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21 August 2018

Laura Nell  
Ofwat  
21 Bloomsbury Street  
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By Email Only

Dear Laura

### **Consultation on revised Board Leadership, Transparency and Governance Principles**

We appreciate the opportunity to respond to your consultation on revised Board Leadership, Transparency and Governance principles, published in July 2018.

We firmly support Ofwat's programme of work to make sure, and help enable, the water sector to uphold the highest standards of corporate governance as expected from companies that deliver such an essential public service. We therefore support the principles laid out in this document to clarify, strengthen and, in certain aspects, improve the corporate governance within regulated water companies.

Our response to the consultation questions are provided in the appendix to this letter. While these responses are broadly supportive of the proposals articulated in the consultation, there are some key items to draw your attention to:

- We have no objection to including a requirement to comply with the (key) principles in a licence condition on the basis that there is a route for companies to challenge future changes to the principles (which we note is intended) and that there is flexibility for companies to explain, if required, how they are adhering to the spirit of the principles. The consultation refers in a number of places to allowing for flexibility for companies to, in effect, "comply or explain" but it is currently unclear how the licence condition would be drafted to allow for this. We consider that this flexibility must be allowed so that in circumstances where a company cannot deliver against a particular sub-principle but is able to demonstrate that its actions are in the spirit of the principle, it is able to explain this.
- While we agree that the role of the independent non-executive director remains key for good corporate governance in all companies, we consider that having independent non-executive directors as the single largest group on a Board, as opposed to the majority, is sufficient to ensure appropriate independent consideration of key company matters (coupled of course with the appropriate calibre of independent non-executive directors). We advocate this view from a practical perspective as well, in terms of being one of the smaller water companies where we consider it would be inefficient to modify the size of our Board.



We look forward to continued engagement on the matters discussed in this consultation and your wider programme on 'Putting the Sector Back in Balance' and we would be happy to discuss any of the items above in more detail. Please contact [REDACTED] [REDACTED] [REDACTED] if you would like to discuss anything further.

Yours sincerely

[REDACTED]  
Finance and Regulation Director

## Appendix 1 – response to questions

### **Q1: Do you agree with the objectives for the principles we have set out (in Table 1 of this chapter)?**

Yes, we agree with the objectives for the principles listed in Table 1. These objectives, pertaining to how the board sets the purpose and values for the company, in addition to engendering trust through its actions and its accountability for long term direction for the company, are all aspects of good corporate governance that we adhere to at SES Water. We note in particular the objective associated with Board effectiveness, which refers to Boards and their committees being “...sufficiently independent”. As you will note from our responses below, we consider that independence cannot always be objectively deduced from a series of prescribed independence tests, and that particular facts and circumstances need to be considered for each company when independence of the chair, board and committees is being assessed.

### **Q2: Do you agree with the aim of setting principles that enable autonomy and flexibility for companies to deliver the highest standards of accountability and responsibility for their behaviour and outcomes, reflecting their own circumstances?**

Yes, we agree with the aim of setting principles (as opposed to specific provisions) to enable autonomy and flexibility for companies to deliver quality board leadership, transparency and governance that can be related to their own circumstances. As noted in the consultation, it is important that companies can explain how such governance principles have been adhered to in their own particular circumstances. With this in mind we consider that a number of the sub-principles do not meet with the intended aim as they are prescriptive in how a company is to comply. For the majority of sub-principles this raises limited concern. However, because of our own particular circumstances (which is addressed in our Annual Report), we note particular concern with sub-principle 4.i “The chair must be independent of management and investors. There must be explicit division of responsibilities between running the board and executive responsibility for running the business”. We consider that only the key principles, and not the sub-principles, be incorporated into the licence, and seek assurance from Ofwat that the aim of principles that enable autonomy and flexibility is enshrined in licence changes to avoid a potential conflict between this aim and a requirement to comply with the licence.

### **Q3: Do you agree that if companies are unable (exceptionally) to comply with specific principles, they should explain very clearly how their approach meets the spirit of the principles?**

We consider that there should be a requirement to meet the four key principles and for a company to explain how its actions have allowed it to meet these principles or, if required, the spirit of the principles.

### **Q4: Do you agree with our proposed principle for purpose, values and culture?**

Yes, we agree with the proposed principle for purpose, values and culture. In our recently published 2018 Annual Report the Corporate Governance Report includes reference to our Board’s key activities, a view on the Board’s vision for the company, the setting of a strategic direction and how the Board reviews company objectives and performance. Incorporating such reporting into an annual statement from the Board, that sits at the front of the financial statements, which would focus on how the company has set its aspiration and performed for all those it serves, is a logical next step in overall transparency. We would also highlight that there are other means – outside of the annual reporting cycle – for the Board to explain their activity, such as with the publication of Board meeting minutes and standing agendas on websites,

together with direct engagement with employees through a nominated independent non-executive director, all of which we are planning to introduce this year.

**Q5: Do you agree with our proposed board leadership and transparency principle?**

Yes, we agree with the proposed board leadership and transparency principle. The reporting proposed in this principle, around executive pay, dividend policies, risks and board and committee membership, aligns closely with recent Financial Reporting Council (FRC) announcements.

