



## **OFWAT Board Principles consultation**

UNISON, the largest union in the water industry with nearly 10,000 members, is pleased to submit this response. We welcome the intention to have more rigorous requirements placed upon boards, though as we explain below we feel that OFWAT has still not got to the right place in terms of requiring appropriate board performance; the proposals have too much in-built flexibility and that it is therefore likely that the companies will find ways to comply in form without actually driving changes in behaviour. Which would make this a pretty pointless exercise.

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

Support the objectives of the principles. However, experience of this sector shows that the companies do not respond to high level principles or flexibility from the regulator; they need detailed prescription with clear consequences for non-compliance. There therefore needs to be very much more detailed and specific requirements as to conduct than this whole consultation envisages. In the responses which follow, we suggest detailed requirements which would be appropriate. In particular, we favour the appointment of worker representatives to boards to enable them to perform their proper function of ensuring stakeholder interests are properly taken into account in decision-making. This is suggested as one of three options in the most recent FRC draft guidance; in the circumstances of the water industry, it would be right that it should be required. Water companies are not trading across international boundaries; running monopoly supply operations, they require the engagement of staff to improve service offerings; and they rely crucially upon motivated, technically skilled staff to deliver their business. These three factors mean that worker representatives can provide a particularly useful contribution in this sector.

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?

As stated above, these need to take the form of requirements, with sanctions, not principles enabling autonomy and flexibility. Any such flexibility will be exploited to enable minimal real improvement by the companies.

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?

No. We cannot see circumstances in which a company would be unable to have a compliant Board structure; though they might prefer to avoid doing so. There is no need to enable an avoidance mechanism.

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

No. There needs to be a requirement placed upon Boards that they will engage with stakeholders, including their workforces, but also environmental and customer groups. The drafted principles could be satisfied without any outside contact of any kind. The “island” of decision-making is not altered unless you require it.

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

No. These relate solely to the Board explaining the basis of dividend policies and remuneration decisions, and other areas of consideration. The point from our perspective is not merely to understand the decisions that are taken, but for these to be different from what they have previously been. For us, the proposals naively posit that simply putting more information out there will lead to better outcomes. We see no support for this in how the companies have behaved in the past. There needs to be genuine, radical transparency, including detailed accounts of Board discussions, how Board members voted in key decisions, and so on. These are not ordinary public companies, but providers of public services; transparency requirements therefore increase.

We are pleased that obligations towards employees are specifically referenced.

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

Yes.

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

Needs to be stronger. The proposed evaluation of board performance should be carried out by an independent entity, preferably with the same one auditing each board, to identify comparative good or weak performance. That independent entity should be appointed by OFWAT and funded through a levy on the companies. The idea of each board marking its own homework or appointing a scrutineer, which it pays, will not give outsiders confidence in that process. Alternatively, trade unions could perform this function.

Board appointments should be made from a panel appointed through fair and open competition in a process superintended by OFWAT. This would avoid the appointment of “independent” directors who are actually trustees and drawn from the same narrow caste of people who already make up the Board cadre. That would build public confidence in the quality, diversity and independence of those appointed to board positions. As set out above, we favour a requirement that Boards have worker representation.

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?

No flexibility is required. There’s no reason not to have an independent chair.

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)?

This aim as described does suggest to us that OFWAT have not yet understood the crisis of public acceptability. This is a classic case for prescriptive rules. These Boards are running public services, not selling fast-moving consumer goods. It does sometimes seem that OFWAT is dazzled by the idea that somehow, set free to innovate these companies will provide a great service. All the evidence points the other way.

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

Yes - but as observed above, in our view, these should not be principles, but more detailed requirements, with clear consequences for non-compliance.

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

Appeals mechanisms are necessary to any just system. However, the change process as set out suggests that companies would have a particular input into any proposed changes. It needs to be absolutely clear that OFWAT defends the public interest, not corporate interests, and that it will provide for full stakeholder engagement with corporate perspectives having no particular weighting in decision-making. OFWAT needs to better defend itself from the suggestion that it has excessively close and sympathetic understanding of company wishes, to command public confidence itself.

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

We guess that this consultation will unearth any such; we cannot conceive of any.

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

See below, question 15.

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?

The task here is different to the FRC's, which is setting rules for companies in ordinary competitive markets. It does not set rules for the particular circumstances of companies which are monopoly deliverers of a critical public service crucial to life and health. Bespoke criteria are appropriate for the water industry. We would be happy to engage on what these should be. It would also be appropriate for the directors to be not simply independent, but possessing (across the whole Board) particular relevant experience. This should include for example service delivery to the poor; employee engagement; and delivering environmental objectives. More engineers and fewer financial engineers would also be appropriate.

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?

UNISON would favour this. As observed above, only licence requirements are likely to actually bring about the desired outcome in this sector. It is crucial that the needs of the service users, rather than the interests of the corporate owners, should be most heavily weighted in decision-making. This has conspicuously not been the case in the past. As pointed out above, these people should be genuinely independent, and selected from a panel appointed through a competitive process not overseen by the holding companies.