent in other circumstances. Such requests will be considered individually in accordance with our statutory duties and taking account of our published guidance<sup>1</sup>.

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<sup>1</sup> [Guidance on Ofwat’s approach to granting derogations from the regulatory ring-fencing framework, February 2020](#)

## Background and nature of consents sought

The credit rating requirement in SES Water's licence<sup>2</sup> states that:

- P26 The Appointee must ensure that it or any Associated Company which issues corporate debt on its behalf maintains, at all times, two Issuer Credit Ratings which are Investment Grade Ratings from two different Credit Rating Agencies, other than where Ofwat provides its written agreement for the Appointee to maintain only one Issuer Credit Rating which is an Investment Grade Rating.

In its Consent Request Letter, SES Water requested our consent to maintain a single Issuer Credit Rating until a second Issuer Credit Rating is obtained in late 2023 or early 2024. In the letter, SES Water set out that this proposed arrangement is required to allow adequate time for the transition to two Issuer Credit Ratings, taking into account SES Water's ongoing strategic review, which may result in a deferral of the annual credit rating review process.

SES Water stated that it considers the proposed arrangement does not present any additional risks to the company's customers or its ability to carry out its functions in the short or longer term, as Ofwat will continue to have access to other sources of information on which to assess any risk to SES Water's ability to carry out its activities and deliver for its customers.

SES Water set out that the additional sources of information include: SES Water's Annual Performance Report (APR) including its Ring-Fencing Certificate due to be submitted in July 2023; PR24 Business Plan submission due to be submitted in October 2023; SES Water's 'Group credit rating' from S&P and the ongoing dialogue on financial resilience matters that the company maintains with Ofwat.

## Ofwat's Consent

In accordance with, and for the purposes of paragraph 26 of Condition P of the Appointment and subject to the conditions set out below, Ofwat consents to SES Water maintaining an Issuer Credit Rating which is an Investment Grade Rating from only one Credit Rating Agency until the date the company obtains a second Issuer Credit Rating from a different Credit Rating Agency, or 31 March 2024 at the latest. We expect the company to obtain its second rating as soon as practicable given the on-going strategic review.

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<sup>2</sup> This updated condition came into effect on 17 May 2023 as set out in '[Decision under sections 13 and 12A of the Water Industry Act 1991 to modify the ring-fencing licence conditions of the largest undertakers](#)', March 2023

We have reviewed SES Water's position in the round and following our consideration of all the issues, this consent is subject to the conditions that:

1. SES Water maintains regular engagement with Ofwat during its strategic review process<sup>3</sup>;
2. there is no material change in SES Water's financial standing or operational performance. If there is such a material change, we may require the company to accelerate the process to obtain a second Issuer Credit Rating. In this case, we would engage with SES Water to understand the reason behind the material change and determine appropriate next steps, and provide the company with reasonable notice should we be unable to provide our further agreement to the company maintaining only one Issuer Credit Rating. Examples of such a material change might include a material deterioration in the company's financial resilience sufficient to raise Ofwat's concerns. An assessment of the company's financial resilience might include but is not limited to: an increase in gearing, a fall in adjusted interest coverage ratio or funds from operations as a proportion of net debt (FFO/net debt), an increase in the mark-to-market value of swaps as a proportion of RCV, a fall in credit rating; and
3. there is no material change in the rating methodology, as determined by Ofwat, of rating analysis provided by the Credit Rating Agency from which the company has procured its sole Issuer Credit Rating.

SES Water must notify Ofwat in writing of any material change in its financial standing or operational performance as soon as possible as part of our ongoing engagement.

## **General Provisions relating to Ofwat's Consent**

The consent described above is effective from 17 May 2023.

## **Reasons for Consent**

Ofwat considers that the consent provided above should be granted because from the information provided and from our assessment of the company, Ofwat is satisfied that the granting of consent is consistent with its statutory duties.

