

Environmental, Social, And Governance Evaluation

Tideway

Summary

Bazalgette Tunnel Ltd., trading as Tideway, is a U.K.-based independent regulated infrastructure provider established in 2015. The company’s purpose is to design, finance, construct, and commission the Thames Tideway Tunnel in London, which is in its construction phase. The construction of the 25 kilometer (16 mile) tunnel aims to manage the amount of sewage discharged in the River Thames and the growth in water and sewerage demand associated with London’s growing population. This will contribute to the broader London Tideway Improvements (LTI) plan, which will help the U.K. comply with the 1991 EU Urban Waste Water Treatment Directive, of which it was found in breach by the European Court of Justice in 2012.

Tideway’s ESG evaluation of 76 reflects our view that sustainability is well embedded in the company’s strategic objectives and operations. Tideway has been set up to deliver a tunnel, which we expect to have significant environmental benefits in terms of increasing sewage storage capacity and reducing the amount of combined sewer overflows (CSOs) discharged into the Thames. In addition to the sustainability benefits associated with the tunnel, our assessment incorporates the company’s own sustainability credentials. These include Tideway’s high governance and social standards partly due to its regulated nature. We also factor the company’s strong safety track record, although incidents increased during the pandemic in line with what we have observed with other engineering and construction companies. Our assessment of Tideway’s adequate preparedness reflects the company’s unique purpose, which limits its exposure to long-term strategic risks and ability to capitalize on opportunities because it will transfer the daily operations of the tunnel to Thames Water upon completion. Therefore, our preparedness opinion has a neutral impact on Tideway’s ESG evaluation.

PRIMARY ANALYST

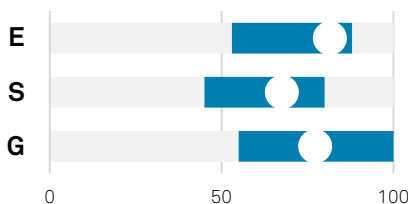
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ESG Profile Score

76 / 100



Company-specific attainable and actual scores

Preparedness Opinion (Scoring Impact)
















Adequate (No Impact)

ESG Evaluation



A higher score indicates better sustainability

Component Scores

Environmental Profile			Social Profile			Governance Profile		
Sector/Region Score	44/50		Sector/Region Score	30/50		Sector/Region Score	35/35	
 Greenhouse gas emissions	Good		 Workforce and diversity	Strong		 Structure and oversight	Good	
 Waste and pollution	Strong		 Safety management	Strong		 Code and values	Good	
 Water use	Strong		 Customer engagement	Good		 Transparency and reporting	Strong	
 Land use and biodiversity	Strong		 Communities	Strong		 Financial and operational risks	Neutral	
 General factors (optional)	None		 General factors (optional)	None		 General factors (optional)	None	
Entity-Specific Score	38/50		Entity-Specific Score	38/50		Entity-Specific Score	42/65	
E-Profile (30%)	82/100		S-Profile (30%)	68/100		G-Profile (40%)	77/100	
ESG Profile (including any adjustments)						76/100		

Preparedness Summary

Tideway’s adequate preparedness reflects the company’s unique purpose and, as a result, its limited exposure to long-term strategic risks and opportunities. Tideway will transfer the daily operations of the tunnel to Thames Water upon completion and will retain exposure to only a limited number of long-term disruptions such as a lack of stability of the tunnel or natural disasters from climate change. We believe the company is aware of these risks and manages them well. Our assessment also incorporates the inclusion of sustainability objectives in its culture and decision-making, which we view as well-balanced with the objective of completing the project on schedule while ensuring the infrastructure’s long-term resilience.

Capabilities

Awareness	Good
Assessment	Good
Action plan	Good

Embeddedness

Culture	Excellent
Decision-making	Good

Preparedness Opinion (Scoring Impact)

Adequate (No Impact)

ESG Evaluation

76_{/100}

Note: Figures are subject to rounding.

Environmental Profile

82/100

Sector/Region Score (44/50)

Engineering and construction activities can have negative impacts on local biodiversity. The industry is also exposed to increasing climate change risk with construction materials a notable source of greenhouse gas emissions, although supply chain emissions from site clearing, excavation, and piling are relatively low. Direct water use is low, but water in the construction material supply chain increases the sector’s exposure. Although companies assume some level of weather-related delays to completion, extreme weather can increase delays and project cost overruns. However, the risk of this in the U.K. is relatively low.

Entity-Specific Score (38/50)

Note: Figures are subject to rounding.

