Department
for Environment
Food & Rural Affairs

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# Consultation on a Regime for Specified (Special) Water and Sewerage Infrastructure Projects in England – Phase 2

## Summary of Responses & Next Steps

**March 2013**

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## Contents

# Summary of Responses to the Consultation on a Regime for Specified (Special) Water and Sewerage Infrastructure Projects in England – Phase 2

# 5 November to 4 December 2012

## Background

1. The purpose of the consultation was to fulfill the commitment given by the Government in its Summary of Responses to the 2011 consultation on a regime for special water and sewerage infrastructure projects in England, that it would inform stakeholders of its decision on how to take the matter forward.

2. The consultation ran for 4 weeks between 5 November and 4 December 2012, and was issued by email to 73 contact addresses previously contacted for the 2011 consultation, including:
    - Mayor of London;
    - London MPs with a known interest;
    - EFRA Committee MPs;
    - Water and Sewerage companies in England;
    - Ofwat;
    - Consumer Council for Water.

3. The consultation documents were placed on the Defra consultation website. An email reminder was sent out to all the consultation contacts on 23 November.

4. In February 2011, Defra consulted on proposals for new secondary legislation to be made under section 36A of the Water Industry Act 1991, enabling the financing and delivery of large or complex high-risk water and sewerage infrastructure projects by separate Infrastructure Providers (IPs) competitively tendered by English water or sewerage companies. The proposals arose because of the risk of such large projects threatening the ability of the water and sewerage companies undertaking them to provide existing services to their customers. The new legislation would isolate and contain the risks and costs of delivering major new infrastructure within an IP, helping provide better value for money for customers and keeping their bills as low as possible

5. After considering the responses to the 2011 consultation, Ministers decided to consult on proposed new secondary legislation to create IPs together with a separate draft Notice to be made under the proposed Regulations which prescribe Special Administration provisions to be applied to IPs on a project-specific basis. The only such large and complex project expected within the next 10 years is the Thames Tideway Tunnel, hence a draft Notice for that was included in the consultation.

# Summary of Replies

6. Defra received 7 replies to the public consultation; the types of respondents break down as follows:

| Replies to Public Consultation | | |
|---|---|---|
| **Organisation Type** | **Number of Respondents** | **% *(rounded)*** |
| Individuals | 2 | 29 |
| MPs | 2 | 29 |
| Water & Sewerage Companies | 1 | 14 |
| Non-Governmental Organisations | 1 | 14 |
| Local Community Groups | 1 | 14 |
| *Total* | *7* | *100* |

7. The public consultation invited comments on the proposed draft Specified (Special) Infrastructure Project Regulations, rather than asking specific questions, since the consultation was primarily to set out the Government's decision on taking the matter forward following the 2011 consultation. A summary of the main points raised by respondents, and the Government's response, is detailed below. The actual replies received to the consultation are reproduced in the Annex to this document.

## Main Points

The 7 respondents provided views and comments on the proposed legislation along with a range of other issues related to the proposed Thames Tideway Tunnel project.

These are summarised below:

- **Supportive of the proposed draft Regulations and Notice**
    - Detailed drafting suggestions to both the draft Regulations and Notice;
    - The proposed 5-year review and report of the impact of the Regulations provides a safety mechanism should further scrutiny be required;
    - Specifying a major project may reduce the risk borne by the undertaker and lead to critical infrastructure assets being completed more quickly and networks becoming more resilient.
- **The draft Regulations should be suspended pending a full review of the Thames Tideway Tunnel project**
    - Greater clarity needed on the rationale for the project, and its financing.
- **The draft Regulations are unnecessary, and another option should be pursued to achieve the intended aims**
    - Thames Water's licence should be varied by Ofwat to allow it to create a subsidiary to carry out the Thames Tideway Tunnel project;
    - Creation of a special purpose company to build the Tunnel would absolve Thames Water's shareholders of the responsibility for decisions that have placed Thames Water in a poor financial position;
    - The Government should not allow Thames Water to avoid its obligations to provide necessary infrastructure by keeping the Tunnel project off its balance sheet through creation of a special purpose company, and thus should not facilitate poor financial behaviour by Thames Water.
- **It is not clear that a separate Infrastructure Provider would genuinely serve the public interest**
    - There should be complete transparency on all aspects of exactly what the Government and its agencies are proposing with the draft Regulations, with appropriate safeguards to ensure protection of Thames Water customers and UK taxpayers;
    - Thames Water as a company, and its shareholders, should not be allowed to benefit financially from the Tunnel project.

- **The proposed Regulations would reward current financial mismanagement in the UK water industry sector**

    - Regulation of the water industry needs to be tightened up to prevent excessive dividends being paid out to shareholders, and increasing companies' overall debt burdens;

    - The Government focus should be on updating the underlying operational, legal, and financial framework for the water sector, rather than handing a lifebelt to imprudent investors through this proposed legislation.

- **Strongly object to the proposed draft Regulations**

    - Takes no account of Thames Water's own contribution to its excessive indebtedness, rendering the company unable to raise the necessary capital itself for the Tunnel project and relying instead on Government help;

    - No incentives for Thames Water to consider less lucrative, generally less risky alternatives to the Tunnel

## Government Response and Next Steps

We have noted the range of views and comments received from respondents on the proposed legislation and relating to the Thames Tideway Tunnel project. In particular, concerns were raised that provision to enable a separate Infrastructure Provider would allow water and sewerage companies to avoid obligations to provide necessary infrastructure themselves within their own financial structures, and so enable continuation of high levels of dividend payments to shareholders.

At present, the Thames Tideway Tunnel would be the sole infrastructure project within the next 10 years expected to be affected by the proposed legislation. It is important to note that the proposed legislation makes provision to enable any water and sewerage company in England to undertake large or complex high-risk major infrastructure projects without threatening their ability to meet their statutory service provision obligations. The current water industry regulatory framework ensures that water and sewerage companies do not make excessive payments. Customers' bills are kept as low as possible while recognising that the companies must attract appropriate investment to meet future needs.

Following this public consultation a decision on whether to proceed with proposed Specified Infrastructure Project Regulations is expected shortly, within the next few months.

After introduction into Parliament, the scrutiny and subsequent affirmative approval of secondary legislation typically lasts around eight weeks. Hence, if made, these proposed Regulations could be anticipated as coming into effect within the second quarter of 2013 at the earliest.

It should also be noted that if any Specified Infrastructure Project Regulations were to be made then they might also require amendment at some point in the future. A particular example would be to give an IP the same powers that currently exist for water and

sewerage companies, such as a power of entry into premises or a power for compulsory purchases. Any such future amendments deemed necessary would also require further public consultation and affirmative Parliamentary approval before they could come into effect.

