

Environment Agency (EA). The Board should inform the DWI at once if it does not implement any of that Committee's recommendations. A similar arrangement is proposed for the oversight of sewerage services provided by outside contractors.

Dwr Cymru will be required to co-operate with its Reporter (an independent consultant, appointed by Dwr Cymru with the Director's approval). The Reporter will review, audit and challenge the work of the Committees and report to the Director and the DWI and EA upon the effectiveness of Dwr Cymru's internal controls. Similar requirements will apply to the contracting-out of the operation of Dwr Cymru's sewerage services.

In addition, the Director proposes a modification:

prohibiting Dwr Cymru from making any arrangement to transfer or delegate any of its functions as a statutory undertaker; or if prosecuted for any criminal offence (for example, the supply of water unfit for human consumption), from relying on the involvement of any contractor to establish that Dwr Cymru had taken all reasonable steps, or exercised all due diligence to avoid the commission of the offence in question.

In other words, that defence would only be available to it, to the extent that would have applied if no contractor had been involved in the activity concerned.

#### *2. Arrangements for contracting-out (or outsourcing) of operations necessary for the discharge of Dwr Cymru's obligations as a water and a sewerage undertaker*

Whilst outsourcing of some operational work is commonplace in the water industry, the scale of the proposed contracts, which will cover the provision of all services to Dwr Cymru, is new. Therefore, the Director considers it important that Dwr Cymru pursues proper market-testing of whatever services it chooses to outsource. This requirement will be formalised within the procurement condition.

In addition to the requirement to comply with the Director's guidance on internal controls this condition will also require Dwr Cymru to:

Submit a Procurement Plan to the Director. This plan will have to set out:

- (i) an assessment of the competitiveness of the market in which the contract is being let;
- (ii) details of the number, mix and type of current and proposed contracts;
- (iii) details of the procurement process including how Dwr Cymru will maintain a "level playing field" for all prospective tenderers, so that no existing contractor derives any advantage from that position;
- (iv) how Dwr Cymru will retain control of contractor's operations, including the ability to direct action and assume control of operations when necessary and to ensure the maintenance of assets so that serviceability to customers is maintained.

The plan will have to cover at least the 3 following years. It will be reported upon annually by the independent Reporter (see section 1). The Director may decide following a report, that he requires an amended plan to be submitted. In any case, the plan will have to be resubmitted (that is, rolled forward over the following 3 years) at least every eighteen months.

#### *Other Regulatory Matters*

#### *3. Financial ring-fencing and corporate governance of the appointed business*

As in all acquisitions, the Director is concerned to ensure that no actions taken by Dwr Cymru's owners (currently WPD, and proposed to be Glas) should jeopardise its ability to go on financing the proper discharge of its functions as a water and a sewerage undertaker. To this end the Director proposes to amend Dwr Cymru's licence to:

prohibit it from raising any finance for the regulated business which include any "cross-default" obligation. (A cross-default obligation is one under which, if lenders to other parts of the enlarged group were to foreclose or otherwise enforce their rights under those contracts, lenders to Dwr Cymru would also be entitled to call in their loans) without the Director's consent;

prohibit Dwr Cymru from holding any investments except those required in the ordinary course of its business;

require it to maintain an investment-grade corporate credit rating.

A further modification will require Dwr Cymru to ensure that its dividends are prudent, in the sense that they do not jeopardise its ability to go on financing its functions and reflect the amount of risk borne by shareholders in financing Dwr Cymru's activities.

To ensure proper corporate governance of Dwr Cymru it will obtain from its owner (either WPD or Glas), undertakings:

that they will refrain from any action which would put Dwr Cymru in breach of its licence obligations; and that there will be at all times on Glas' Board a majority of independent, non executive directors.

Dwr Cymru's Board will be required to comply with the Principles of Good Governance and Code of Best Practice as for the time being approved for the purpose of the listing rules of the London Stock Exchange.

#### *4. Access to comparative information*

The Director places considerable importance on his ability to make comparisons between undertakers in order to assess their relative efficiency. Access to this information is required in particular to enable the Director to review price limits at Periodic Reviews, but is important on an ongoing basis to monitor and publish information on Companies' relative performance.

To ensure that the Director will continue to have access to the information he requires (including information from contractors) he has proposed that Dwr Cymru should obtain from its immediate parent and from either WPD or Glas, as the case may be, undertakings that they will provide to Dwr Cymru information:

necessary to enable it to comply with the conditions of its appointment; which the Director may reasonably require about the activities and financing of either WPD or Glas as appropriate.

Furthermore, Dwr Cymru will be required to:

maintain the listing on a recognised Stock Exchange of a financial instrument (either a bond or a preference share), although it will be permitted to seek the Director's approval to the postponement of that listing, depending upon market conditions; and publish the information which would be required to comply with the listing Rules of the London Stock Exchange, if Dwr Cymru were itself a listed Company.

#### *5. Additional proposals provisional upon the successful acquisition of Dwr Cymru by Glas*

Because Glas' plans are predicated on the pursuance of a single purpose, namely the provision of water and sewerage services, the Director proposes to modify Dwr Cymru's licence to:

require Dwr Cymru to obtain a legally enforceable undertaking from Glas prohibiting Glas and its subsidiaries from making any changes to their Memorandum and Articles of Association without the Director's consent;

prohibit it, or any other subsidiary of Glas from conducting any other activities of a material nature except those required of or connected with a water and a sewerage undertaker.

Finally, one minor change to Dwr Cymru's licence will be required to reflect the fact that Dwr Cymru will be wholly debt-financed rather than owned by Shareholders. This modification will be to:

Amend the interest-cover test used, by the Director in the context of interim determinations of price limits in determining whether a Company is able to finance its functions. This will require him to assume that Dwr Cymru will fund new expenditure solely by raising new debt finance. (846)