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Dear Laura

Thank you for the opportunity to comment on your consultation on revised Board Leadership, Transparency and Governance principles.

Since joining Thames Water in January 2018, Ian Marchant, our independent chair, has been leading a governance review to align corporate governance to best practice, with the aim of improving the effectiveness of our governance structures and provide greater transparency to our customers about what we do as a business. We are committed to demonstrating industry-leading performance on corporate governance and we support revising principles to continue to drive improved governance and transparency across the industry.

Please contact me if you would like to discuss any of the points raised in our response.

Yours sincerely

[REDACTED]

[REDACTED]  
**Director of Strategy & Regulation**

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

### **Q1: Do you agree with the objectives for the principles we have set out?**

Yes, we support the proposed objectives for each main principle and agree that they will support the implementation of good corporate governance. More generally, we recognise the need for the standards of corporate governance across the water industry to evolve to reflect latest best practice, and acknowledge that the proposed objectives will deliver this evolution.

### **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?**

We support principle based regulation and we agree with the need for principles to enable autonomy and flexibility. In particular, it is essential that each regulated company's Board, in meeting its responsibility consider the wide range of factors affecting the regulated company, and has the flexibility to judge what the most appropriate approach is to meeting the principle. This flexibility will allow for better outcomes for customers and stakeholders than a prescriptive "tick-box" approach. Strong consideration should, therefore, be given to whether prescriptive principles or sub-principles should be mandated, as there is the potential that they may not deliver the results for the company, customers and stakeholders.

In addition, we think the industry has demonstrated that it is capable of taking responsibility for delivering good corporate governance. For example, since the introduction of the Board Leadership, Governance and Transparency ("BLTG") principles in January 2014, there has been a dedicated, voluntary effort across the industry to deliver a step-change in corporate governance standards. Thames Water has taken a number of steps to align its governance to both Ofwat's 2014 BLTG principles and best practice corporate governance, as evidenced in our most recent Annual Report. Led by our independent Chairman, we are reviewing our governance arrangements to ensure they continue to meet best practice. We agree, therefore, it is appropriate that this willingness to improve be reflected through entrusting companies with flexibility and autonomy.

We have discussed with Ofwat our concerns that the drafting of the sub-principles, in particular the articulation of comply or explain in the consultation document may have conflicted with the objectives of autonomy and flexibility. Following clarification from Ofwat, we are comfortable that the intention is to allow companies flexibility and autonomy to take different approaches where they meet the objective of the main principles.

### **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?**

Yes, we agree with the requirement to comply or explain, as per the FRC's UK Corporate Governance Code. As explained in our response to question 2, we strongly support the need for companies to have autonomy and flexibility in how they meet the corporate governance

principles and we were concerned that the companies would only be permitted to diverge from meeting the specific sub-principles in exceptional circumstances, were they are unable to comply.

Following clarification by Ofwat, we understand that it is intended for companies to have flexibility in how they meet the corporate governance principles, and Boards will have the ability to consider the wide range of factors affecting their companies and to decide on the appropriate approach to meeting the principles. We support this approach, as it will place the onus on companies to challenge themselves and demonstrate to customers and stakeholders how they are delivering the spirit of the principles. As such we are happy to go further than this in our Annual Returns/Annual Performance Reports by providing a clear explanation of how the main principles have been met.

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

We fully support this proposed principle and agree that the Board should develop and promote our company vision. Our Board is committed to ensuring the regulated company's business is completely aligned to the customer-centric vision that emerged from our recent strategic review. This review has led to the significant changes in how we operate as a business, including a cross-company reorganisation to facilitate collaboration and align ourselves to delivering what customers want.

There should be transparency in what the Board is doing and is planning to do, so there is a clear understanding of what their aim is and why. In this way, we support the continuing publication of an assured annual board statement.

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

We fully support this proposed principle. As most customers do not have a choice in their water services provider we agree it is important to ensure they know we are doing our best to deliver for them. We are continuously looking to increase the level of transparency we provide to our customers and stakeholders about our business and our 2017/18 joint Annual Report and Annual Performance Report ("our Annual Report") demonstrates our commitment to providing customers and stakeholders with transparency about how we run our business. For example, we know that customers rightly take a great interest in dividend policy and as a result, we set out in our 2017/18 Annual Report our intentions in respect to dividend payments until 2020 and stated our dividend principles for 2020-2025.

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

Yes, we agree with the proposed principle, and the main principle is analogous to an existing requirement in our current instrument of appointment to operate the appointed business as if it were substantially our sole business. We understand this requirement will be replaced with this requirement under the corporate governance principles following the recent notice under s.13 of the Water Industry Act 1991 ('WIA91') relating to our change of control.