**Q6: Do you agree with our proposed principle for the stand-alone regulated company?**

Yes, we agree with the proposed principle for the stand-alone regulated company, which is a continuation of how we currently operate the Board and committee structure within our group of companies. Our regulated water company acts as if it is a stand-alone company, and the Board of our company takes full responsibility for all aspects of the regulated company's business.

**Q7: Do you agree with our proposed board effectiveness principle?**

Yes, we agree with the proposed board effectiveness principle, with the knowledge that ensuring the Board and its committees have the appropriate balance of skills, experience, independence and knowledge of the company has been a particular area of focus for our Board in recent years and has yielded positive results from our perspective. We would ask that Ofwat considers the following items in relation to the sub-principles detailed in Section 2.4:

- As noted throughout this response, we consider that incorporating the sub-principles into the licence will reduce the desired flexibility for companies' particular facts and circumstances, and that incorporation of the four key principles is sufficient (although it is currently unclear how the licence condition would be drafted to allow for this).
- While we consider an evaluation of the Board performance is required on a regular basis, consideration should be given to whether this is required each year or whether an evaluation every two years would suffice (unless significant issues arose from the evaluation). This would allow for a more efficient process to be followed for a company of our size.
- Consideration should also be given to periodically utilising a third-party facilitator for Board evaluation, in line with recent FRC announcements, to add another layer of objectivity to the process.

**Q8: Do you think that the requirement for an independent chair should be a stand-alone licence obligation or should we allow some flexibility? If the latter, what mitigations would be appropriate where a company does not have an independent chair?**

We do not consider that the requirement for an independent chair should be a stand-alone licence condition. We consider it sufficient to incorporate the key board effectiveness principle into the licence, with the flexibility to explain why the chair is deemed to be independent, taking into account particular company facts and circumstances. We consider that at the forefront of this concept is being able to demonstrate, through the chair's actions and interactions with the Board and associated committees, his or her independence. While flexibility could be obtained through a balance of work performed by the other independent non-executive directors, we consider that the focus should be placed on establishing the independence of the chair themselves in the first instance. In exceptional circumstances, should the explanation of chair independence not be considered acceptable, a suitable transition period should be considered for current chair arrangements, being flexible to an individual company's facts and circumstances.

**Q9: Overall, how well do the proposed principles meet the aim of enabling autonomy and flexibility for companies to deliver the highest standards of accountability and responsibility for their behaviour and outcomes, reflecting their own circumstances (rather than setting overly prescriptive rules)?**

We consider that the proposed principles overall provide a good framework for achieving the highest standards of accountability and responsibility with respect to board leadership, transparency and governance, and – as long as their remains an ability to “comply or explain” for particular company circumstances – we consider this will be a positive step. A principles based framework with a comply or explain function, without the need for overly prescriptive rules, is in our opinion the best way forward.

**Q10: Do you agree with our proposal to insert a requirement in companies’ licences that they must meet the principles?**

We do not object to a licence requirement that requires the principles to be met, albeit we consider that adherence to these principles could still be achieved outside of the construct of the licence, sitting alongside the FRC’s Governance Code. However, if this requirement is inserted within the licence, we expect there to be a clear mechanism provided that allows for flexibility in delivery against these key principles that can be objectively reviewed in light of individual company’s facts and circumstances, and that the sub-principles themselves are not inserted into the licence, as this reduces flexibility.

**Q11: Do you agree with our proposal for an appeal mechanism and a change process in the proposed licence condition to meet the principles?**

If adherence to the principles are enacted as a new licence condition, we agree that there needs to be an appeal mechanism and change process in place, not only if the appointee disputes whether revisions to the principles are reasonable and appropriate, but also to provide an appeal process if there is any dispute on the “allowed flexibility” used by companies to explain how they have delivered against the principles or spirit of the principles. Again, this is based on incorporation into the licence of the four key principles, not the associated sub-principles.

**Q12: Are there specific instances where individual companies’ licence conditions might conflict or overlap with the revised principles?**

We are not aware of any of our current licence conditions that would overlap or conflict with the revised principles.

**Q13: Do you agree that we should insert a requirement in companies’ licences that independent non-executive directors should be the single largest group?**

We consider it is not essential for such requirements be inserted into companies’ licences, as adherence to such governance matters can be performed in a similar way to the FRC’s Governance Code, but do not object if this requirement is inserted into the licence.

**Q14: Do you agree with our proposal to use the criteria for independence as set out in the UK Corporate Governance Code? Do you think that there are any merits in instead setting out an alternative approach whereby we would insert criteria for independence in the licence?**

We agree that alignment with the independence criteria as set out in the UK Corporate Governance code would be preferable as an assessment mechanism. We recommend that care be taken to ensure that the principles being proposed in this consultation do not diverge from established and accepted principles under the FRC's Corporate Governance code or override director's responsibilities under the Companies Act.

**Q15: What are your views on the merits of going further than our proposal and instead requiring that independent non-executive directors to be the majority on the board? If we take this approach, should this be a sub-principle or licence requirement?**

We consider that having the independent non-executive directors as the single largest group on the Board is sufficient for the purposes of good governance. Going further – and making the independent non-executives directors the majority – will not provide incremental benefit. Quality, integrity and commitment of the individual independent non-executive directors will enhance corporate governance at that point, not necessarily larger numbers of such individuals on the Board.