**March 2013**

# Annex – Replies Received to Phase 2 Consultation

## Thames Water Utilities Ltd

**Thames Water Utilities Limited response to the consultation on the Regime for Specified (Special) Water and Sewerage Infrastructure Projects in England – Phase 2**

This paper is submitted by Thames Water Utilities Limited ("**TWUL**") in response to the consultation paper published by the Department for Environment, Food and Rural Affairs ("**Defra**") on 5 November 2012, on the "Regime for Specified (Special) Water and Sewerage Infrastructure Projects in England – Phase 2" (the "**Second Consultation**"). .

TWUL is a water and sewerage undertaker pursuant to the Water Industry Act 1991 ("**WIA 1991**") and is the UK's largest water and wastewater services company, servicing circa 13.8 million customers in the London and Thames Valley areas. TWUL is working closely with Defra and the Water Services Regulation Authority ("**Ofwat**") to develop a route for delivery of the Thames Tideway Tunnel project under the regime for specified water and sewerage infrastructure projects (the "**SIPR regime**") as introduced into the WIA 1991 by the Flood and Water Management Act 2010.

We would be happy to discuss any aspects of our response with you in further detail and can be contacted at:


| | |
|---|---|
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**Introduction**

We welcome the excellent progress that is being made in relation to the SIPR regime and which is clearly evident in the draft *Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013* (the "**Regulations**") and the accompanying *Application of the Water Industry Act 1991 to the [Thames Tideway Tunnel] Project Notice 2013* (the "**Notice**") which have been put out to consultation. In particular, we appreciate the careful thought and consideration that has gone into producing these drafts, publication of which is a significant milestone in the development of the SIPR regime and, from our particular perspective, for the Thames Tideway Tunnel project (the "**Project**").

However, we do have a number of comments on the drafts as they currently stand. These are primarily directed at:

- ensuring that there is sufficient clarity in the Regulations and Notice. To that end, we have provided some comments below on some details of the drafting in relation to which we think further clarification could be helpful. We have also made some suggestions around the procurement provisions set out in the Regulations, which we hope could clarify the requirements; and

- securing that the regulatory and legislative regime within which an incumbent undertaker and infrastructure provider would operate is sufficiently stable and certain. Our particular concerns in this respect relate to the ease with which notices issued under the Regulations could be revoked and varied. This impacts on the certainty that infrastructure providers and incumbent undertakers are given regarding the status of a project as a specified infrastructure project (and therefore their relative duties and powers) and the stability of an infrastructure provider's appointment. It also impacts on the level of entrenchment of any application of relevant sections of the WIA 1991 to an infrastructure provider – which again, goes to the stability of the legislative framework within which an infrastructure provider and undertaker would operate. Our comments are made in the interests of securing a stable legislative and regulatory framework for the utilities industry in the United Kingdom and encouraging further investment in the water industry.

**Summary**

| Issue | Proposal |
|---|---|
| **Entrenchment:** provisions applied by way of the Notice may be varied or disapplied at any time, including the 'financing functions' duty, the special administration regime and the charging powers of the IP as well as other IP powers set out in this notice. | Move such provisions from the Notice to the Regulations. |
| **Revocation of specification:** a Secretary of State power to de-specify a project before the IP is appointed could disincentivise competition for the role of IP. A unilateral and unlimited power to de-specify or vary the specification post appointment of the IP would cut across the regulatory and contractual regime agreed and would put the credit rating of the incumbent undertaker and the IP at risk. | Revocation should not be permitted following appointment of the IP (with participants being compensated for abortive costs in the event of de-specification during the tender process). Once the IP is appointed, variation should only be permitted with the consent of the IP and incumbent undertaker. |
| **Procurement rules:** the current drafting could be read to disapply the exemptions / exclusions under the | Where the UCRs or Public Contract Regulations 2006 apply they should continue to do so, unmodified. If they do |

| Issue | Proposal |
|---|---|
| UCRs in relation to each aspect of the specified infrastructure project (design, construction, ownership and operation). We understand that this is not the intended effect. | not apply, an open and transparent procurement process should be followed unless otherwise agreed with Ofwat. The IP should also be subject to the UCRs as if it were a utility. |
| **Designation process:** there is currently no certainty that the winning bidder appointed by the incumbent undertaker would be designated. Further uncertainty is engendered by the possibility of conditions under regulation 8(2), the consultation process at regulation 8(5) and any uncertainty during the tender process around the terms of the licence or Notice. | Tender documentation for the Project should include a commitment that the Secretary of State / Ofwat will designate the winning bidder and will issue a licence and the Notice in the form attached in the tender documentation. The consultation process in regulation 8(5) should take place at the beginning of the tender process so as not to cause subsequent delays. |
| **Revocation of designation:** currently the power of the Secretary of State or Ofwat to revoke a designation notice could cut across the detailed regulatory and contractual regime which will set out the circumstances in which the licence can be revoked, infrastructure provider put into special administration and/or project discontinued. | De-designation should not be possible unless the licence has been revoked / project discontinued in accordance with the regulatory and contractual terms agreed. In the event of transfer of a licence under special administration, the designation should move with the licence automatically. |
| **Powers of the IP:** not all of the powers that the IP may need to deliver the Project have been extended to it by virtue of the regulations and notice. | A number of additional powers have been proposed for inclusion. |

**Part A: the Regulations**

**Definitions (Regulation 2)**

**Definition of "infrastructure project":** we understand that "operating" in s.36A(3)(a) of the WIA 1991 was intended to cover both operation and maintenance; this is clear from the first consultation on the SIPR regime issued by Defra on 22 February 2012 (the "**First Consultation**") (see paragraph 1.1 of the First Consultation). It may be helpful to use the opportunity of making the Regulations to clarify this in legislation. Paragraph 1.1 of the First Consultation also states that infrastructure providers may also have responsibility for financing the relevant infrastructure, and the First Consultation goes on to explain that one

of the reasons for introducing the SIPR regime is to introduce competition for the "right to *finance* infrastructure projects in the water and sewerage sector" (emphasis added). This is corroborated by the impact assessment accompanying the Second Consultation, which specifies that delivery can include financing. Whilst the phrase "owning" in s.36A(3)(a), as incorporated into the Regulations by the definition of "infrastructure project" in regulation 2, could be interpreted as including "financing", Government should clarify this in the Regulations by defining ownership to include the financing of the assets.

**Definition of "infrastructure":** We note that the definition of infrastructure is "infrastructure relating to the provision of a system…". Whilst we understand that infrastructure which is *part of* a system could be "relating to" that system, we think it might be clearer to insert a reference to "a system or any part thereof".

**Definition of "incumbent undertaker":** as the operative part of the definition is already covered in the Regulations, we query whether it would be clearer if the definition of "incumbent undertaker" simply referred to the undertaker whose services will be impacted by the specified project.