We agree with the need for the regulated part of the business to be run as a stand-alone company and for the regulated company boards to have ‘meaningful control’ of the business. In saying this, we note that the interpretation of ‘meaningful control’ should take account of the legitimate interests of investors to be able to input in decisions relating into their investment. For example, in the case of retail exit where companies had an opportunity to withdraw from providing non-household retail services within their area of appointment, it is wholly appropriate for shareholders to have a say in whether the regulated company exits.

More generally, we consider that changes we have recently made to the way Thames Water Utilities Limited (TWUL) is governed further strengthen the control of the TWUL Board. These changes ensure that all decisions of strategic importance are made by the TWUL Board; and a reduced number of matters are subject to ratification by the Kemble Board. We sent details of these changes to Ofwat in July 2018.

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

Yes, we agree with the proposed principle and agree that companies should be led by a well-qualified board entrusted with setting the company’s agenda in order to make the best decisions for customers and business. For this reason, our independent Chair has led a review of the existing governance arrangements to ensure our board is effective and has the skills it needs to meet the future challenges.

Our Annual Report explains some of the activities we are undertaking to ensure Board effectiveness, including details of the recruitment and training procedure for board directors and our annual board reviews. We are also committed to empowering the board to make the best decisions possible. In support of this aim, our independent non-executive directors form the majority on our Audit and Risk, Nomination, and Remuneration Committees; this is something we are committed to upholding for the foreseeable future.

**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 currently have an independent Chair and do not think this is a position we would ever want to reverse. Consequently, we would not object to a licence obligation to have an independent chair, if it was proposed. However, if flexibility is retained, we recommend considering the following potential mitigations:

- A requirement to explain why the company has chosen to appoint a chair who is not considered independent, including highlighting how they do not meet the FRC’s definition of independence, what conflicts of interest may exist and how they are being managed by the regulated company;
- Progress towards having a majority of independent non-executive directors (“INEDs”) on a board and its sub-committees; and
- Transparency around remuneration of an executive chair, demonstrating how it is linked to delivery for the customer, rather than just financial performance.

**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 believe that the principles are consistent with the latest, best standards of corporate governance and are flexible enough to allow us to make the best decisions for our customers and business. We were concerned that the corresponding sub-principles would remove our Board's autonomy and flexibility by placing prescriptive requirements on companies, but in the context of our conversation with Ofwat earlier this month, we are content that there is enough flexibility to take into account a wide range of factors and to take a different approach to deliver the spirit of the principle.

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

As explained in our response to Ofwat's May 2018 change of control consultation, we fully support the proposal to insert a requirement in our licence to meet the BLTG principles. However, the change of control consultation consulted on the simple requirement to comply with the corporate governance principles. This consultation on BLTG principles suggests further changes to that licence condition may be necessary to provide for a transition period and how the condition applies in the event of unforeseen circumstances. We would, therefore, like to have the opportunity to engage on a more detailed version of the condition that addresses these aspects.

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

As part of our response to the consultation on our change of control in May 2018, we accepted Ofwat's proposed appeal mechanism. If through engagement on the BLTG principles Ofwat changes its preferred approach, we would expect our licence to be updated accordingly to ensure appeal mechanisms are aligned across the industry.

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

Due to the forthcoming alterations to conditions P and F proposed in Ofwat's May 2018 change of control consultation we do not foresee any other instances of overlap or conflict to that identified in our responses to questions 10 and 11. We will review our position once the change of control licence amendments are implemented and we have received the drafting of the licence obligations proposed in this consultation.

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

INEDs currently make up the largest single group on our board, and we also have an independent chair. Therefore, we would not object to a licence condition for INEDs (including an independent Chair) to be the single largest group on regulated company Boards. We have also signalled in our Annual Report that we are progressing towards having a majority of INEDs.

**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 with proposals to use the criteria for independence as set out in the UK Corporate Government Code.

**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 are progressing towards having a majority of INEDs. We do not think it is necessary to include this now as a licence obligation or a sub-principle. We feel good corporate governance in this area should give companies flexibility to assess the competency and effectiveness of the board as a whole.

Further, we need to consider how a requirement for a majority of INEDs might interact with the rest of the regulatory framework and the incentives to improve both levels of service and efficiency. The current composition of our Board supports this balance of tension and encourages effective debate on these issues. Should companies voluntarily move to a majority of independent directors, they will need to keep in mind the balance and effectiveness of the overall Board, and how to maintain an appropriate balance of Board challenge to both levels of service and efficiency. We will, therefore, continue to assess the effectiveness and balance of our board and whether at some point a move to a majority is in the best interests of our customers and the company.