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By email: efracom@parliament.uk

Rt Hon Alistair Carmichael MP
Chair
Environment, Food and Rural Affairs Committee

23 June 2025

OFFICIAL-SENSITIVE

Dear Mr Carmichael

Re: Thames Water Management Retention Plan and ownership developments

Thank you for your letter of 9 June and the questions from the committee on Thames Water. I have provided below our responses to each question which I hope are helpful to the committee's ongoing scrutiny of the sector. I remain very happy to meet with you and other committee members to discuss these issues further if that would be of interest.

Retention payments in the Management Retention Plan

What discussions Ofwat has had with Thames Water on its MRP?

Prior to the evidence session discussing this issue before the Environment, Food and Rural Affairs (EFRA) Select Committee on 13 May 2025, Ofwat had had no discussions with Thames Water in relation to its "Management Retention Plan" ("MRP"). We were aware that a proposition in relation to staff retention might be put in place, but were told at the time that none had been developed.

Following Sir Adrian Montague's appearance before the Committee, we wrote to Thames Water on 16 May 2025 requesting further information on its MRP. We received a response on 30 May 2025. We wrote again on 10 June with clarificatory questions on their response which Thames Water replied to on 18 June.

We recognise stakeholders' concerns that senior executives should not be rewarded for poor performance and that Thames Water should clearly explain the rationale behind the scheme. We are also disappointed at the lack of transparency that Thames Water has shown in this regard. At a time when remuneration in the water sector is under significant public scrutiny, we expect water companies to be proactive and transparent and share any information that may relate to our regulatory requirements, such as executive remuneration. We have recently met with senior leaders at Thames Water, including their Remuneration Committee Chair, to make this clear and will be closely monitoring any further decisions they make on the MRP and other remuneration plans in the future.

What undertakings Ofwat has received from Thames Water regarding the withdrawal or pausing of the MRP?

In a letter to David Hill on 19 May 2025, copying our Chair Iain Coucher, Sir Adrian Montague shared Thames Water's board decision to pause the MRP "and await the forthcoming guidance from the regulator in relation to the implementation of the relevant aspects of the Special Measures Act". This was confirmed again by Thames Water in a letter to Ofwat on 30 May 2025. This was a voluntary commitment by the company.

Whether you were aware of the payments made by Thames Water under MRP on 30 April?

We received no information on the MRP until the response we received to our letter of 16 May 2025. This was received on 30 May 2025 and confirmed the structure of the payments as detailed in Sir Adrian's letter to the EFRA committee, including that the first payments had been made on 30 April 2025.

Whether you expect to claw back the MRP payments made on 30 April under the Water (Special Measures) Act, and what you expect will then happen to the funds earmarked for MRP payments?

The performance related executive pay (PRP) Prohibition Rule[1] applies to PRP paid to "any person who is or was a member of the undertaker's board". Based on the information that Thames Water has provided, none of the recipients of the MRP payments to date are or were members of the company's board. As a result, the payments made on 30 April 2025 are not within the scope of the rule. We explain in our answer to the next question the rationale for our decision on the scope of the rule as well as our plan to review the rule in 2027.

By way of further detail on the PRP Prohibition Rule, the definition of "performance related pay" as it relates to the rule is the same definition contained in the Water (Special Measures) Act 2025, which reads:

[1] https://www.ofwat.gov.uk/wp-content/uploads/2025/03/prp-rule-june-25.pdf

> "any payment, consideration or other benefit (including pension benefit), the giving of which results from the meeting of any targets or performance standards on the part of the undertaker or the person to whom such payment, consideration or benefit is given."[2]

In our guidance that accompanies the rule[3], we explain that this definition extends to "any amounts which are payable in relation to a Director being in post at a specified point or points in time, which may be known as 'retention payments', 'retention bonuses' or 'retention incentives' or similar terms, if these payments are in any way contingent on the meeting of any targets or performance standards on the part of the undertaker or Director".

We will be reviewing all water companies' decisions on executive remuneration and their compliance with the rule in the coming months and in future years, including in relation to Thames Water's "retention payments". The Water Industry Act 1991 gives Ofwat powers to issue a direction to a company which we suspect has not complied with the PRP Prohibition Rule. A direction may include requiring a company to recover any payments of PRP that breached the rule. If a company does not comply with a direction that we issue under the Act, we can take enforcement action which can include imposing a financial penalty.

Whether the new rule on performance-related pay is limited to executive directors, or will it allow Ofwat to block payments to the 21 members of Thames' senior management included in the MRP?

The PRP Prohibition Rule applies to "any person who is or was a member of the undertaker's board". This was something we proposed in both the policy consultation in October 2024[4] and statutory consultation in March 2025[5] when developing the rule.

As we stated in these consultations, individuals at this senior level hold the ultimate accountability for companies' overall performance and the leadership responsibilities that are most capable of driving forward changes to company culture and behaviour. Given the rule's standards for prohibiting PRP relate to company-wide failures, we concluded it was appropriate that the rule focuses on these roles at the top of the organisation which hold the most senior levels of responsibility. This received widespread support from respondents to both consultations.

