



Consultation on Ofwat's principles of water company Board leadership, transparency and governance

1. The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales.
2. We welcome Ofwat's publication of proposed principles to improve Board leadership, transparency and governance in the sector. While this is aimed primarily at water company Chairmen, we would like to offer support for this initiative and provide suggestions on how the key principles could be applied to increase customers' trust and confidence in the sector.
3. CCWater has previously stated that water companies should be focussed and incentivised to deliver improvements for customers. Board leadership and governance that focuses on demonstrating accountability to customers is an important factor in building public confidence and trust. We have also raised concerns in the past about the lack of financial transparency by water companies¹.
4. We agree with the Ofwat Chairman's statements in March and September 2013^{2 3} observing that
 - the ownership structure of many water companies has become more complex and unclear, leading to a lack of trust and/or fairness for customers; and
 - some non-executive Board members are not always independent of management and investors.
5. We agree with Ofwat's views that
 - in this monopoly sector corporate standards must be very high to help companies increase customer trust and legitimacy;
 - the existing licence condition obligations on Board governance, leadership and transparency do not go far enough in building customer trust in the sector; and
 - there is scope to improve governance now in the context of changing ownership across the sector.
6. We have already supported Ofwat's requirements for company Boards to 'sign off' 2015-20 business plans with an assurance statement showing that the Board is fully responsible for the plan, that it meets Ofwat's requirements, and that the Board has provided strategic leadership and a transparent process in its production^{4 5}.
7. We now support Ofwat's proposed self regulatory approach where companies' Boards take the lead in setting out how they meet or exceed a core set of governance principles covering:
 - Transparency and open reporting to maintain legitimacy of the sector (including how companies are structured within a corporate ownership).
 - Full ownership and accountability of the company's strategy.
 - Significant independent representation on the Board to secure strong Board leadership and allow greater challenge to help develop strategy.

¹ In our work in pressing companies to share the benefits of financial outperformance with customers, and in media statement in response to issues relating to companies' corporation tax payments.

² Observations on the regulation of the water sector, Jonson Cox, Ofwat (Board leadership and governance, page 20)

³ Jonson Cox (Chair, Ofwat) Lorch Lecture speech, Cranfield University, 12 September 2013

⁴ Setting price controls for 2015-20 - final methodology and expectations for companies' business plans, Ofwat July 2013 (Section 3, page 60 'Board assurance')

⁵ CCWater response to Ofwat's expectations on Water Company Business Plans (May 2013)

- Chairs independent of management and investors, demonstrating that the Board acts independently in the interests of the regulated company.
- Regulated companies acting as if they are separate public listed companies.

8. We have some thoughts on how these high level principles could be interpreted and applied to benefit customers. The table below sets out the key Ofwat principles for customers with a suggestion on what this could deliver when implemented by companies:

Proposed principles as per Ofwat’s letter	How to implement this to benefit customers.
<p>Transparency:</p> <ul style="list-style-type: none"> • Reporting must meet or exceed the standards set out in the Disclosure and Transparency rules. • Group structure must be explained in a way that is clear and simple to understand. 	<p>In applying this principle, companies should demonstrate their responsiveness to customers as well as their accountability to shareholders.</p> <p>This could include making information available to customers on</p> <ul style="list-style-type: none"> • company financial/ownership structure. • financial performance. • delivery of outcome commitments (as Board performance should be evaluated against such commitments). <p>Companies could make this information available to customers via websites and other communication ‘tools’ (such as newsletters). We would expect to see such information presented clearly, adhering to ‘Plain English’ principles. CCWater is able to provide companies with the means to ‘test’ their communications with customers on this basis.</p>
<p>Independent non-executive Directors and Chairs:</p> <ul style="list-style-type: none"> • There must be significant independent representation on the Board (and audit and remuneration committees). • The Chairman may be independent of management and investors 	<p>While Non-Executive Directors (NEDS) have the same legal responsibility to shareholders as executive directors⁶, independent NEDS bring a focus on the regulated business itself and a diversity of skills and experience. We agree that the independent NEDs should be the largest single group on the Board, and the Chair should also be impartial by not being linked to any shareholders.</p> <p>To help increase customer confidence, all Board members should regard the interests of their customers as of paramount importance but that it would help the Board to fulfil its responsibilities most effectively if at least one NED possessed wide-ranging experience of customer issues and were able to act as the designated lead customer champion for the Board.</p>

9. We note that Ofwat also intends to propose similar high level governance principles to apply as guidance for holding companies (‘HoldCo’) in the sector. We would expect holding companies to follow similar principles to the regulated business. In the wider context, the policy focus from BIS on making companies more accountable to

⁶ The role of the non-executive director - Institute of Directors (2010)

shareholders and the public⁷ would be a good starting point to help increase public confidence in a sector where for the majority of customers there is no choice of supplier. We look forward to seeing a copy of these proposed 'HoldCo' principles when available later in the year.

10. We note that as confirmed in the PR14 methodology, Ofwat will also establish a financial structure monitoring regime to examine company capital structures, with particular focus on gearing⁸. This regime can support the water company Board principle on transparency. We would like to engage further with Ofwat as plans for the monitoring regime develop.
11. We would also welcome an update after 31 October on the extent to which company Chairs have accepted the proposed principles, and how companies should be expected to implement them to benefit customers. While the principles are the minimum Ofwat expects, there is an opportunity for company Boards to implement the principles in a beneficial way for customers as suggested above.

Enquiries

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⁷ BIS, 'Making companies more accountable to shareholders and the public' (July 2013)
<https://www.gov.uk/government/policies/making-companies-more-accountable-to-shareholders-and-the-public>

⁸ Setting price controls for 2015-20 - final methodology and expectations for companies' business plans, Ofwat July 2013 (section 9.3)