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Board Leadership, Transparency and Governance Consultation
Ofwat
21 Bloomsbury St
London
WC1B 3HF

20 August 2018

Dear Sir / Madam

Response to Ofwat consultation on revised Board Leadership, Transparency and Governance principles

Tideway welcomes the chance to respond to the above consultation.

We understand and welcome Ofwat's work to develop the Board Leadership, Transparency and Governance (BLTG) principles. We agree that the interests of customers and the public interest are best served through companies maintaining high standards of corporate governance and to that end, the consultation is helpful in setting out proposals for discussion. We anticipate that taking these proposals forward will require further, significant engagement with companies and other stakeholders.

We have the following general points to make:

- **Compliance:** The Introduction to the consultation sets out the high-level problem Ofwat wishes to address. Tideway supports the introduction of a single set of BLTG principles and are keen to maintain our sector-leading standards of corporate governance. We believe we have met Ofwat's existing principles and will be keen to comply with future principles that have gone through appropriate development and consultation. Tideway considers that it already sets a very good example for the sector and the wider customer population in promoting trust and legitimacy. However, the consultation proposes compliance with a set of principles that are essentially subjective in interpretation and may change over time. Our view is that those characteristics do not sit easily with an undertaking to be embedded in the licence, which is the instrument which grants the company its rights and rigorously defines its mission and regulatory substance;
- **Consistency:** We note that the existing UK corporate governance framework is currently in a state of flux: The Financial Reporting Council (FRC) recently published a new UK Corporate Governance Code, new legislation has been laid before Parliament in the form of the Companies (Miscellaneous Reporting) Regulations 2018, and the Wates Corporate Governance Principles have also been published for consultation, all within the last few months. In addition, we note that Ofwat is considering a number of other changes to the corporate governance of water companies (e.g. ultimate controller principles). To ensure consistency across all these fronts, it might be appropriate to consult again on the BLTG principles once there is clarity on those other changes;

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- **Proportionality:** Some of the requirements, which may be appropriate for large, complex businesses employing thousands, may not be proportionate for companies like Tideway after System Handover and Acceptance. For example, we anticipate that Tideway will then have a reasonably large RCV, but it could be a relatively simple asset ownership business. We believe that Ofwat should therefore recognise in its principles that diversity goes beyond simply scale but also needs to take into account other factors; and
- **Clarity:** In some areas, which we list below, we would welcome more clarity on Ofwat's proposals.

We consider the legitimacy of the sector to be critical to its future success. A single set of principles, which recognises the diversity of the sector, could be a helpful step forward in promoting this legitimacy. In that regard, we are keen to continue to engage with Ofwat and support it in considering how best to address current and future challenges. In Annex 1, we have commented on each of the consultation questions.

Yours faithfully

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Chairman

Annex 1: Tideway Response to Specific Consultation Questions

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

We agree with the objectives of the principles that Ofwat has proposed. We would, however, highlight some of the general matters set out in our cover letter above (particularly those relating to proportionality and consistency) which we believe should guide Ofwat's work in this area.

2. 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 agree with Ofwat's aim in this area and acknowledge that the BLTG principles are key to setting high standards of accountability and responsibility. It is important that the principles allow for flexibility in their interpretation to reflect the circumstances of individual companies. It might be helpful if Ofwat were to develop a guidance paper on how it was going to interpret compliance with the principles taking into account issues such as flexibility and the process for evolving the principles including consistency with other corporate governance codes and guidance.

3. 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 agree with Ofwat's proposal in this area. Tideway is fully compliant with the current BLTG principles but we agree that, if a situation arose where we were unable to comply with a specific principle, it would be reasonable for us to explain why that non-compliance had arisen and to set out the measures we had put in place to ensure that our standards of governance were not adversely affected. We believe that this approach is consistent with that required for the new UK Corporate Governance Code.

4. Do you agree with our proposed principle for purpose, values and culture?

We are generally supportive of the proposed principle regarding purpose, values and culture.

We note that underlying this principle is an emphasis on putting customers at the heart of business models, and we acknowledge that for Tideway, the relationship with the "customer" is different compared to that of other water companies. We also appreciate that the precise wording of the principle takes into account 'the needs of those it serves', which Tideway acknowledges to be a very wide and diverse range of stakeholders.

