

T. Martin Blaiklock
Consultant
Infrastructure & Energy Project Finance

182 Broom Road,
Teddington,
Middlesex TW11 9PQ, UK

Tel: (44)-208-255-3851
E-mail: tmbaiklock@aol.com

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Consultation : “Board Leadership, Transparency & Governance - Principles”

Sir,

I wish to contribute some comment to the above Consultation.

- 1 Firstly, let me congratulate the OFWAT staff in, - at last, - attempting to rein in some of the corporate excesses that have taken place in the England & Wales (“E&W”) water utilities over recent years.

I can also understand the intention in drafting the Principles that the sector utilities should, to a great extent, self-regulate.

However, the events of the past 20 years have not provided much evidence that the sector has the conscience or managerial will to put customer/public service as the prime corporate objective, with profit as a subsidiary aim. Indeed, in many cases, - albeit not all, - the reverse has seemingly taken place.

Hence, I believe that, in a number of areas, a firmer line needs to be taken by the Regulator than is indicated in the Proposals.

- 2 OFWAT has focussed in this Consultation on three important and interdependent characteristics of a well-run privately-owned, monopolistic public service utility: Board Leadership, Transparency and Governance.

On their own, however, these three characteristics form only part of the whole. Equally important criteria are: Financial Control, Accountability and “Responsible Citizenship”.

All six characteristics overlap to some degree, but they are all equally important.

Taking each in turn:-

3 **Board Leadership:**

I have nothing to add to OFWAT's proposed Principles for this criterion. My only concern is how these Principles can be policed in practice. No sanctions are identified.

4 **Transparency:**

OFWAT's Proposal is somewhat weak. Many E&W water utilities are now owned by non-UK shareholders via Limited Liability Partnerships, oft domiciled in a tax-haven. Hence, the underlying financial and managerial arrangements between, shareholders, shareholder funds, fund managers, and the regulated water utility are opaque and can change without public knowledge.

In addition, some utilities raise much of their debt offshore via bond issues for subsidiaries in tax-havens.

Even if the utility was a LSE-listed company, the above scenario could just as easily exist, albeit that public scrutiny would prevail.

The OFWAT proposals are, therefore, weak for this criterion. One might argue that UK privatised public service utilities should always remain as LSE-listed companies, whatever their ownership, thereby ensuring public transparency (and accountability (see below).

Unfortunately, in all the UK privatisations over the last 20 years, - not just for water utilities, - the "horse has already bolted the stable" to the public and Exchequer's loss.

5 **Governance:**

Notwithstanding OFWAT's admirable intentions, my impression of the financial performance of E&W water utilities over the last 20, - and, in particular, the last 10 years, - has been that Governance has not been at the top of the managerial agenda in many utilities. Customers have been short-changed, and the underlying business ethics of the sector need a quantum change.

In addition, corporate leverages have increased across the board to a level where the underlying utility is at risk against unforeseen events, and shareholders have benefitted more than what might have been expected for investment in public service utilities.

Furthermore, many such utilities have adopted aggressive taxation policies, which has short-changed the Exchequer to the benefit of non-UK domiciled shareholders and their managers.

The OFWAT proposals need tightening, therefore, in this area [see below], albeit that, in the context of Director personal suitability and performance, I have no comment to make on OFWAT's proposals.

6 **Financial Control:**

As mentioned above, the ultimate financial control of many utilities may be beyond the realms of the regulated utility. Complex corporate structures prevail in many E&W utilities, oft based on the “Private Equity” model, where long-term financial objectives, upon which capital-intensive water utilities flourish and are sustained, are in conflict with the shorter-term investment objectives of Private Equity Funds and their managers.

It is interesting to note that recently I have attempted (twice) to find out in writing more about the arrangements between one unlisted, E&W regulated water utility, - I am a customer, - their shareholder Funds, - represented by a Limited Liability Company in a tax-haven, - and the Fund managers or General Partner, - similarly based in a tax-haven. Between them, these entities are identified as “Ultimate Controller” under Condition P of the underlying licence.

To date I have met with a wall of silence! I have not even received an acknowledgement from the Company Secretary to my written enquiries!

There is a strong argument, therefore, that such complex and opaque, corporate structures should be outlawed by the Regulator.

7 **Accountability:**

To date (1990-2013), the E&W water utilities have been accountable to the Regulator and, if LSE-listed, to shareholders. As many have now de-listed from the LSE, there is no accountability to customers in the UK, apart from for those listed utilities whose customers may also be shareholders.

[NB. The regional Consumer Councils for Water provide accountability only on consumer issues, and possess no powers to sanction a utility for breaches of performance.]

In the end, there is no better “accountability” measure for directors and companies than the demand that they hold a public Annual Meeting every year, as do listed companies.

Notwithstanding that customers are not necessarily shareholders, as a minimum E&W water utilities should be required to hold a public “Annual Meeting”, where customers can question directors and hold them to account. OFWAT could act as Facilitator for such event.

At the limit, one could argue that E&W water utilities should be required under their licence to maintain an LSE listing, no matter their ownership. Not only would that ensure transparent corporate governance, but also provide notional values to the companies.

As it stands today, for unlisted utilities, shares can change hands without public knowledge, scrutiny or value. This measure might also release OFWAT from some policing roles.

8 Responsible Citizenship:

It is noted that OFWAT is reluctant to impose on water utility directors a 'fit-and-proper purpose' test. Fair enough. However, water utilities, which are public service monopolies, should still attain this measure at the corporate level.

Water utilities should be seen to adopt policies and strategies, which represent "good citizenship". Aggressive tax minimisation structures should be outlawed, and financial constraints on measures such as leverage and aggressive dividend policies imposed in the spirit of assuring the long-term sustainability of the utility.

I accept that, within this criterion, there is a fair degree of subjectivity. However, a prudent Regulator should err on the side of caution rather than adventure. "Lines in the sand" should be drawn as to OFWAT's and licence expectations with respect to these measures. If a utility breaches these measures, then fines should be imposed, with the ultimate sanction of licence withdrawal.

What should be clear in any OFWAT proposal for "Responsible Citizenship" is for the utility to demonstrate under its licence that it measures up to the Principles or standards required, and not for the Regulator to have to impose the standards and police the miscreants.

Many of the Citizenship measures described above can, nevertheless, always be circumvented by innovative and unscrupulous managements. Much is subjective.

One way to overcome this, however, might be to require utilities to post an on-demand "performance" bond to ensure compliance with OFWAT's Principles. If the market perceives the utility management to be strong and compliant, then the bond will have low cost, et vice versa. Given the profits that some utilities have made in recent years, that is a small price to pay for continued

A final comment. Recent media comment on the performance of E&W water utilities suggests that, in general, the public have little knowledge or exposure to the Regulator and how the system works.

Just as OFWAT bi-annually undertakes a City "road-show" for investors, an annual meeting with customers, - possibly in tandem with public Annual Meetings for each utility, - might go along way to providing the public with the assurances they seek. Jonson Cox' March 2013 Paper to the RAE could provide useful starting material for such an event.