The following factors have also informed our decision to grant consent:

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<sup>3</sup> The scope and frequency of the engagement will be agreed between SES Water and Ofwat on an ongoing basis.

- SES Water's request to maintain only one Issuer Credit Rating which is an Investment Grade Rating is for a limited time only.
- The company is already taking the necessary steps to procure a second Issuer Credit Rating.
- In the period during which SES Water will continue to hold only one Issuer Credit Rating, the company will provide Ofwat with regular updates on the progress of its strategic review.
- Moreover, Ofwat will have access to additional independent views on the company and the wider group within which it sits from SES Water's group credit rating assigned by S&P. This additional information, taken with other data Ofwat has access to, will provide Ofwat with sufficient information to continue to monitor SES Water's financial resilience in the interests of customers while the company obtains its second Issuer Credit Rating.

We trust that you will keep us advised of any material changes to the matters set out in your letter including, without limitation, those which relate specifically to the consent requested and any material change to the basis on which the consent has been granted as set out above.

Yours sincerely,

John Russell

**Senior Director, Sector Performance**

## **Appendix 1 – Consent Request Letter from SES Water**

Attached to email.

Our Ref: PK/LAT/Ofwat

16 May 2023



John Russell  
Senior Director – Strategy, Finance, and Infrastructure  
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Dear John

**Decision under sections 13 and 12A of the Water Industry Act 1991 to modify the ring-fencing licence conditions of the largest undertakers – consent application.**

Thank you for the recent discussions regarding the implementation of the pending modifications to SES Waters' ring-fencing licence conditions issued in March 2023. In line with Ofwat's request, we provided further comments on the above decision document on 28 April 2023.

As we noted in such discussions, we require time to transition to Ofwat's new requirement with respect to "two Issuer Credit Ratings" as noted below (extracted from Pg 41 of the above decision document):

*"The Appointee must ensure that it or any Associated Company which issues corporate debt on its behalf maintains, at all times, two Issuer Credit Ratings which are Investment Grade Ratings from two different Credit Rating Agencies, other than where Ofwat provides its written agreement for the Appointee to maintain only one Issuer Credit Rating which is an Investment Grade Rating."*

Given that Ofwat have noted the deadline of 17 May 2023 for the above modification to the licence, utilising Ofwat's consent process we are requesting that SES Water continue to maintain a single Issuer Credit Rating (Moody's) while on-boarding a second Credit Rating Agency to issue a second Credit Rating. The latter process has already commenced, with formal engagement of such a Credit Agency expected in summer 2023. It should be noted that – given the current strategic review of the ESH Group (including SES Water) – it is management's understanding from initial discussions with our current Credit Rating Agencies that annual Issuer Credit Ratings (including the second Issuer Credit Rating) may not be updated until late 2023 or early 2024. In forming this understanding, management have articulated their views to the credit agencies that there would be little value in obtaining an updated Issuer Credit Rating prior to further clarity on the status of the strategic review.

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We have followed Ofwat's guidance (as issued in February 2020) to seek consent for the above proposed transition arrangement as detailed in the Appendix to this letter. As always, we are happy to discuss further as needed.