				
Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Good	Strong	Strong	Strong	None

We anticipate that the environmental benefits of the tunnel will exceed those of other infrastructure projects in terms of reducing water pollution, which will have a positive impact on biodiversity. We believe the infrastructure will significantly improve water quality in the Thames by reducing over 90% of the typical CSOs discharged in conjunction with the other infrastructure of the LTI plan. Furthermore, unlike many other infrastructure projects, we believe that this reduction in water pollution will support biodiversity in the river. Tideway recently completed its Thames ecology research program, completing its commitment to support research on the ecology of the tidal Thames. Despite this, the company encounters biodiversity risks due to its operations on foreshore sites, although we view positively that it commits to prioritize mitigation actions on-site to the extent possible.

We expect that improved water quality will contribute to better water availability in a city highly exposed to water stress. We see the water stress for London as great due to the city’s high population density, exposure to changing weather patterns, and strict regulation on water withdrawals. Upon project completion, we believe the tunnel will redirect wastewater to a sewage treatment works, thereby increasing available freshwater in the region.

Tideway monitors and manages its indirect greenhouse gas emissions well. The company has made significant efforts to minimize emissions arising from construction, although its most material carbon impact stems from the embodied carbon in construction materials. Now approaching project completion, Tideway is undertaking a review to determine where carbon savings could be made if the project was commissioned today. It expects to share the results with other infrastructure projects to aid carbon savings across the broader industry, which we view as a stronger practice.

Our assessment also incorporates the company’s reliance on contractors and their oversight of contractors’ environmental risk management practices. Tideway has robust policies to select and monitor contractors’ performance, which we believe helps the company to mitigate these risks.

Social Profile

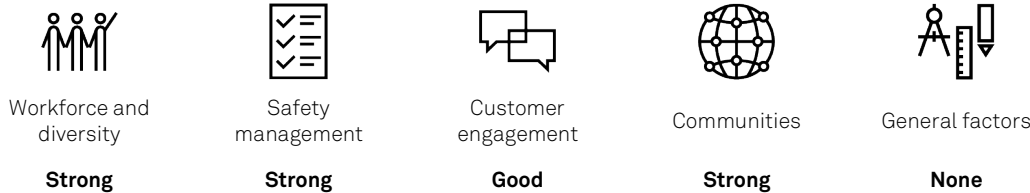
68/100

Sector/Region Score (30/50)

The engineering and construction sector is highly exposed to health and safety risks to employees, contractors, and local communities. Despite this, safety standards tend to be well developed among large companies, although this is not always the case for subcontractors or smaller companies. The industry is labor-intensive, and companies in this sector may face challenges attracting a highly skilled, innovative workforce. On the other hand, social standards in the U.K. are high and in line with global best practices.

Entity-Specific Score (38/50)

Note: Figures are subject to rounding.



Tideway has stronger safety performance than some of its main peers. Still, incidents have increased during the pandemic, although this is consistent with what we have observed in the wider sector. We will monitor Tideway’s safety metrics to determine whether they return to pre-pandemic levels. We do expect an improvement due to the company’s comprehensive health and safety strategy, which applies to all employees and contractors. This includes providing training, delivering health checks, and encouraging safe behavior through local recognition schemes. Tideway also partnered with a charity to tackle mental health issues in construction, an initiative that we see as more advanced among infrastructure projects. As well, and in line with the industry, the company links executive compensation to health, safety, and wellbeing metrics.

Tideway’s workforce and diversity policy goes beyond regulatory requirements to consider socioeconomic impacts. The company has targets to hire new apprentices, people with convictions, and locals from surrounding London boroughs, although these initiatives are being phased out as the project approaches completion. Tideway is managing the reduction in workforce associated with project completion well, with employees notified of their indicative end dates, which are regularly reviewed and discussed as the project progresses. All employees are given access to training opportunities and focused opportunities to help them prepare for future roles. It has 36% female direct employees and employees of its program manager, which is somewhat higher than many infrastructure projects. Furthermore, we view positively that the company monitors its gender and ethnicity pay gaps and is taking steps to address these.

Despite high exposure to complaints from local communities, we believe Tideway manages its exposure better than many other infrastructure projects. The company has initiatives to engage with local communities to raise awareness of the project, including site visits and working groups. Although complaints initially increased during the pandemic, with many people working from home, these were managed well and have now decreased to more typical levels.

Tideway has limited exposure to customer-related risks. Customers are the residents of London, with the project financed by increased water bills collected by Thames Water. Although the company is still in its construction phase and has limited customer interaction, it recognizes that project cost increases will incur further charges to customers. The cost overrun has increased to 21% from 8% due to delays caused by the pandemic, but we understand that the cost passed to Thames Water customers is still lower than forecast.