**General duties with respect to the water industry (Regulation 3)**

**Financing duty of the Secretary of State / Authority:** notwithstanding our general comments on entrenchment / irrevocability, we consider that the application of the duty of the Secretary of State / Authority under s2(2A)(c) of the WIA 1991 to an infrastructure provider is sufficiently important that it ought to be applied in respect of designated infrastructure providers by way of the Regulations rather than the Notice. This would give infrastructure providers comfort that the Secretary of State and Ofwat have a statutory financing duty both in respect of designated infrastructure providers as well as undertakers and provides a level of entrenchment of this duty which will comfort potential investors. We recognise that not all infrastructure projects specified under regulation 4(1) will necessarily include owning and financing the assets in question and it might not be appropriate for the 'financing functions' duty to apply to infrastructure providers who are tasked only with designing, constructing and / or operating infrastructure (but not with owning or financing such infrastructure). Perhaps this concern could be ameliorated by limiting the 'financing functions' duty to apply only to infrastructure providers appointed to deliver an infrastructure project which, pursuant to the specification notice, includes owning / financing and where such infrastructure provider is economically regulated by Ofwat.

**Protected land:** an infrastructure provider's licence may well contain a condition similar to condition K (*Ring-Fencing, Disposals of Land and Changes of Use of Land*) in the licence of water and sewerage undertakers. However, condition K does not deal with the treatment of the proceeds of a disposal and thus we consider that, as a matter of public interest, s.2(3)(c) of the WIA 1991 should be extended to apply to an infrastructure provider (in which case, the definition of "protected land" in s.219 would need to be amended accordingly).

**Specification of infrastructure projects (Regulation 4)**

**Irrevocability:**

We note that regulation 4(7) gives the Secretary of State / Authority the power to revoke a specification notice if he / it considers that either of the conditions are no longer satisfied. Potential bidders, appointed infrastructure providers and incumbent undertakers will incur costs and make business decisions on the basis of a specification that has been made and thus, these entities will need to be protected from the risk that the Secretary of State could subsequently change his opinion as to whether the conditions for specification are satisfied. We suggest, if the Secretary of State has the power to revoke a specification notice before an infrastructure provider is appointed in relation to that project, it will need to compensate participants for abortive costs in the event that he exercises such power.

Following the appointment of an infrastructure provider, the regulatory regime established for the appointed infrastructure provider will apply and we do not consider that the Secretary of State should have separate powers to de-specify a project as this would cut across that regulatory regime.

Consideration should also be given to the Secretary of State's power to vary the specification notice. We appreciate that there may be a need to vary a specification notice in certain circumstances (for example, where technical reasons dictate that the scope of specification should change, or where the details of the scope of works have evolved during the procurement process), but it is our view that this should be possible only with the consent of the incumbent undertaker and the infrastructure provider. Similar concerns around revocation and variation arise in relation to regulation 5(6) (in relation to work done by an incumbent undertaker in relation to a specified infrastructure project) as well as regulation 8(9) (in relation to designation of the infrastructure provider) and regulation 8(4) (in relation to further provisions applying to an infrastructure provider) – please see paragraph 5.2 below.

**Authority guidance:** we welcome the requirement that the Authority publish guidance to be followed in determining whether it should exercise its powers to specify / de-specify. We consider that the Authority should publish this guidance as soon as possible so that the market has sufficient time to digest its contents in advance of specification and procurement.

**Requirement to put specified infrastructure projects out to tender and procedure (Regulation 6)**

**Application of UCRs to the incumbent undertaker:** We are concerned that the procurement provisions included in the draft Regulations could prove to be unclear and cause uncertainty as to which provisions apply. In particular, we consider that the Regulations should operate such that utilities contract rules and public contract rules should apply without modification in cases where they already apply, and that in other situations a similarly open and transparent procurement process should be adopted (unless Ofwat agrees that this is not necessary for a particular procurement). We are concerned that the current drafting does not achieve this.

**Application of UCRs to the IP:** In addition, we would welcome express provisions in the Regulations that the infrastructure provider will also be subject to the utilities contract rules as if it were a utility. This would ensure that customers are protected by securing an open and transparent procurement process.

**Designation, licensing and regulation of an infrastructure provider (Regulation 8)**

**Issuing a licence:** it is our understanding that designated infrastructure providers will be issued with a licence. However, this is not brought out in regulation 8 or Schedule 2. We would suggest that a provision should be included in regulation 8 clarifying that an infrastructure provider which is designated under regulation 8(1) will be issued with a licence by the Authority under 17BA of the WIA 1991. The licence could apply functional regulation to the IP only, or alternatively could apply both functional and economic regulation. Where economic regulation is imposed, the "financing functions" duty should apply (see also paragraph 2.1 above)

**Certainty and irrevocability:** potential bidders for the role of infrastructure provider are likely to want certainty around designation upfront at the start of the procurement process. Potential bidders may find it helpful if this certainty was provided by the Authority or Secretary of State (as the case may be) by:

declaring a commitment to designate the winning bidder appointed by incumbent undertaker (where it is intended that the winning bidder will be a designated infrastructure provider);

announcing any conditions under regulation 8(2); and

publishing (as part of the tender documentation) the draft notice under regulation 8(4) and the draft licence to be issued to the winning bidder.

In addition, and in line with our comments on irrevocability of the specification notice (see paragraph 3.1 above), we consider that parameters should be set around when and in what circumstances a designation notice or notice under regulation 8(4) could be varied or revoked. In particular, we do not think it would be appropriate for a designation notice or a notice under regulation 8(4) to be revoked once an infrastructure provider has been appointed, in such a way as could cut across the terms of the licence, the enforcement and special administration regimes, and any contractual arrangements made between Government and the infrastructure provider.

**Consultation:** In our view, it is important that the consultation process described in regulation 8(5) is carried out prior to the commencement of the tender process (together with the consultation on the infrastructure provider licence), in order to avoid having a further consultation process at the end (or during) the procurement process.

**Provision of information by a relevant undertaker or infrastructure provider (Regulation 9)**

**Breadth of obligation:** we note that the obligation on the undertaker and infrastructure provider to provide information to the Secretary of State as drafted in regulation 9(1) is very

broad when compared with s.202 of the WIA 1991, which specifies that the information must be connected to the carrying out by that company of the functions of a relevant undertaker and must be material to the Secretary of State's functions. We consider that this provision should replicate the s.202 duty as we see no reason why a different approach should be taken here.