We further consider this to be an area where, for clarity and consistency, it may be beneficial to consider the wording of the principle in line with the FRC's new UK Corporate Governance Code. – For example, we note that the new Code focusses on reporting the "outcomes" of Board activities and decision making. It would be helpful to clarify if the same outcomes focus is intended to apply in the application of the BLTG principles.

5. Do you agree with our proposed board leadership and transparency principle?

Broadly, we agree with Ofwat's principle although we have reservations on certain sub-principles. There are three areas in which we consider further clarification and discussion could be helpful:

- First, we would welcome more clarity on why Ofwat wishes companies to disclose pay policies at the regulated company level, rather than the group level

- Second, we do not support the requirement to report details of “votes cast” at board and committee meetings. In our view this could hamper debate by encouraging boards to pursue a consensus position in order to avoid situations that might involve division. It is also possible that in some circumstances directors might be inhibited from challenging a majority. We would welcome further opportunity to examine this issue with Ofwat and to explore if other mechanisms for reporting on Board activities might assist with transparency in relation to Board decision-making
- Finally, we note that Tideway currently complies with the UK Corporate Governance Code requirement to set out, in the annual report, the number of meetings of the board and its committees, and individual attendance by directors across the year. The sub-principle, as currently drafted, could be interpreted to imply more detailed reporting to the level of individual member at individual meetings. If this is the proposal, it might have a negative impact on our ability to attract individuals to INED positions in the sector and would certainly add to the complexity of reporting on Corporate Governance with little obvious benefit. We would welcome clarity from Ofwat as to what is intended, and if there is a need to change our current levels of reporting. If Ofwat is proposing more granular reporting then it would be helpful if Ofwat were able to set out the problem this proposal is designed to solve and the overall benefits of the approach.

6. Do you agree with our proposed principle for the stand-alone regulated company?

We support the overarching principle in this area, though we would encourage further consideration regarding some of the sub-principles and their potential impact as currently proposed:

- Point (ii) is a development of the existing sub-principle that requires reserved matters to be clearly articulated in the annual report. Tideway complies with the current sub-principle by setting out in our annual report the limited number of matters that are reserved to shareholders. We believe this provides a good level of transparency and helps to ensure that the board of the regulated company, Bazalgette Tunnel Limited, is the leading company in the group in terms of accountability. Further requirements to explain and justify reserved matters could potentially deter investors in the sector and increase the cost of finance and we would, therefore, query the value of developing the sub-principle as currently proposed.
- In relation to Point (iii) while we would support the principle that final decisions should be made by the Board, some ability to delegate is essential to ensure the Board runs smoothly and is appropriately focussed. We would therefore welcome, for clarity in the sub-principle, some recognition of the appropriate role of Board committees, and on occasion responsible Board members, in receiving delegated authority from the Board.
- On point (iv), Tideway has in place various mechanisms for identifying and managing conflicts of interest. We consider that the Board Chairman should manage, and where possible resolve, any conflicts of interest and that our existing processes are sufficient to comply with the relevant provisions of the UK Corporate Governance Code. Elimination of any conflicts of interest, as proposed by Ofwat may be difficult to achieve in practice and could be undesirable if, as a consequence, individuals with relevant experience are prevented from contributing to discussions or taking board positions in the sector.

7. Do you agree with our proposed board effectiveness principle?

We agree with Ofwat’s proposed approach in this area. Again, we note that Tideway’s “customer” relationship is somewhat different compared to that of other water companies, but we acknowledge that we have a large and diverse range of stakeholders whose interests and needs should be addressed by our board.

8. 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?

The UK Corporate Governance Code already requires the appointment of an independent Chairman and provides assessment criteria that are well understood, and which we consider to be appropriate. Tideway therefore considers that it is unnecessary to make this a licence requirement.

9. 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)?

Subject to the reservations expressed above, the proposed principles meet Ofwat's aims in this area. As noted, we are keen to engage on the proposed principles to help develop these further.