Governance Profile

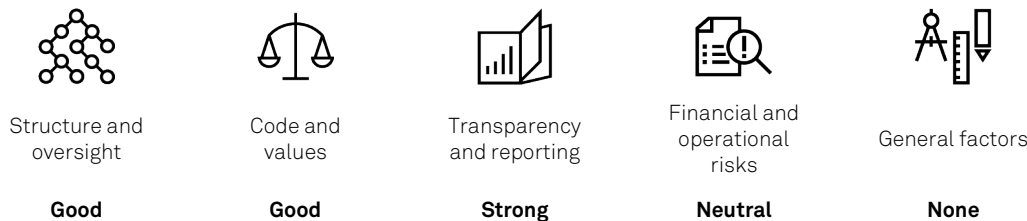
77/100

Sector/Region Score (35/35)

Tideway is headquartered and operates in the U.K., a country with strong governance standards that benefit from strong rule-of-law and independent institutions, in addition to very low actual and perceived corruption levels.

Entity-Specific Score (42/65)

Note: Figures are subject to rounding.



We view Tideway’s governance structure and oversight as in line with good practices. The company’s independent directors represent the largest group on the board constituting six of the 13 board members, including the chairman. According to Tideway’s policy, within the company’s five committees, at least 50% of members must be independent, including the committee chair, which we view as in line with best practice. The board also has four non-executive directors representing shareholders, all asset management firms, with no shareholder represented by more than one appointment. We do not currently see concentration of interest in any one party. However, only one board member of 13 is female, which is below average compared with publicly listed U.K. companies (one in three board roles across the FTSE 350 were held by women in 2020). Board members have skills concentrated in infrastructure and finance, which we view as appropriate given the company’s nature. We expect Tideway to simplify its corporate structure after the project’s completion, because the company will only have a minor role of inspecting and maintaining the tunnel, which it expects to undertake on a 10-year cycle.

Tideway’s code and values reflect its emphasis on environmental and social responsibility.

The company mapped its Legacy Commitments against the UN Sustainable Development Goals (SDGs) detailing the specific SDGs the project intends to contribute to. This is tied into the company’s wider Sustainable Finance Framework and investors can follow progress in these areas in the Sustainable Finance Report. We view positively that a relatively high proportion of executive compensation is variable (43% for the CEO in year ended March 2021). Both the annual bonus and long-term incentive plan (LTIP) vary according to each executive’s performance with the LTIP’s main aim to maintain the executive team’s commitment to deliver the project on schedule. This is divided into tranches covering the timeline of project construction, with the final tranche due on project acceptance, expected in 2027, although none was payable in March 2021.

We believe Tideway’s reporting practices are in line with international best practices.

The company provides more nonfinancial information than other infrastructure projects in its annual reporting. Disclosures are aligned with the World Resources Institute’s and World Business Council for Sustainable Development’s definitions of emission scopes and, since 2021, the company has produced TCFD reporting. During the design phase, Tideway published its expected carbon footprint over the tunnel’s lifespan, in line with regulatory requirements to monitor and report environmental impacts during the construction and operational phases. Social reporting is also relatively advanced and includes the ethnicity pay gap.

Preparedness Opinion

Adequate
(No Impact)

Preparedness

Low

Emerging

Adequate

Strong

Best in class

Tideway's adequate preparedness reflects its unique purpose and therefore limited exposure to long-term strategic risks and opportunities, and good management of these risks. The company's purpose is to deliver a project to improve water quality and wastewater treatment that will help the U.K. meet European regulation. Although the strategy is mostly based on the project's completion, upon which most responsibilities will be transferred to Thames Water, Tideway is making efforts to share lessons learned during construction with the wider industry, such as methods to reduce GHG emissions in materials, which supports better sustainability performance across the industry. Beyond tunnel completion, the company has an obligation to ensure the tunnel's availability with 10-year inspection and maintenance cycles. Risks that may prevent it from meeting its obligations include a lack of stability of the structure or natural disasters from climate change. The remaining post-construction risks will be transferred to Thames Water. The company's exposure to many long-term risks is limited since it is unlikely to embark on another project after the tunnel's completion.

Tideway's board is aware of potential disruptions and has the tools to assess these risks. The senior leadership team has demonstrated good awareness of the company's main strategic risks and their evolution throughout the project lifecycle, with the most material near- and long-term risks identified. Tideway has considered potential long-term disruptions during the design phase, such as changing weather patterns and rising population. The company is also closely monitoring the construction activities of its contractors, although we believe it remains exposed to potential safety risks given the complex and risky nature of tunnel construction. During the pandemic, it was well prepared and implemented standard procedures to mitigate the virus' spread, such as staggered start times.

Tideway has effective mechanisms to deliver its commitment to a culture of inclusivity, fairness, and safety in operations. The company raises awareness on its desired culture across its employee and contractor-base through on-site campaigns and dedicated training. It puts particular emphasis on health and safety-related topics such as mental health. As part of its process to select contractors, Tideway conducts interviews to ensure cultural alignment and uses recognition schemes to align behaviors with its key values. The company also encourages its employees to come up with ideas to limit the environmental and social impacts associated with its operations and have recently seen their contractors transitioning from diesel to vegetable-based oil for power plant and equipment. We also believe that sustainability and stakeholder-engagement is embedded in the terms of the license set to Tideway by the regulator. Of importance, we believe the company has the human resources to embed its values across its operations and those of its contractors, with around 350 employees in 2020.