**Restrictions on disclosure of information:** we presume that it is Government's intention that s.206 of the WIA 1991 applies to information obtained by virtue of the Regulations and furnished under Regulation 9, and that this is achieved by the reference in s.206(a) to information obtained "by virtue of any of the provisions of this Act" (since the Regulations are passed by virtue of the Act). However, additional clarity would be highly desirable here and we would ask Government to consider carefully whether it would be preferable to apply s.206 explicitly under the Regulations.

**Application of the Act (Schedule 2)**

**Modification of project licences:** as the scope of an infrastructure provider's licence is likely to be highly relevant to the regulatory responsibilities of the incumbent undertaker, we would suggest that the incumbent undertaker should be expressly included in the list of people on whom notice / documents are served under 17IA(4)(b), 17K(5)(b), 17N(10((a) and 17P(7)(b). Indeed, we would go further and suggest that the incumbent undertaker should be consulted before any modification to a project licence.

**Enforcement:**

We believe that regulation 6(3)(a) should refer to subsection (1)(b) of section 22A of the WIA rather than subsection 1(a).

We note that the Regulations apply the existing enforcement regime to the infrastructure provider, including the same cap on enforcement penalties (set at 10% of the turnover of the company being enforced against) as applies to water and sewerage undertakers. Whilst potential bidders may be willing to accept this risk and this level of fine during the construction phase of the Project, the level of the cap may be considered inappropriate during the operational phase when the financial structure of the infrastructure provider may be different from ordinary water and sewerage undertakers because of its low capex programme and minimal activity but high turnover due to historic debt.

**General powers:** given that the nature of the infrastructure projects that may be specified and the scope of future infrastructure providers' functions are as yet undetermined, we query whether it would be useful to grant infrastructure providers a general power similar to the power given to local authorities who carry out sewerage functions on an undertaker's behalf, set out in s.97(3) of the WIA 1991.

**Part B: the Notice**

**General**

Our comments on the notice provided are subject in all respects to reviewing the designation notice and specification notice once available.

**Citation, commencement, application and interpretation (Paragraph 1)**

**Timing:** we note the reference to 2013 as the date on which this notice comes into force and assume therefore that the intention would be to issue this notice early in the process - and certainly before the TTT project as specified (the "**Project**") is actually designated - to give the industry some certainty around the functions, powers and duties of the infrastructure provider.

**Definition of the IP:** we suggest that this definition should recognise that the powers of the IP could be transferable to any other infrastructure provider to which the licence is transferred or to which a new licence is issued in respect of the Project. This would be particularly important in the case of special administration to enable the special administrator to transfer the licence to a new IP without the need for a further designation notice to be issued.

**Functions of the IP:** we note that there are references throughout to the functions of the IP. It will be helpful to show what the functions of the IP are on the face of the notice, by defining these as the activities authorised by the licence and any statutory functions imposed on the IP in consequence of the licence. This would also allow for such functions to be varied by agreement with Ofwat which allows flexibility of a regime which is intended to exist for a significant period of time.

**Special administration (Paragraph 4)**

**Entrenchment:** notwithstanding our general comments on entrenchment / irrevocability, we consider that the application of the special administration regime to an infrastructure provider is sufficiently important that it ought to be applied in respect of designated infrastructure providers by way of the Regulations rather than the Notice, so that this could not be changed without approval of the Houses of Parliament.

**Incumbent undertaker:** we note the reference to TWUL in section 4(2)(b)(ii) and query whether, as a drafting matter, it would be preferable to refer to the "affected incumbent undertaker for the TTT Project", given that the powers under this notice will be continuing and changes in the industry over the longer term may result in corporate reorganisation. The "affected incumbent undertaker" could then be defined as TWUL or a replacement sewerage undertaker appointed in accordance with s.7 of the WIA 1991.

**Modification of the Insolvency Act or Companies Act:** we note that the modification power given to the Secretary of State in relation to other special administrations in the industry under s.23(2E) of the WIA 1991 is repealed in relation to the infrastructure provider (as are sub-sections (3A), (3B) and 3(D) of s.23 of the WIA 1991), and that the existing regulations and rules applicable for licensed water suppliers are extended to the infrastructure provider by virtue of paragraph 4(6) of the Notice. It would be helpful to understand from Government the process by which it would extend to the infrastructure provider any new rules and regulations passed following issuance of the Notice, and what comfort the infrastructure provider and its creditors would have that they would be subject

to the standard regime applying to other regulated bodies in the water and sewerage industry from time to time?

**Schedule 2:** it might be clearer to refer, in the amendments to 1(3A)(b) of Schedule 2, to the "**activities** authorised by the project licence respectively", to make clear that this is not referring to "introduction or introductions of water".

**General functions of sewerage undertakers (Paragraph 5)**

**Compliance with the Urban Waste Water Treatment Regulations:** Government and the EA have each approved the Project as the preferred means of complying with the Urban Waste Water Treatment Directive (the "**UWWTD**"), and hence with the Urban Waste Water Treatment Regulations ("**UWWTRs**"). Both TWUL and the IP would need a certificate issued in accordance with regulation 4(3) of the UWWTRs, confirming that those CSOs which are not caught by the Project are not required to be dealt with under the scheme. This will need to be included in the tender documentation and will need to be affirmed by both Ofwat and the Environment Agency (as regulatory bodies with enforcement rights).

**Sewer ownership:** we would suggest that the IP's sewer is a defined term, which refers to an attached plan of the proposed sewer set out in the specification notice. This will give clarity around the extent of the sewer.

**Charges (Paragraph 7)**

**Entrenchment:** notwithstanding our general comments on entrenchment / irrevocability (see paragraph 5.2 of Part A of our response), we consider that the application of charging rights to an infrastructure provider would be sufficiently important that they ought to be applied in respect of designated infrastructure providers by way of the Regulations rather than the Notice.

**IP's works powers and supplemental provisions (Paragraphs 8, 9 and 10)**

**Land ownership:** it is likely that the IP may need to acquire additional land to perform its functions over the course of the years. We therefore consider that the IP should be granted CPO powers under s.155 of the WIA 1991. Given that the IP's land will be important to the performance of its functions and the IP is a distinct regulated utility, we also query whether s.156 of the WIA 1991 should apply to the IP, although we recognise that condition K will also impose restrictions in relation to protected land and this may be sufficient.

**IP powers and duties:** whilst the majority of the powers needed by infrastructure providers to deliver projects of national significance (including the Project) will be obtained through a development consent order ("**DCO**"), there may be powers required beyond those granted in the DCO, both in geographical and temporal terms. Similarly, there may be duties or obligations which apply to a water and sewerage undertaker which ought to apply to the IP. We consider that the following sections of the WIA should (in addition to those already listed in the Notice and Regulations) be applied to the IP: 168, 173 and Schedule 6. In addition, we consider that a level of entrenchment will be appropriate to ensure that these statutory powers and duties cannot be changed at will and that this

concern could be dealt with either through revising the revocation provisions in relation to the Notice or by applying such sections through the Regulations.

