Centre City Tower, 7 Hill Street, Birmingham B5 4UA
11 Westferry Circus, Canary Wharf, London E14 4HD

By email – efracom@parliament.uk

Rt Hon Mr Alistair Carmichael MP
Chair, Environment, Food and Rural Affairs Committee
House of Commons
Palace of Westminster
London SW1A 0AA

28 March 2025

Dear Mr Carmichael,

Ofwat involvement in Thames Water legal dispute

Thank you for your letter dated 12 March 2025 and for the opportunity to assist the Committee in its consideration of Thames Water's restructuring plan.

In December 2024 Thames Water Utilities Holdings Limited applied to the High Court to sanction a proposed restructuring plan (the "Restructuring Plan") under Part 26A of the Companies Act 2006. The proposed Restructuring Plan was sanctioned by Mr Justice Leech on 18 February 2025 and subsequently upheld by the Court of Appeal on 17 March 2025. The Court of Appeal has yet to give written judgment, and we address the points raised in so far as we are able at this stage.

The focus of Ofwat's engagement with the Thames Water restructuring process is to ensure that the interests of customers are protected. With that in mind, Ofwat carefully considered whether it was appropriate to take a position on which of the proposed restructuring plans before the Court (if any) should be pursued by the Company.

The central issue for Ofwat is whether the costs of the interim restructuring plan are borne by customers. We have sought through our correspondence with the parties to the court proceedings to provide assurance that this is not the case. Cost recovery from customers is addressed by Ofwat's price review determinations (PR24)[1] and by Ofwat's Regulatory Accounting Guidelines[2]. We can confirm that neither the advisory costs

[1] Final determinations - Ofwat
[2] Regulatory Accounting Guideline 4.12 (item 4C.4)

associated with refinancing nor interest or other debt fees that go beyond the benchmarked allowance that is used to calculate Thames Water's revenue allowance in its final determination for PR24 will be borne by customers[3].

To set this out in more detail, Ofwat sets a revenue allowance for each water and sewerage company in its PR24 final determinations: the total amount they can recover from customers through bills. If a water and sewerage undertaker is having to pay interest and other fees on its debt over and above what is included in the revenue allowed by Ofwat, it cannot recover the costs through customer bills. The base allowed return to investors is set at the same rate for all companies. Finance costs that exceed this rate of return will not be borne by customers.

Ofwat also ensures that its cost sharing arrangements which apply to over- or under-expenditure do not apply to costs relating to financing. This principle applies to costs such as refinancing and takeover costs. In relation to advisory costs, to the extent these costs relate to financing, including the negotiation of such financing, they will not form part of allowed costs.

Accordingly, Ofwat considered that the pursuit of this Restructuring Plan was a matter for the Company, its creditors and the courts in the usual way.

Ofwat engagement in court proceedings

We actively monitored and where necessary made written submissions to the Courts through the parties to those proceedings to make our position clear where relevant to our remit. Throughout the proceedings at the High Court and the Court of Appeal, Ofwat kept abreast of all developments, including actively considering the submissions made by the parties and dealing with correspondence addressed to it from the parties. Our legal representatives were present throughout both hearings to monitor developments and we reconfirmed and clarified our position through correspondence with the parties and the Courts to assist in advance of the Court hearings. In circumstances where a regulator determines that it will not oppose a restructuring plan, it is commonplace for it to indicate this in correspondence (as Ofwat did) and a regulator would not usually attend the Court hearing through Counsel unless it actively opposes a plan.

[3] This is subject to the company's right to seek a redetermination of their PR24 final determination from the CMA. Thames Water initially requested such a redetermination, but has since asked that we defer making this reference for a period as the company continues to pursue an equity raise and recapitalisation, to which we agreed.

Special administration

Legislation ensures that in the event of special administration, there is no disruption to customers' water or wastewater services. In our correspondence referred to above, on the costs of funding in the event of special administration, we drew attention to that fact that in the first instance, Government would seek to recoup all the funds spent on financing a special administration through the sale or rescue of the relevant water company[4] and referenced the new "shortfall recovery mechanism" set out in the Water (Special Measures) Act 2025 which would only be used in the unexpected event that it was not possible to recover in full the funding advanced by Government for the special administration[5].

Conclusion

Ofwat is closely monitoring the financial position of TWUL and would like to reassure the Committee that it is prepared to act should TWUL enter special administration. Our focus is to monitor TWUL's progress with its equity raise process and ensure that it complies with its Licence, wider statutory and other regulatory obligations whilst delivering for its customers and the environment. We expect the company board to take all appropriate steps to pursue all options to secure its financial resilience, both in the short and longer term. We will continue to hold TWUL to account for its performance and drive the company to establish the appropriate conditions for its turnaround.

Given that the legal proceedings have yet to conclude and the relevance of certain of the issues above to the substance of the Courts' consideration of the Restructuring Plan, we do not consider it appropriate to comment further at this stage. We would be happy to clarify our views further once the proceedings have concluded.

Yours sincerely

David Black
Chief Executive

[4] See the "special administration regimes for the water industry" section within the policy statement for the Water (Special Measures) Act; https://www.gov.uk/government/publications/water-special-measures-bill-policy-statement/water-special-measures-bill-policy-statement

[5] Ibid