Tideway's senior leadership has demonstrated commitment to deliver the project on time while maintaining good social and environmental practices. Although the cost overrun of the £3.8 billion project increased to 21% in 2021 from 8% in 2020 due to delays from coronavirus-related restrictions, we see this as unavoidable given the pandemic's widespread impact. These delays mean that Tideway is now nine months behind schedule for completion, with commissioning due to commence in 2023 and handover in March 2025. In addition to cost- and quality-related criteria, the company has linked the remuneration of its executives to its health and safety performance and the management of reputational risks, which ensure these risks are prioritized.

Sector And Region Risk

Primary sector(s)	Engineering & Construction
Primary operating region(s)	United Kingdom

Sector Risk Summary

Environmental exposure

The capital goods sector includes companies operating in the industrial equipment, components, and services segment. It also includes companies operating in aerospace and defense, and in engineering and construction. We believe the sector has moderate exposure to environmental risks, including greenhouse gas emissions from energy consumption, water use and pollution, waste discharge, and climate-related physical change, although risks and exposures vary by subsector. Capital goods must meet required environmental standards and customers' demand for more energy-efficient products, while mitigating the potential for costs and fines. Given the broad nature of capital goods' end-markets, the sector is exposed to environmental risks in downstream sectors such as oil and gas and utilities, where regulations are also stringent. In the aerospace defense subsector, aircraft engine emissions are increasingly globally regulated, which could increase demand for the newest aircraft, but might also require investment in product development. This could be material if ever-stricter regulations require major technological changes. Companies in engineering and construction are exposed to increasing climate change risk. Although they factor in some weather-related delays to complete construction projects, extreme climate events can cause major delays and project cost overruns. The sector is also very materials-intensive, using mainly steel, concrete, iron, aluminum, glass, plastics. The increasing number of electronic components in machinery and vehicles has made them reliant on critical materials that are only produced in a few countries and/or in politically unstable countries. The sourcing of conflict minerals (most common ones being tantalum, tin, tungsten, and gold and largely used in electronic components) is increasingly regulated, and good management of complex supply chains is key to managing this risk. To manage the growing scarcity of materials, the sector will also need to improve recyclability of products and take charge of product end-of-life management by remanufacturing, for example.

Social exposure

Material social risks for capital goods companies include those related to human capital management and employee health and safety, albeit exposure to social risks differs by subsectors. Human capital risks include the management and retention of skilled labor, which the industry increasingly relies on to adapt to a changing work environment brought about by greater automation at production plants, increased digitalization, and robotics. Companies also need to maintain productive and long-lasting relationships with employees in fairly highly unionized industries. This is also relevant for aerospace and defense, and engineering and construction. Employees' safety is a key risk for the sector given the use of large and dangerous equipment in the production process. For aircraft manufacturers, product safety is of paramount importance as an aircraft accident caused by a design flaw or poor quality can result in injuries and deaths, as well as order cancellations or significant remediation costs. More specifically for engineering and construction companies, community opposition to construction and the dangers of operating in countries with civil unrest or weaker regulatory regimes is heightened. This can result in more stringent regulations for contractors, as well as higher costs and risks of business disruption.

Regional Risk Summary

United Kingdom

The U.K. benefits from strong institutions and corporate governance practices. This includes robust and independent institutions and high rule-of-law standards, as well as very low actual and perceived levels of corruption. Governance guidelines are primarily based on the U.K. Code of Corporate Governance published by the Financial Reporting Council (FRC) and updated in 2018. The revised and strengthened code provides a broad set of recommendations including executive remuneration and board composition, follows a comply-or-explain model, and is widely regarded as best practice internationally. The recent version strengthened provisions on the role of the audit and nomination committees, chair tenure, and stakeholder engagement. An updated version of the U.K. Stewardship Code published by the FRC also came into effect on Jan. 1, 2020. It sets out principles for investors. Overall levels of corporate disclosure on ESG are strong and the country benefits from a very active institutional investor base, which has been fuelling the demand for better disclosure and corporate engagement. Legislation that took effect in 2019 will also require pension funds to disclose the financial risks they face arising from ESG factors. The U.K. ranks 11 out of 180 on Transparency International's 2020 Corruption Perceptions Index.

Related Research

- “The ESG Risk Atlas: Sector And Regional Rationales And Scores,” published July 22, 2020
- “Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide,” published July 22, 2020
- “Environmental, Social, And Governance Evaluation: Analytical Approach,” published December 15, 2020
- “How We Apply Our ESG Evaluation Analytical Approach: Part 2,” published June 17, 2020

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