**CC Water:** Government may wish to consider whether it might be appropriate for the scope of CC Water's functions to apply in respect of the IP as well as undertakers – that is, to extend s.27A – 29A of the WIA 1991.

## Society of British Water and Wastewater Industries (SBWWI)

**The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013**

SBWWI is the trade association representing the water and wastewater supply chain. Our members build, maintain and repair water and wastewater infrastructure and non-infrastructure assets for water and sewerage companies ('undertakers') across the United Kingdom.

SBWWI has studied the draft Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013, the Defra 'Next Steps' consultation letter (5 November 2012), the impact assessment, and the draft notice.

SBWWI is in broad agreement with the motivations behind the legislation and the proposed legislative framework. It is in the interest of our members, as well as water and sewerage customers, that undertakers do not over-extend themselves operationally and financially on larger, complex water and sewerage infrastructure projects.

Defra's 'Next Steps' consultation letter anticipates that the Thames Tideway Tunnel is likely to be the only specified project undertaken in the next ten years. Clause 11 states that there will be a review and published report on the impact of the Regulations within five years from the day on which the Regulations come into force. SBWWI believes this provides a safety mechanism should the Regulations require further scrutiny following the Thames Tideway Tunnel tender process, contract award, and initial implementation.

Should the Thames Tideway Tunnel show that specifying a project enables it to be delivered more quickly and cost-effectively, SBWWI believes a case could be made for further projects to be specified by the Secretary of State or the Authority. The current regulatory model – the five-year AMP cycle – encourages water companies to manage risk and financial exposure by breaking large projects down into smaller, more manageable schemes spread over more than one cycle. However, the impact of this approach is that customers have to wait longer for the benefits generated by completion of the project. In certain cases – witness recent flood events – delays can have major consequences for customers. If specifying a project reduces the risk burden carried by the undertaker, then it may lead to critical infrastructure assets being completed more quickly and networks becoming more resilient.

SBWWI would like to thank DEFRA for providing the opportunity to respond to this consultation and would also like to take this opportunity to confirm its interest in participating in future consultations and discussions.

Yours faithfully

Carol Hickman
Executive Director
SBWWI

## Damien Hinds MP

In response to the consultation, I wish to register my concerns about the introduction of these regulations to allow the creation of a special infrastructure company to undertake the Thames Tideway Tunnel project.

I think the draft regulations should be suspended pending a full review of the project itself – about which I understand doubts have been expressed by professionals and experts as to its being fit for purpose - and also its financing. In this respect, I also understand that it may not necessarily be the case that Thames Water is not, itself, in a position to undertake the works necessary to meet the Government's environmental obligations without jeopardising its normal water supply and sewerage commitments.

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**Damian Hinds**
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## Simon Hughes MP

I write in response to the consultation on the regime for Specified (Special) Water and Sewerage Infrastructure Projects in England.

It is my view that the regulations are unnecessary and that the desired objectives of the scheme could be met by pursuing the other policy option explored in the impact assessment. This was the solution of varying the license of Thames Water to allow it to create a subsidiary to carry out the tunnel.

The reason why Thames cannot fund and finance the tunnel itself is not because of the complexity of the scheme but because of the poor financial position of the company. Allowing the creation of a special purpose company to build the company would absolve Thames Water's shareholders of the responsibility for these decisions which have put Thames in this position. This would not be in the public interest.

**Background**
The draft regulations take forward provisions in the Water and Flood Management Act 2010 which gave the Secretary of State powers to make regulations for the creation of special purpose infrastructure companies to carry out large infrastructure projects for English and Welsh water companies.

It is clear from the debates during the passage of the legislation that the government had the Thames Tideway Tunnel specifically in mind when creating this new power.

It is the government's view that this project is so large and complex that if Thames Water were to carry out the scheme itself it would put at risk the ability of Thames Water to carry out its regular activities.

By creating a special purpose vehicle, the government allows Thames Water to keep off the balance sheet the debt required to finance the tunnel, and to keep the financial risk separate from the operating company.

**Current financial position of Thames Water**
In 2007 Thames Water were taken over by the Macquarie Infrastructure Fund, a private equity fund. Macquarie bought the company for £8bn in a deal which included £3.2bn of debt.

Macquarie subsequently transferred this debt onto the balance sheet of Thames through a finance subsidiary of Thames which had been specially set up for this purpose in the Cayman Islands – Thames Water Cayman Finance Limited.

Today Thames Water Cayman Finance has borrowed £4bn, all of which lies on Thames Water's balance sheet.

Thames have said that they set up the Cayman Islands Finance vehicle to escape UK company law as this kind of financial manoeuvre is illegal in the UK.

Thames have also had an aggressive dividend policy and in the last two years have paid out more in dividends than they have made in profit. This policy further increases their indebtedness.

Today Thames has a ratio of debt to regulated capital value of around 80%. Before the sale of the company to their current owners Ofwat the regulator warned prospective buyers that the ratio should remain under 65%. Thames is currently values at about £10bn.

It is important to note that Thames has started to pay particularly large dividends since the passage of the 2010 Act when it assumed that it would no longer have to build the tunnel itself.

Thames Water are required by their license to keep an investment grade credit rating. A further increase in their debt to equity ratio could see them lose their investment grade rating and be put into special administration.

It is therefore not the size or complexity which makes it impossible for Thames to finance this scheme itself but Thames corporate actions which have taken it to the limits of what it can borrow without incurring severe penalties.

**Value for money**

Another important part of these regulations is that they should only be applied in cases where creating a special purpose vehicle would provide better value for money.

This rests on the assumption that by placing large complex infrastructure on the balance sheet of a water undertaker would change the risk profile for the entire business and therefore push up all financing costs.

The impact assessment for the draft regulations on special infrastructure providers state that the increase in the cost of capital for Thames Water if it was to build the tunnel itself would be 1%.

Since the company was taken over by Macquarie Thames Water has decided to issue high yield bonds in order to refinance the debt of its parent companies. These bonds payout up to 7.75% while senior debt issued by the company can have an interest rate of less than 2%.

It would clearly be absurd for the government to argue that such a vehicle would represent value for money as it would save 1% on the cost of capital when Thames Water have made a corporate decision to issue subordinate debt at a 5% premium!

**Conclusions**

When the water industry was privatised it was done on the premise that the government would no longer need to invest in water infrastructure and that private sector investment could deliver all of the UK’s infrastructure needs. This would be achieved by having water companies with strong cash revenues which had the financial strength to finance large infrastructure projects.