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

Tideway is committed to high standards of behaviour and a culture of transparency and accountability which supports good quality decision-making, assists us in our engagement with stakeholders and supports our overall project outcomes. It is entirely consistent with our approach that we comply with Ofwat's existing governance principles and we would seek to comply with well-developed and appropriate principles in the future.

Notwithstanding our total commitment to the highest standards, as set out above, we consider the proposed licence change would be inappropriate for the following reasons:

- Licence conditions should be specific, measurable and targeted, giving both the regulator and the regulated business clear rights and responsibilities that are enforceable if the regulated business fails to comply or is likely to fail to comply. Introducing in licences a set of principles which are, by their nature more general, could be problematic in terms of enforceability, particularly where compliance is difficult to measure objectively.
- Our understanding is that Ofwat does not intend to set prescriptive BLTG principles and the onus will be on companies to take ownership of the principles and apply them appropriately in the context of their own organisations. While we agree with Ofwat's approach that companies should take ownership we consider introducing compliance with the principles into the licence could undermine the prospects for flexible application, which is valuable given the diverse range of companies in the sector and the challenges it faces.
- It seems likely that the BLTG principles will continue to evolve, over time, as will the UK Corporate Governance Code and the various other codes that help define best practice in corporate governance in the UK. This likelihood of change creates an inherent uncertainty, and hence could increase the cost of finance where compliance with the principles is enshrined as a licence condition.
- We recognise and welcome other recent developments in UK corporate governance which require companies to explain their approach to compliance and to justify their approach by reference to outcomes of Board decision-making. It may be appropriate for Ofwat to consider if such developments in corporate governance provide an alternative and preferable route to ensuring companies focus on delivering what is right for their customers.

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

Tideway is not supportive of enshrining a compliance condition in the licence, however, should Ofwat impose such a condition, we would expect a suitable change and appeal process to be agreed between the parties before implementation.

12. Are there specific instances where individual companies' licence conditions might conflict or overlap with the revised principles?

There may be some areas of potential overlap, particularly in relation to certain conditions in Tideway's licence:

- K2.1 – Licensed Business to be independent and a separate public limited company;
- K2.2 – Conduct of Tideway as a Licensed Business;
- K8.1 – Ultimate Controller Undertaking (UCU) requirement;
- K8.2 – Information sharing between Tideway and other companies, UCUs and the number of required INEDs;
- M4.2 – Notifying Ofwat of Board member changes;
- M4.3 – Providing information on Board member changes;
- M4.4 – Providing Ofwat with certificates of any UCU; and
- M4.5 – Notifying Ofwat of a UCU breaching terms/ceasing legal enforceability.

We do not believe there are any instances of conflict with the revised principles.

We understand that Ofwat may want to simplify the licences of companies that agree to the new condition to comply with the governance principles. For companies, such as Tideway, that do not agree to the licence change then we would welcome further discussions with Ofwat on the how the principles relate to our existing licence conditions.

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

We note that INEDs form the single largest group on Tideway's Board and therefore it would not be proportionate or necessary for a licence condition.

We do, however, consider that there may be circumstances where it might not be desirable for INEDs to be the single largest group on a Board. For example, smaller companies are likely to have at least a CEO, a CFO and a COO, as well as a number of shareholder directors. Therefore, requiring INEDs to be the largest single group will require a large Board, with the associated expense.

14. 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 support the use of the existing criteria in the Corporate Governance Code which we believe to be well understood and fit for purpose. We do not believe there would be any overall benefit in an alternative approach as suggested, but we would be happy to discuss any specific concerns.

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

We do not agree with Ofwat's proposal requiring that INEDs are the majority on the Board. There are a range of factors that determine the functioning of a board beyond simply the proportion of board directors that are independent. Please see our response to Question 13. As noted, we believe it is appropriate for Ofwat to consider the circumstances of individual companies concerning the composition of their boards.

Independent non-executive directors currently form the largest single group on the Tideway Board, but not an overall majority. Allowing for three executive directors and four shareholder directors, requiring an overall majority of INEDs would result in a board of 15 directors which we believe would be unwieldy to administer, impractical for debate and decision making, and an unnecessary expense.

Again, we would welcome the opportunity to discuss this further with Ofwat so we can make a positive contribution to the proposals in this area.