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Centre City Tower, 7 Hill Street, Birmingham B5 4UA  
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To CEOs of licensed water and wastewater, and water only companies in England and Wales

13 April 2018

Dear xxxx

### **Putting the sector back in balance**

Our goal is a thriving water sector that holds the trust and confidence of customers and wider society. The corporate behaviour of some companies, along with significant service failures, has damaged that trust. The measures we are taking to put the water sector back in balance are set out in a letter Ofwat's Chair has written to the Secretary of State this week<sup>1</sup>. This letter provides you with more information on what we expect from you and the timing of our consultations and other actions.

Much of the input we need from companies in the programme of work below occurs while companies are devising their business plans for PR19 and the next regulatory period. The concerns around corporate behaviour and the damage to public trust mean this work cannot wait.

The aims of the work set out in this letter complement and are consistent with the PR19 objectives of delivering more for less for customers, by improving resilience, affordability, service and innovation. While we are seeking to clarify and make some targeted amendments to the PR19 approach, our commitment to these overriding objectives and all other aspects of the PR19 methodology we published in December last year, remain in place.

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<sup>1</sup> Letter from Jonson Cox to Secretary of State, relating to the behaviour of water companies, 9 April 2018

<https://www.ofwat.gov.uk/publication/letter-jonson-cox-secretary-state-relating-behaviour-water-companies-9-april-2018/>

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## Rebuilding trust

As we make the improvements to our regulatory regime which are set out below, I am looking to the water sector to engage with customers and the wider public about how it can redefine its role and rebuild trust. Some of the questions the industry should ask itself in this process are set out in our letter to the Secretary of State. I expect individual companies to move quickly to make the changes needed to put customers' interests at the heart of everything they do. We expect companies to report back to us on progress on this and other areas of this programme this summer.

This approach involves a substantial change of gear. We are considering a new principles-based licence condition (see below) to underpin this. We want companies to shift their sights beyond compliance with individual licence conditions to take an enduring responsibility for meeting customers' interests. This is essential if the sector is to hold public trust and confidence into the future.

To help progress this agenda and as Ofwat considers the regulatory framework post PR19, we will conduct our own work to understand what customers expect from a first class public service, and how those expectations may evolve over time.

Together this work will have implications for how companies run their businesses, and for Ofwat's role as a sector regulator. We will be engaging with the UK and Welsh governments, regulators and other stakeholders as part of this process. My team will be in touch with you to discuss this initiative in the coming weeks.

## Improving our regulatory regime

Below is a table of our planned activity over the next six months to improve our regulatory regime.

Consult on new proposals for PR19 to require companies to share financing outperformance from higher gearing

April

Set out our expectations for PR19 business plans around the transparency of policies on dividends and executive performance pay, and around the approach boards should take when making dividend payments and awarding executive performance related pay

Publish additional clarification on how we expect companies to demonstrate financial resilience in their PR19 business plans

<p>When consulting on proposals relating to recent changes of control, we will highlight sector wide issues we have identified and seek views on how we might address them. This will include our goal of bringing all companies' regulatory ring-fencing arrangements up to the standard of industry leaders</p>	
<p>Formally launch our engagement with water companies on proposed new licence conditions as set out in our letter to the Secretary of State, including a common principles-based licence condition for companies to put customers at the heart of everything they do</p> <p>Industry engagement on potential changes to update and strengthen our board leadership, transparency and governance principles</p>	<p>May</p>
<p>Consult on changes to our board leadership, transparency and governance principles</p> <p><i>Publish the conclusions to our review of company approaches to dealing with the operational challenges presented by the recent freeze and thaw</i></p>	<p>June</p>
<p>Finalise changes to our board leadership, transparency and governance principles</p> <p>Publish proposals on licence changes required to implement changes to our policy approach, including on board leadership, transparency and governance principles, ring-fencing and any principles-based licence conditions</p>	<p>September</p>

As you would expect we are considering the impact of this programme of work on our budget. I will update you on this if necessary in due course.

I am confident you and your teams will engage positively and constructively with us on these initiatives. Having already received a promise of assistance from one company, I will be in touch with others to invite them to play a role in strengthening the regulatory ringfence, particularly where there are complex, securitised structures.

I look forward to working with you.

Yours sincerely

**Rachel Fletcher**  
**Chief Executive**