

Consultation on draft guidance on Ofwat's approach to granting derogations from the regulatory ring – fencing framework.

Response on behalf of Severn Trent and Hafren Dyfrdwy

We welcome the opportunity to comment on the draft guidelines. We support the production of guidance so that companies can understand better Ofwat's processes and requirements for granting derogations. We provide our comments as follows:

1. A key change proposed by the consultation is the requirement that a company seeking Ofwat's consent provide a wide range of detailed information and evidence that has not been required hitherto, including:
 - a. Details of alternative approaches the company has explored (e.g. potential financing options); to what extent they were explored; and why the proposed arrangement is the most appropriate
 - b. An impact assessment – comprising both qualitative and quantitative analysis, including key inputs, assumptions, calculations and models.
 - c. A risk assessment (including risk mitigation actions) – again, including key inputs, assumptions, calculations or models. Generally, supporting evidence including financial analysis/models, market reports, etc.

The above is very helpful in assisting companies understand what is required. However we also think some degree of pragmatism is required otherwise it could create an unnecessary workload without delivering any apparent customer benefit.

In addition we note that the additional requirements could increase the burden on Ofwat. This raises the risk that reviewing and approving applications could become quite time consuming. Given that market opportunities to raise finance can come and go in relative short timeframes, it could reduce the opportunity to secure the best deal for customers. We therefore would welcome thoughts on how this risk could be mitigated.

2. The change described in point 1 above could, if not well controlled, add significantly to the administrative burden on companies in preparing a consent request, which is likely to have resource, cost and timing implications; for example it may be necessary to engage external advisers solely in order to provide the requisite evidence and conduct the impact and/or risk assessments. Consistent with our earlier comments, we would welcome some judgment/pragmatism to ensure that the requirements and overall approach in this regard will be proportionate. In particular, we would suggest that companies should not be required to provide voluminous evidence to support consent requests that fall within the ordinary course (e.g. cross default obligations for financing companies).

3. As to the time required by Ofwat to consider a request, we feel that Ofwat could go further in making clear it will work with companies to ensure that consents are provided on a timely basis and, in particular, that Ofwat's approach to consent requests will not be so formalistic as to effectively deny companies access to certain types of financing. We also suggest that the statement that Ofwat will not begin to engage with a

consent request, until it has been provided with every item of information it requires be re-considered, as we feel that in certain circumstances this could be unhelpful in meeting funding deadlines

4. We suggest that the consent documentation be standardised as much as possible which ensures that a third party reader can quickly understand what has been consented to.

5. We would hope that, as much as possible, any consents be provided "clean" i.e. with no further conditions attached such as additional oversight requirements or further controls over the capital structure.

6. We believe that where possible any particular consent granted should be irrevocable for the life of a particular financing transaction, to avoid the need for the Licensee to go back to lenders in the future to amend existing financing documentation, which can prove disruptive, expensive and time consuming.

7. We feel that Ofwat should clarify that, where possible, a consent covers not just a specific transaction, but also future similar transactions, so as to avoid the need to continue to request consent for a particular departure from the ring-fencing provisions.

We would like to thank you for providing the opportunity to contribute to the preparation of the guidelines.