Yours sincerely



Paul Kerr  
Group Chief Financial Officer

## Appendix – SES Water consent application responses

Category	Requirement	SES Water response
Description	Set out the licence condition that is applicable to the proposed arrangement	Updated licence condition P26 re maintenance of two Issuer Credit Ratings from different Credit Rating Agencies.
	Set out the details of the proposed arrangements including the key contractual structures, named entities, structure charts, key responsibilities and liabilities, and any terms or conditions that are attached to the proposed arrangement.	Proposed arrangement is as follows: <ul style="list-style-type: none"> <li>- Formal engagement with second Credit Rating Agency in summer 2023.</li> <li>- Issuance of second Issuer Credit Rating in late 2023 or early 2024 (depending on status of SES Water's strategic review).</li> <li>- Maintenance of one issuer credit rating during the above transition period.</li> </ul>
Purpose of proposed arrangement	Provide a detailed explanation of the purpose of the proposed arrangement including as to why it is necessary for the Appointee to enter into it and why it is in the interests of customers.	The above proposed arrangement is required to allow adequate time for transition to two Issuer Credit Ratings, taking into account SES Water's ongoing strategic review. The latter may result in a deferral of the annual credit rating review process (both for our incumbent and the new Credit Rating Agency) depending on the status of the review. <p>Allowing for a formalised transition process, taking into account our strategic review, is in the best interests of customers to ensure an appropriate second Credit Rating Agency is onboard with due care and in light of current Company circumstances.</p>
Alternative options	Set out if relevant: whether there are any alternative approaches (which may or may not require consent), for example other potential financing options that could be taken by the Appointee; to what extent they have been explored; and why the proposed arrangement that requires the consent is the most appropriate and will allow the Appointee to deliver the stated purpose.	No relevant alternative arrangements were applicable as it is considered by management that no Credit Rating Agency would provide another Credit Rating immediately (even if formally engaged prior to 17 May 2023) given the uncertainty presented by the ongoing strategic review.
Impact of the proposed arrangement	Provide any qualitative assessment which is appropriate to demonstrate how the proposed arrangement ensures that the interests of customers are protected, and the expected impact of the proposed arrangement on the Appointee	No qualitative assessment considered appropriate for the proposed arrangement above. All stakeholders – including Credit Rating agencies and customers – will require further clarity on the outcomes of the going strategic review – prior to next Credit Rating assessment. In the meantime, we maintain our recent Baa2



		stable credit rating from Moody's and our shareholders continue to support the Company through the strategic review process.
	Provide quantitative analysis with key inputs, assumptions, calculations and models where applicable to support your assessment.	Not applicable – see above.
Risk assessment	Provide a risk assessment setting out the risks that may arise as a result of putting the arrangement in place, including the risks to customers (actual or potential) that may arise as well as risks to the ability of the Appointee to carry out its functions both in the short and longer term	<p>We consider that the proposed arrangement – whereby our single Issuer Credit Rating is maintained, and the second Issuer Credit Rating is issued in late 2023 or early 2024 – does not present any additional risks to our customers nor to our ability to carry out our functions in the short or longer term. Management have considered that additional risks will not manifest in such circumstances as Ofwat will continue to have access to other sources of information on which to assess any risk to SES Water's ability to carry out its activities and deliver for its customers. Such sources of information will include our upcoming Annual Performance Report (APR) 2023 (including our Ring-Fencing Certificate), the information to be provided in the October 2023 PR24 Business Plan submission, the Group credit rating in place from S&amp;P and the ongoing regular dialogue on financial resilience matters with Ofwat.</p> <p>The lack of a second credit rating at this point in time does not impact the ongoing work by the Board to ensure that Financial Resilience is maintained by the Company during the strategic review, including ensuring ongoing shareholder support.</p>
	Provide key inputs, assumptions, calculations or models where applicable to support your assessment.	Not applicable as noted above
	Provide any risk mitigation or avoidance actions that could be taken by the Appointee to minimise or eliminate risk to customers or the Appointee.	Not applicable as noted above
Supporting evidence	Provide supporting evidence to justify why the consent should be granted to the Appointee. This might include (but is not limited to),	No further supporting evidence considered relevant at this time.

	depending on the nature of a request, financial analysis/models, relevant legal documentation, market reports etc.	Expanded disclosure will be provided in the July 2023 Ring-Fencing Certificate on maintaining overall financial resilience of SES Water over the next 12 months during the strategic review.
Timing	It is helpful to let us know as soon as possible any timings which are relevant either to the grant of consent or the entry into the proposed arrangement.	Consent for the above proposed arrangement will be required prior to 17 May 2023 as previously discussed with Ofwat.