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[2] Water (Special Measures) Act 2025
[3] https://www.ofwat.gov.uk/wp-content/uploads/2025/03/prp-guidance-june-25.pdf
[4] Consultation on new rules on remuneration and governance provided for in the Water (Special Measures) Bill - Ofwat
[5] Consultation – Performance related executive pay (PRP) Prohibition Rule - Ofwat

For several years, we have been clear that companies must do better to ensure their remuneration decisions better reflect performance and customers' concerns and we will be closely monitoring all water companies in terms of how they meet this expectation going forward. As we noted in our March 2025 consultation, we plan to conduct a review in 2027 to assess how this rule has operated and what outcomes it has delivered. We may bring this forward if circumstances arise which we consider merit an earlier review.

Withdrawal of the KKR takeover proposal

We respond to your questions regarding the ongoing equity raise process below. As you will appreciate, much of the information relating to the process is market sensitive and/or confidential to the Company, and the current review of the submission from the group of senior creditors is a live process. However, taking account of those constraints, we have provided as much information as we are able to at this time having regard to our obligations under the Water Industry Act 1991 and with respect to the market abuse rules.

Ofwat considers it appropriate and essential that the confidentiality and integrity of the equity raise is preserved, mindful also of the responsibilities of the company's board of directors. We have therefore not disclosed any such information in the below responses.

When were you first made aware of KKR's withdrawal from the bidding process?

Ofwat was informed of KKR's confirmed decision to withdraw on Monday, 2 June. We were aware on 29 May that they were not intending to pursue the investment which was communicated that day by Ofwat and the Company to Defra. Following further discussions, KKR confirmed its decision which led to the announcement by the Company on Tuesday, 3 June.

What assessment has Ofwat made of the potential impact on Thames Water of not receiving the first instalment of the second tranche due on 30 June? What discussions have you had with Thames Water on the liquidity currently available to Thames and how long can it continue to operate as a going concern without the additional funding?

We trust it is helpful to clarify the position with respect the Company's funding pursuant to its interim restructuring plan.

The £3 billion further funding from certain of the Class A creditors (the **Super Senior Creditors**) is split into two tranches as mentioned in your letter. The first tranche of £1.5 billion, which is committed funding, was due to be lent to a financing subsidiary of the Company and to be drawn down in one instalment. However, as a result of the appeals in relation to the Company's restructuring plan which was first sanctioned by the High Court on 18 February 2025, including Mr Maynard's application for permission to appeal to the Supreme Court, the Super Senior Creditors have not been willing to release the full funding in this way. The Super Senior Creditors instead agreed that the Company would request the money in smaller tranches; consequently, the Company has not yet borrowed the full amount of the first £1.5 billion.

Ofwat anticipates that the Company and Super Senior Creditors will continue to engage in this process of monthly extensions and smaller tranches of funding being advanced during negotiations in relation to the equity raise progress. This includes access to further draw-downs of Super Senior funding from the first £1.5 billion as may be required after 30 June, and we understand that the Company and Super Senior Creditors are in active discussions in respect of the next draw-down. We have had no indication that this will not be forthcoming.

The second tranche of funding is not yet committed but linked to progress being made in the Company's equity raise process, among other pre-conditions to funding.

The Company provides regular updates to Ofwat on the liquidity currently available to it, by way of regular 13-week cashflow forecasts, weekly update calls between the Company and Ofwat, and additional weekly stocktake calls with the company's Chief Restructuring Officer.

If circumstances were to arise where creditors informed the Company that they were not willing to continue to provide additional funding, we would anticipate that the Company board would pursue all options to continue to fund the Company although these may be limited absent support from the current creditors. The board would need to consider their directors' duties to the Company and to the Company's creditors as a whole.

As commented on previously pursuant to the court hearings earlier this year, working with the Government, Ofwat has carried out, and continues to carry out, appropriate and prudent contingency planning for a potential special administration, as any regulator would in a position of uncertainty of this kind.

Which potential alternative investors are you engaging with and what is the nature of that engagement?

Ofwat will always be prepared to engage with prospective investors to ensure they have an understanding of the regulatory regime and our role within it. Nevertheless, the Company has primary responsibility for running the equity raise process and, as noted above, Ofwat considers it is important to respect the confidentiality, and integrity, of that process. Therefore, we do not believe it would be appropriate, or beneficial to the equity raise process, to provide further details of any such engagement.

Ofwat continues to engage regularly with Thames Water as it has progressed its process to raise additional equity. Our focus is on ensuring that the company takes the right steps to deliver a turnaround in its operational performance and strengthen its financial resilience to the benefit of customers. We have commenced a thorough review of the submission from the group of senior creditors. The submission includes their turnaround plans, approach to financial resilience and proposals for governance. Our focus is on assessing whether the plans are realistic, deliverable and will bring substantial benefits for customers and the environment.

What preparations Ofwat is making for a potential SAR in the coming weeks or months?

As commented on above, Ofwat has carried out, and continues to carry out, appropriate and prudent contingency planning for a potential special administration, as any regulator would in a position of uncertainty of this kind. It expects that it could make a special administration application promptly if necessary.

What resources you have dedicated to overseeing developments at Thames Water?

Ofwat has a team of staff working on all aspects of oversight of Thames Water, drawn from across the organisation, notably from our operational and financial resilience teams and our enforcement team. We are also supported by legal, financial and business advisers, as well as the independent monitor, L.E.K. Consulting, who have been in place since October 2024.

The independent monitor liaises with the Company regularly and there is a set cadence of reporting to Ofwat, albeit the Independent Monitor also informs Ofwat immediately if something comes to its attention that Ofwat should be informed of. There are in addition numerous routine and ad hoc calls between Ofwat and the Company each week.

Yours sincerely

David Black
Chief Executive