

# **WATER INDUSTRY ACT 1991, SECTION 13 (2) PROPOSALS BY THE WATER SERVICES REGULATION AUTHORITY (OFWAT) TO MODIFY THE CONDITIONS OF APPOINTMENT OF YORKSHIRE WATER SERVICES LTD AS A WATER AND SEWERAGE UNDERTAKER**

## **THE PROCESS**

This Notice seeks responses to the proposed modification described below. Any representations or objections must be sent in writing to Emma Cochrane, Head of Corporate Finance, Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA (fax, 0121 625 3609 or e-mail [emma.cochrane@ofwat.gsi.gov.uk](mailto:emma.cochrane@ofwat.gsi.gov.uk)) to be received no later than 5.00pm on 11 September 2008.

## **DESCRIPTION OF AND REASONS FOR THE PROPOSED MODIFICATIONS**

The boards of directors of Saltaire Water Limited and Kelda Group Plc announced on the 26 November 2007 that they had reached agreement on the terms of a recommended cash offer for the entire issued and to be issued share capital of Kelda, to be implemented by way of two schemes of arrangement<sup>1</sup> (the 'Acquisition'). The schemes of arrangement implementing the Acquisition became effective in accordance with their terms on 8 February 2008.

We issued a consultation document in June 2008 in which we invited views on:

- the capacity of Saltaire Water and its investors to be the owner of a UK regulated water business;
- which entities should provide parent undertakings to Yorkshire Water under Condition P of its Appointment;
- the need for modifications to Yorkshire Water's Appointment to ensure that, whoever its owners, it has sufficient financial and managerial resources to carry out its functions as a water and sewerage company and is appropriately ring-fenced from the rest of the group.

## **ISSUES ARISING IN RESPONSE TO THE CONSULTATION**

We received responses to the consultation from CCWater and Unison. Both broadly agreed with our proposed Appointment modifications. Unison raised a concern over the short length of time HSBC held its stake before selling it and whether it was likely any other consortium member would follow suit. The HSBC stake was sold to existing consortium members and Yorkshire Water has informed us that the Consortium sees Kelda as the most compelling long-term investment opportunity within the sector and that it is committed to the long-term ownership and continued stability of Yorkshire Water's business.

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<sup>1</sup> Kelda's share capital comprised two separate classes of shares – ordinary shares and non-voting "B" shares. Saltaire Water acquired both classes of shares by way of two separate schemes of arrangement under section 425 of the Companies Act 1985.

We do not propose any additional Appointment modifications to those described in our consultation paper which are restated below.

### **Condition F**

The amendments we propose to Appointment Condition F will bring the ring-fencing Appointment Conditions into line with the current standard. These will ensure that any activity of Saltaire Water will not prejudice the financial and managerial viability of the appointed business. The amendments we propose are listed below.

1. Additional transfer pricing conditions, including requirements for the provision of information to Ofwat from associated companies.
2. Restrictions on the transfer of assets to associated companies.
3. Prohibition (without Ofwat's consent) on any guarantee or loan between the regulated business and any associated company.
4. Prohibition (without Ofwat's consent) on Yorkshire Water entering into cross default arrangements, whereby Yorkshire Water's financial liabilities are increased or accelerated because of a default of any other companies in the group.
5. The requirement for Yorkshire Water to have regard to the Principles of Good Governance and Code of Best Practice as applied for the purposes of the Financial Services Authority.
6. The requirement for Yorkshire Water, at such times and in such ways as may be required by the Listing Rules of the Financial Services Authority, to publish such information about its results as is by those rules required to be announced as if it were listed on the London Stock Exchange.
7. The requirement for Yorkshire Water to use all reasonable endeavours to maintain an issuer credit rating which is an investment grade rating.
8. The requirement for Yorkshire Water to act at all times in the manner best calculated to ensure that it has adequate systems of planning and internal control to enable it to secure the carrying out of its regulated activities. This modification will also require Yorkshire Water to submit an annual certificate that in the opinion of the Directors, Yorkshire Water will, for at least the following 12 months, have available to it systems of internal control which are sufficient to enable it to carry out its functions.
9. The requirement for Yorkshire Water to maintain a listing of a financial instrument whose market price should react to the financial position of Yorkshire Water. Although not a substitute for an equity listing, this would ensure the existence of a helpful financial comparator.
10. Introduction of the cash lock-up provisions which would prohibit, subject to certain limited exceptions, and without Ofwat's prior consent, the transfer of

cash or other assets to an associated company in certain circumstances where the company's investment grade credit rating is threatened.

### **Condition P**

Yorkshire Water's existing Condition P requires it to obtain from its ultimate holding company legally-enforceable undertakings in favour of Yorkshire Water. These are designed to ensure that Yorkshire Water has the active co-operation of its ultimate holding company in complying with the conditions of Yorkshire Water's Appointment, including the ring-fencing provisions, and with the proper discharge of its functions as a water and sewerage undertaker.

Under the proposed modification, the existing Condition P will be amended to require Yorkshire Water to obtain these undertakings from an Ultimate Controller and where the Ultimate Controller is not the UK holding company, from the UK holding company. The amended condition will also include a successor clause that requires Yorkshire Water to obtain new undertakings in the event of a change of control.

We also propose to amend Yorkshire Water's Condition P to require it to maintain not less than three independent non executive directors on the board.

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