

Introduction

United Utilities welcomes the opportunity to comment on the revised “Board Leadership, Transparency and Governance principles” consultation. In reading this consultation, we note that there are a number of references in the consultation to both ‘the board’ and ‘the board of the regulated/regulated water company’. We have taken any reference to the ‘board’ on its own to refer to the ‘regulated company board’ as opposed to the parent company board. We suggest that the words ‘of the regulated/regulated water company’ be deleted each time to avoid any confusion.

Questions

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

United Utilities welcomes this review of the principles behind Board Leadership, Transparency and Governance. We support the focus of the proposed principles and welcome the alignment with the FRC’s UK Corporate Governance Code (“the FRC Code”) where appropriate. It is, however, important not to set overly rigid rules that can create unintended consequences whilst not necessarily furthering the goal of protecting customers.

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 strongly support the flexibility for companies to ensure they meet the principles set out within the consultation, whilst having due consideration for the individual circumstances of each company. In particular, it should be recognised how the flexibility in the FRC code of ‘comply or explain’ is one of the great strengths of UK corporate governance.

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 are mindful of Ofwat’s need to ensure companies meet high standards of board leadership, transparency and governance. In order to ensure that this can be delivered most effectively across a range of circumstances, some flexibility in how companies meet those principles needs to be available. This flexibility needs to go beyond situations where companies are ‘unable’ to comply, and allow for situations where meeting the strict wording of a possible new licence condition creates significant inefficiencies, or situations that are unworkable in practice. We therefore suggest that when referencing the flexibility to consider an alternative approach, the words ‘unable’ or ‘cannot comply...’ should be followed by additional wording such as ‘or where it is either impracticable or unworkable to comply...’.

One particular scenario where this would apply for United Utilities would be in relation to the creation of sub committees to the stand alone regulated company board. Since 2008, United Utilities has received flexibility in terms of meeting the requirements of the FRC Code (as required by Condition F) regarding the need for the regulated company to itself operate specific board sub-committees as required by the Code. (e.g. audit, remuneration and nomination committees).

We have been able to explain why the previous Ofwat BLTG principles, requiring board committees to operate at the regulated company level, were not necessary and would be duplicative for United Utilities, because U UW represents in excess of 98 per cent of group revenues. This means that the activities of the principal group board committees, as required by the FRC Code, are necessarily targeted towards U UW matters, thus ensuring that the interests of U UW and its customers are safeguarded. Duplication of these committees would add no benefit in terms of BLTG, but would present significant practical difficulties and inefficiencies.

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Also, in terms of executive remuneration, the actual employing entities of many executives and, in particular, the corresponding share incentive schemes, necessarily occur at group level and therefore a remuneration committee at regulated company level would be unworkable. This approach was communicated to Ofwat in 2008 as part of the work considering modifications to condition F. United Utilities Group PLC has its own Remuneration Committee which reviews the remuneration of directors and the pay scales applicable to senior management. The board has concluded that UUG having its own remuneration committee is therefore unnecessary and would not improve governance.

As long as the overall activities and interests of the parent company and the regulated company remain closely aligned and are carefully explained, we believe that this alternative approach should continue to be permissible under the new principles without the need to prescribe any specific rules or thresholds.

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

We agree with the proposed principles. We believe it would be helpful to clarify what the reference to 'annual statement' in sub-principle (iv) of the 'Purpose, values and culture' section refers to. We note that the new board statement, introduced this year into the Annual Performance Report, meets many of the obligations set out within this section.

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

We see no reason to object to the proposed principle. However, the wording "an explanation of the company's executive pay policy" seems to fall short of capturing pay that is made at the group level (as is the case at United Utilities as stated above) or elsewhere.

Although it is not technically 'company' pay, this group level pay nonetheless relates predominantly to the performance of the regulated company.

In summary, in order to clearly reflect arrangements at UUG we suggest the wording '..and they hold responsibilities elsewhere in the group, pay policies should...' be amended to '..and they receive remuneration for these responsibilities at the group level or elsewhere, all such pay policies should...'. For companies with more complicated corporate structures, it may be necessary to set out a more expansive definition.

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

While we have no 'in principle' objection to this proposed principle, for the reasons stated above, we would want the flexibility not to require sub committees to the board of the regulated company. In addition, we also believe that there are matters relating to the operation of the regulated business that are rightly the concern of the parent company and that the parent company must have some control over the operation of the regulated company. We do accept that matters reserved for parent companies should be identified and the reasoning explained. By way of example, the UUG board currently has oversight of major capital expenditure where it materially increases the parent company's risk profile. Without this ability, the UUG board members would arguably not be discharging their individual duty to UUG as a company, in accordance with s172 of the Companies Act 2006. See schedule of matters reserved for decision by the board, https://www.unitedutilities.com/globalassets/z_corporate-site/corporate-governance/03---schedule-of-matters-reserved-for-decision-by-the-board.pdf.

We would add that any principle that is aimed at binding the parent company board should be considered in the context of Condition P parent undertakings rather than attempting to impose new obligations in the principles alone. This should avoid problems with enforcement either now or as the principles evolve over time because it can be legally problematic for a subsidiary to have to procure obligations from its parent company.

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

We broadly support the principle behind the focus on board effectiveness, subject to the comments above on board committees at the regulated company level.

We certainly support the view that independent board members bring valuable experience and challenge to the operation of a company.

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?

United Utilities supports the requirement for independent board members, however we believe that there should be some flexibility in requiring chairs to be independent on an ongoing basis.

Whilst a chair may be considered independent on appointment, it is generally considered that this independence wanes over time. This is because the FRC Code recognises the hybrid nature of the chair's role, spanning both the executive and non-executive. Indeed, the FRC Code excludes the chairman from the requirement that a majority of the board comprises non-executive directors.

We believe that there is benefit to having a chair in place who understands the water industry through experience. We recommend that Ofwat adopts an alternative approach whereby if the majority of the board, excluding the chair, comprises non-executive directors, then the chair need only be independent on appointment (as per the FRC Code on board composition). If, on the other hand, there is not such a majority of independent NEDs on the board, then the chairman should be independent on an ongoing basis.

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)?

Provided that the proposals allow alternative approaches to be followed, as proposed in the consultation, we believe that the proposed principles will meet these aims very well.

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

While we do not object to this proposal, we do not feel such a requirement is necessary given that the 'comply or explain' approach works perfectly well in the FRC Code.

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 Ofwat proceeds with a formal licence amendment, then we support both the inclusion of an appeal mechanism and a change process.

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

Within Licence condition P there are sections that, depending on the final requirements flowing from this consultation may require, and would benefit from, review and amendment.

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 would not object to the proposal that independent non-executive directors form the largest grouping on the board, but we do not believe that a formal licence change is necessary, but that this requirement should simply be incorporated into the principles.

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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 support the use of the same criteria for independence as set out in the FRC Code and specifically in relation to the chair, although we recommend that the chair be excluded from the independence test where the FRC Code on board composition is also being adopted. We don't see any merit in setting an alternative approach, rather it would be up to companies to explain why an alternative approach meets or exceeds the spirit of the principles, as is proposed.

For example, as long as the overall activities and interests of the parent company and the regulated company remain closely aligned and this is carefully explained, we believe that common board membership between parent companies and wholly owned regulated companies (as is the case at United Utilities) should continue to be permissible under the new principles, without impairing independence.

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?

As a company who already includes a majority of independent non-execs on our board, we would not object to either proposal, but it should be a sub-principle allowing for flexibility, rather than a prescribed licence condition.