Although the Thames Tunnel is a particularly large project it is abundantly clear that Thames Water would have had the financial strength to finance the project if it had not used that financial strength to pay out unusually high dividends and take out billions in loans in order to pay off the debt of its owners. The financial restructuring which allowed Thames to borrow money to pay off the debt of its shareholders was unlawful under UK law and Thames water set up a vehicle in the Cayman Islands to get around this.

These were corporate decisions made by Thames' management, which have put the company in position which it is today. By allowing Thames Water to keep the financial risk of the tunnel project off its balance sheet the government will in effect be facilitating this poor behaviour from Thames.

The government should therefore withdraw these regulations and instead look at the other policy option available in the impact assessment and modify the licence conditions of Thames so that it can create a subsidiary to carry out the tunnel. This would consolidate Thames' debt on its balance sheet. If this forced the company to deleverage and had a negative effect on its shareholders, then that is simply the price they will have to pay for the damage that they have inflicted on the financial strength of the company.

Rt Hon Simon Hughes MP
**MP for Bermondsey & Old Southwark**

Rt Hon Simon Hughes MP
Deputy Leader, Liberal Democrats in the House of Commons
House of Commons, SW1A 0AA
**0207 219 1677**

## Save Your Riverside (community group)

**Regime for Specified (Special) Water and Sewerage Infrastructure Projects in England – Phase 2**

1. Save Your Riverside are a community group, centred on Chambers Wharf but with supporters from all along the Southwark riverside. Chambers Wharf is proposed as a major construction site by Thames Water for the Thames Tideway Tunnel (TTT). Accordingly we have a direct interest in this project, and its financing and delivery.

2. Defra explains its rationale for proposing a separate parallel regime for constructing, owning and operating the TTT, as being concerned with the isolating and containing the risks and costs associated with the project, including the possibility that Thames Water's statutory duties in relation to water supply and sewerage could be compromised through 'risk contagion' spreading from the tunnel project. It is notable that the IA recognises the possibility that there will be a "high risk of project cost-overruns, delays and significant risk of damage to assets with such a large-scale tunnelling project across London". Before commenting on this proposal we should consider how we arrived here. The need for significantly expensive infrastructure works on the lower Thames, whether the full tideway tunnel now proposed, or a combination of shorter tunnels and other works, has been identified from the 1990s onwards. The European Court of Justice has recently found the UK in breach of its obligations under the Urban Waste Water Treatment Directive in relation to the Thames, with the presently preferred solution of a major tunnel not becoming available before 2023 at the earliest, nearly a quarter of a century after the due date for compliance; the prospect of the UK having to pay potentially huge infraction fines looms.

3. We understand the point that there may have been (and may still be) doubt about the exact requirements of the directive in relation to the Thames, but there can be no doubt why water consumers and taxpayers are now faced with footing huge bills for 'grand design' works being promoted by a private monopoly supplier; a supplier which is barely accountable to its customers and some of whose activities may well be beyond the reach of a regulator whose independence and credibility in being seen to act as a fierce watchdog to protect the interests of water customers looks highly doubtful. In our view the undertaker has been grossly irresponsible, and its regulating authorities are in gross dereliction of duty, to allow a position to have been reached where completely inadequate financial provision for the necessary works has been made, and where the company's credit rating and therefore ability to borrow on favourable terms has been compromised (despite protecting its investment grade rating being a condition of the company's licence). Defra and Ofwat have permitted Thames Water's owners to pay generous dividends to shareholders over a period of years, whilst the company's debt has doubled to some £8bn in the last five years. Consequently it is in our view scandalous for the water consumer and potentially every UK taxpayer to be now forced into a position of providing huge funding for the scheme, both directly and in the form of guarantees, when the scale of the scheme could be more modest, when it could have been brought forward earlier at lower cost, and when the undertaker should have made provision for at least a substantial part of the funding of the project from its own resources.

4. Why should consumers and taxpayers be given no choice but to fund, or at the least be forced to pay for financial underpinning, for the most expensive design option that could

have been selected (and therefore potentially the most valuable of capital assets) when the promoter itself has an insouciant disregard to financing because it seems to think it can offload the burden onto the public? Defra argues that having a special IP arrangement "**should** enable better project continuity" if the IP were to go into administration during the construction phase "so minimising any potential expensive delays for this large project which would subsequently be passed onto customers"; that it "**should** help provide better overall better value for money….whilst help keep water or sewerage customers' bills as low as possible"; and that it **would** be possible for an IP to assume part of the risk of any cost overruns and so reduce water customers' exposure to such overruns. Yet the consultation provides no convincing evidence to support the implication that the actual outcomes under these arrangements will in practice match any of these assertions. On the contrary it confirms that Thames customers will end up footing the bill whatever route is taken - either by being directly charged by the IP (as well as receiving their normal Thames Water bills) or by inflated Thames Water bills after the IP had charged Thames Water for its functions. Moreover the IA document confirms that the Government is minded in principle to use the powers it took in the Water Industry (Financial Assistance) Act 2012 to use taxpayers' money to provide contingent financial support for exceptional risks in the construction of the new TTT. This is hardly a reassurance to consumers and taxpayers - more a warning they will soon be caned, and quite possibly more harshly than currently suggested.

5. Although presented as a safeguard for the public interest, the creation of a parallel regime IP to ring-fence the costs and the risks associated with the tunnel project would serve the interests of Thames Water and its owners very well. Taking the tunnel off Thames Water's balance sheet is likely to lead to financial opacity. Under the draft regulation Thames Water would put the SIP out to tender and though it would have to consult Defra and Ofwat on the terms to be put out to tender and on the bids received, it would be for Thames Water to "determine which bid to accept". This seems uncomfortably close to, in Lord Leveson's recent phrase, Thames Water 'marking its own homework'! Of course Thames Water would seek to select the bid which best suits their commercial interest - not the **public** interest. Supposing the selected IP is an offshore company. How could the regulator control - or even know - whether Thames Water is a major shareholder in that company and/or has negotiated favourable financial arrangements with it e.g. receiving a proportion of the £80pa increase forecast for each customer's bill? How in these circumstances could the ultimate costs to consumers of the tunnel be controlled? What is to stop the increase in annual bill prices being hiked to £200pa? What confidence can the public have that skilful companies will not continue to run rings round their regulatory masters? What may seem a superficially attractive model for a separate IP, presented as in the public interest, could turn out to be a cash cow milked by Thames Water and the IP at the expense of consumers and taxpayers.

6. We are not convinced that the proposal for a separate IP would genuinely serve the public interest. The doubts expressed above need to be addressed and resolved before proceeding any further down this route. Above all there must be complete transparency on all aspects about exactly what the government and its agencies propose. Draft regulation 7 makes reference to the Secretary of State or Ofwat having an opinion on "transparency in the process" but a passing mention is inadequate - where is the regulation that guarantees total transparency of process? It is not good enough to assert "this is to protect the public interest" without far more convincing evidence that the public interest - as opposed to the interests of the existing private monopoly supplier, its owners, and whoever the owners might be of a possible remote offshore separate IP - would truly be served and protected. As matters stand consumers and taxpayers can have little

confidence they are not about to be ‘taken for a very expensive ride’ in relation to the TTT project - by Defra anxious to avoid the Treasury deducting any infraction fines from its departmental budget, by an apparently supine (and certainly remote from the consumer) poodle of a watchdog regulator with seemingly unhealthily close sympathies for Thames Water, and by a private monopoly supplier which has irresponsibly run up vast company debts whilst paying out generous dividends, and which appears bent on using its position to exploit further financial benefits for its owners with a cynical disregard for the public interest in terms of money or the environment. What is already a sorry tale of mismanagement and missed opportunities shows every promise of getting sorrier still from the public’s point of view. The public deserve better than this, and there will be no place for government, its agencies and the undertakers to hide when in due course the Thames customers and the wider public realise what has been done on their behalf and by whom.

## Martin Blaiklock

***T. Martin Blaiklock***
*Consultant*
*Infrastructure & Energy Project Finance*


November 26th, 2012

## Consultation: Water & Sewerage Infrastructure Projects in England Phase 2

Sir,

I wish to respond to the above consultation.

### Summary


**As an energy and infrastructure 'banker' who has studied the financial performance of many English water companies over the last few years, I believe that the proposed legislation will perpetuate the significant damage that private owners have inflicted on the water sector over the last 10-12 years.**

**The proposed legislation rewards financial mismanagement and, as someone who in recent years has given more than 70 public and private Courses internationally on financing of infrastructure, it will bring ridicule to the UK's privatisation of public service program.**

**Given that water services in England are a private sector, public service monopoly, taxpayers, who are captive customers for such services, will not be pleased to learn that financial mismanagement seemingly reaps its rewards by this legislation.**


### Commentary:

1. The following companies have been analysed:

| | |
|---|---|
| Thames Water | Severn Trent |
| Portsmouth | South West |
| South East Water | United Utilities |
| Sutton & East Surrey Water | Wessex |
| Southern Water | Yorkshire |
| Veolia Central | Bournemouth |
| Veolia Southeast | Bristol |
| Anglia | Cambridge |
| Dwr Cymru | Dee Valley |
| Northumbrian | South Staffs |

### Note:

A degree of caution has to be taken in undertaking such analysis. Firstly, the data has been derived from either OFWAT Reports, or Annual Reports published on Company websites or alternatively from Companies House. Further, some Companies are just water companies, whereas others are water and sewerage, and others may have additional subsidiary activities. Further, many companies are owned offshore.

In addition, measures of "leverage" (i.e. % of debt in the Company's capital) can be variable, depending on: (a) the definition of 'leverage", and (b) whether the Company data reflects current or historic costs.

Nevertheless, the conclusions drawn from the analysis are broad in nature and variations within individual accounting treatments are deemed to have minimal impact on such conclusions.

## 2. Total Annual Revenues

| **2010-11** | **2009-10** | **2008-9** |
|---|---|---|
| £10.575bn. | £10.616bn | £10.515bn. |

**Commentary:**

- The overall England & Wales water business is worth £10bn per year in revenues
- Scottish Water revenues are £1.125bn annually, **10% that of England and Wales.**

## 3. Annual Revenues v. Ownership

| | **UK** | **Non-UK**** | **Total** |
|---|---|---|---|
| **2010-11** | £5.110 bn | £5.465 bn. | £10.575 bn. |
| **2009-10** | £5.135 bn | £5.481 bn | £10.616 bn. |
| **2008-9** | £5.228 bn | £5.289 bn. | £10.515 bn |
| **%** | 48% | 52% | 100% |
| | | | |
| **2010-11 [post-Northumbrian]** | £4,372 bn | £6,203 bn. | £10.575 bn. |

[ ** = ownership outside the UK for tax purposes, e.g. in the C.I or overseas]

**Commentary:**

- In 2012, Northumbrian was taken over by Cheung Holdings [HK]. **This will increase the proportion of non-UK ownership of the market to 60%.** If the change had taken place in 2010-11, the figures would have been as shown in the Table above.

- 15 (75%) of the 20 Companies analysed are non-UK owned, largely by "Private Equity" groups.

## 4. Annual Profit before Tax v. Tax Paid

| | | **UK** | **Non-UK**** | **Total** |
|---|---|---|---|---|
| **2010-11** | **Profit before Tax** | £957 mn | £820 mn. | £1777 mn. |
| | **Tax Paid** | [£159 mn] | [£37 mn.] | [£197 mn]. |
| | | | | |
| **2009-10** | **Profit before Tax** | £1118 mn | £1540 mn | £2658 mn |
| | **Tax Paid** | £227 mn | £359 mn | £586 mn |
| | | | | |
| **2008-9** | **Profit before Tax** | £943 mn | £1446 mn | £2389 mn |
| | **Tax Paid** | £519 mn | £378 mn | £897 mn |
| | | | | |
| **TOTALS** | **Profit before Tax** | £3018 mn | £3805 mn | £6824 mn |
| | **Tax Paid** | £586 mn | £701 mn | £1286 mn |

[ ** = ownership outside the UK for tax purposes, e.g. in the C.I or overseas]

**Commentary:**

- Over the 3 year period, the average tax payment has been 19% of Profit before Tax.

- There is little difference between the proportion of Profit before Tax generated by UK, as opposed to non-UK, owners.

- In 2011 the HMRC effectively credited the Water Companies by £200mn as a result of the reduction in corporation tax from 28 to 26% (according to the accounts of many Companies). The impact of this tax change over 2010-2011 is greater than might have been expected.

- **In tax year ending 2011, the Water Companies overall paid no tax, and indeed were, in effect, subsidised by taxpayers! Yet still the Companies paid out significant dividends to shareholders.**

- Comparison with state-owned Scottish Water shows that over the 3 year period 2008-2011 the average Tax Paid represented 25% of Profit before Tax, and in 2011 alone, 19%. (Is the taxman more efficient in Scotland?).

## 5. Dividends v. Tax Paid

| | | UK | Non-UK** | Total |
|---|---|---|---|---|
| **2010-11** | **Dividends** | £527 mn. | £1255 mn | £1782 mn |
| | **Tax Paid** | [£159 mn] | [£37 mn.] | [£197 mn]. |
| | | | | |
| **2009-10** | **Dividends** | £510 mn | £1205 mn | £1715 mn |
| | **Tax Paid** | £227 mn | £359 mn | £586 mn |
| | | | | |
| **2008-9** | **Dividends** | £780 mn | £1143 mn | £1924 mn |
| | **Tax Paid** | £519 mn | £378 mn | £897 mn |
| | | | | |
| **TOTALS** | **Dividends** | £1817 mn | £3604 mn | £5421 mn |
| | **Tax Paid** | £586 mn | £701 mn | £1286 mn |

[ ** = ownership outside the UK for tax purposes, e.g. in the C.I or overseas]

**Commentary:**

- Over the 3 year period, 2008-11, dividends of over £5.4 bn have been paid by all Water Companies to shareholders, with tax receipts of £1.3bn.

- **In the two year period 2009-2011, total dividends have reached £3.5 bn,, while the tax receipts are only £380mn, or 8.5% of Profit before Tax. One could ask if the taxman (& taxpayer) has been 'short-changed over the last 2 years? Have such Dividends been justified??**

**[Note: when 75% of the Companies are owned by Private Equity-type investors, there is little, if any, shareholder opposition to the payment of such Dividends, nor is there any way that the consumer can object].**

## 6. Profit after Tax v. Dividends

| | | UK | Non-UK** | Total |
|---|---|---|---|---|
| **2010-11** | **Profit after Tax** | £1060 mn | £856 mn. | £1916 mn |
| | **Dividends** | £527 mn. | £1255 mn | £1782 mn |
| | | | | |
| **2009-10** | **Profit after Tax** | £890 mn | £1180 mn | £2070 mn |
| | **Dividends** | £510 mn | £1205 mn | £1715 mn |
| | | | | |
| **2008-9** | **Profit after Tax** | £424 mn | £1068 mn | £1492 mn |
| | **Dividends** | £780 mn | £1143 mn | £1924 mn |
| | | | | |
| **TOTALS** | **Profit after Tax** | £2374 mn | £3105 mn | £5479 mn |
| | **Dividends** | £1817 mn | £3604 mn | £5421 mn |

[ ** = ownership outside the UK for tax purposes, e.g. in the C.I or overseas]

**Commentary:**

- **Over 2008-11, the England & Wales Water Companies made £5.48bn of Profit after Tax, of which they paid out £5.42bn (95%) to shareholders.** The tax paid over the same period was £1.28bn..

- **The UK-owned Companies have, on average, over the 3 year period, 2008-11, have been paying 76% of Profit after Tax as Dividends.**

- **The non-UK owned Companies have been paying, on average over 2008-11, 116% of Profit after Tax as Dividends.**

- **As a consequence of these trends, Water Companies, in general, have not been growing corporately, particularly after one takes inflation into account.**

**In fact, the non-UK Companies have been shrinking in capital terms. Their financial strength has been weakened by owners paying to shareholders Dividends, which cannot be fully paid out of ordinary profits, so owners have turned to debt to**

**finance the shortfall, which in turn increases the leverage in the Companies' balance sheets.**

**In effect, this is "asset-stripping".**

- **Using OFWAT data for 2001-2 and 2009-10, the ratio of Net Debt / RCV *** rises from average 52% to 69.3%, and it will be higher again today given the increased indebtedness by most utilities 2010-2012. Currently, some utilities have a leverage of over 80%, which leaves little room for manoeuvre.**

**Such companies (e.g. Thames), due to excessive leverage arising from excessive dividends to shareholders, are now unable to raise the debt they need to fund new infrastructure, which is an integral obligation of their licence.**

**[*** Net Debt = Long-term debt + short-term debt less cash & equiv.]**
**[RCV = Regulatory Capital Value ]**

## 7. Some General Conclusions:

- **Unfortunately, OFWAT's remit under the Water Industries Act (1991) is passive and constrained, and they have very limited powers to intervene in the financing of the Water Companies, other than trying to ensure through regulation that the Companies are able to finance their businesses.**

- **However, it can be seen from the trends above, particularly for the non-UK owned Companies, that the position is unsustainable; these Companies will not be able to continue to pay shareholders more than they make money!!**

- **Over the last 15 years their credit ratings have all declined from being well into Investment Grade ("AA") after privatisation to only one or two 'notches' above junk bond status, …….. and ratings have a habit of changing!! There is a limit as to how much debt these Companies can carry and also meet their public service obligations.**

- **Furthermore, for the non-UK Companies, there is no UK forum for holding Directors to account for their decisions. The licencing regime imposed by OFWAT to constrain excesses [ref. Conditions 'F' (requirement for "investment grade" status on debt, plus supposed constraints or ring-fencing on dividends] and 'P' (re. legally enforceable undertakings from the UK parent or, when owned by overseas entities, undertakings from that entity) is passive rather than proactive.**

- It is noteworthy that to date I am not aware of any Company having had its licence threatened or even taken away. Secondly, enforcing undertakings on entities hidden in tax-havens is somewhat fictional.

- **One concludes, therefore, that the current regulatory regime is not 'fit for purpose' in financial terms. The sector is open to abuse by unscrupulous investors, many of whom operate outside UK jurisdiction. Sooner or later there will be a**

**financial collapse in a Water Company, ……..and I suspect that OFWAT has no "Plan B' for such event**.**

**Conclusions:**

There is no doubt that the English water industry is struggling to find the investment capital to fund future infrastructure. However, the current legislative proposal, as reflected in the "Water & Sewerage Infrastructure Projects in England, Phase 2", is the wrong way forward. It perpetuates the current position and rewards bad financial management.

New infrastructure schemes will undoubtedly arise which stretch the finances of individual water companies, but through prudent planning these can and should be overcome. The industry is characterised by long-term, low risk investment returns, and should not be open to short-term exploitation by investors.

Water company balance sheets need to be conservatively structured, - which currently they are not, - and financial management held to account, - which also, for many, they are largely not.

The 1991 Water Industry Act and its concomitant regulation is out of date, and the focus should be on updating the underlying operational, legal and financial framework for the sector, rather than handing a lifebelt to imprudent investors through legislation.

## Rose Ades

I strongly object to this proposal - it takes no account of the Thames Water's own contribution to its own indebtedness - it is that rather than the size of the project that makes Thames Water itself unable to borrow to build the Thames Tunnel - which I believe was the original rationale for privatising the water industry and establishing regional monopolies.

This regional monopoly of the water companies requires vigorous and continuous democratic scrutiny and robust regulation. Instead we have a situation where Thames Water has considerable disincentive to consider less lucrative, generally less risky alternatives (which being more decentralised would also offer multiple benefits). What is certain, under current proposals is that we, as water ratepayers and tax payers, will be paying, indefinitely, for wanton waste/mismanagement of our resources/assets.

Finally do you have any plans to update the 'needs' report for the tideway tunnel in the light of the progress made at the olympic park, with the lee tunnel, and the upgrading of the sewage treatment works in London.

Yours sincerely
Rose

Rose Ades