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Dear Rachel

Wessex Water Services Response to Ofwat Consultation on revised Board Leadership and Governance Principles

Thank you for the opportunity to respond to this consultation. We understand the background context and that the behaviours of some companies have precipitated it and are keen to continue to work with you to support good governance across the industry.

Summary

We agree that water companies need strong governance structures so that decisions are taken in the long-term interests of the company and all its stakeholders.

Company boards must have the right mix of high quality directors that enable the board to act independently and exclusively in the interests of the business and its stakeholders.

Whilst we broadly support the objectives and principles you have set out, we believe that endeavouring to incorporate them into our licence is not appropriate and could lead to regulatory uncertainty and unintended, adverse outcomes.

Current arrangements

Our current licence requires us to act as if we are a separate public limited company, having particular regard to:

- FRC guidance on good governance, including the need to explain our reasoning where we do not match the guidance
- a Board composition that enables it to act independently and exclusively in the interests of the Appointee.

As a private company we will take full account of the recommendations of the Wates review as we continue to adapt our governance to meet future challenges.

Company law requires directors to act having regard to the interests of all its stakeholders and, as a company providing an essential public service, we have always considered this a moral as well as a legal duty.

Our existing governance arrangements are in our view consistent with your main principles and objectives of good governance, and as a consequence, over the long term we achieve high quality outcomes for customers, environment, investors and all our stakeholders including:

- a long-term improvement in customers' views about the fairness of our charges
- high levels of customer trust
- industry leading environmental performance
- leakage targets met every year, leakage reduced by more than 50% since privatisation and no restrictions on customer use of water
- continuing outperformance of the regulatory deal through a focus on efficiency
- leadership of innovation in the sector.

Proposed licence changes

Whilst we understand the background context, we do not agree it is necessary or appropriate to import the suggested main principles and objectives into our licence.

We support your approach that meeting the principles should continue to be on a comply or explain basis, and this is consistent with the approach adopted by the FRC. The principles however, are broadly expressed and susceptible to different interpretation depending on the circumstances and this creates regulatory uncertainty.

Moreover, meeting the sub-principles would require changes to our governance arrangements which, in our view, would be inappropriate and in some cases detrimental to good governance. In particular, they could increase the size of the board, making it less effective. We note that the Wates review highlights that a one-size fits all approach is not appropriate and our board composition has evolved over time to meet changing requirements.

FRC guidance is written for companies which are likely to have a dispersed ownership structure, but still allows companies to explain reasons why they do not comply with the guidance. A chair appointed by a sole shareholder is clearly in a position to have regard to the sole owner's interests, but this is always subject to acting in the interests of members as a whole to promote the success of the company. In instances where the shareholder base is highly concentrated, the requirement for a chair to be independent of investors is not a prerequisite and the protection of all members' and stakeholders' interests can be achieved through other means, particularly given each director's wider responsibilities.

The key therefore is to have non-executive directors with the necessary skills, experience and knowledge to act and influence independently. Companies should ensure that no one individual or group of individuals is able to dominate board decision making, and our current arrangements are such that no group is larger than the independent non-executives. Any material disagreement between the board and an independent director or the independent directors collectively in our view would lead to significant scrutiny, including from Ofwat.

We support the proposal that new directors meet Ofwat as part of their induction process and similarly we have welcomed the opportunity for our Board to meet new independent directors of Ofwat. However, care should be taken to avoid creating the impression, and even more important the reality, that an external body has a veto over any individual appointment.

We answer your specific consultation questions in the attached appendix.

Very best wishes,

A large black rectangular redaction box covering the signature of the Managing Director.

Managing Director

Appendix: Wessex Water Services Ltd - Responses to consultation questions

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

Subject to the comment below, we broadly agree with your main principles and the objectives behind them, but, as explained in our covering letter, not that they should be imported into the licence.

We suggest principle four may benefit from greater clarity on the purpose of independence, namely that it is a board's role to act in the interests of the company and its members as a whole taking into the account the interests of other stakeholders. Each director has a duty under the Companies Act to act in a way that promotes the success of the company. And in practice, diversity of thought and relevant expertise outside of the executive assists a board to act independently in furthering this interest.

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, but it is worth noting this is very substantially already provided for in Company Law, FRC Guidance and Codes and in the Wates proposals.

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 agree that companies should explain how their governance approach meets the main principles. "Unable to comply" suggests that the company is being constrained from taking a best practice approach. We don't think that this acknowledges that companies could choose alternative approaches in line with their ownership structure that can equally deliver good governance and outcomes.

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

Broadly yes, but again we do not believe these should be incorporated in our licence.

The words 'monopoly supplier' need to be tempered to ensure it does not deter the very innovation that Ofwat wish to incentivise and we are seeking to find. For example, Companies should be able to set strategies that promote more market-based approaches rather than assume the status quo will remain.

We note that the 2018 FRC Code and related Guidance issued after this consultation now includes a requirement for boards to satisfy themselves that purpose, values and strategy are aligned with culture. Given that the Licence requires water companies to follow the FRC Code/Guidance then it would be useful for any references here to be aligned.

Under principle 2.1 we recommend substituting 'those it serves' with 'all its stakeholders recognising the importance of customers and the environment'. This keeps the principle in line with the Company law obligations placed on directors, while acknowledging the particular status of the environment alongside customers for the industry.

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

We agree, but these need not be included in our licence.

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

Largely yes, but disagree that these need to be in our licence.

We consider that good governance in procedural terms will require a board to retain the ability to delegate authority to sub-committees for detailed consideration and review and for reaching decisions which are then reported back to it with recommendations for endorsement. This does not reduce the accountability of the board for those decisions.

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

FRC guidance is written for companies which are likely to have a dispersed ownership structure, but it still allows companies to explain reasons why they do not comply with the guidance. A chair appointed by a sole shareholder is clearly in a position to have regard to the sole owner's interests, and this is always subject to acting in the interests of members as a whole to promote the success of the company. All directors are obliged to have regard to the interests of other stakeholders in the company, including employees, suppliers, customers and others and moreover to have regard to the impact of the company's operations on the community and the environment. In our view, in instances where the shareholder base is highly concentrated, the requirement for a chair to be independent of investors and shareholders is not a prerequisite and the protection of all members' and stakeholders interests can be achieved through other means.

We also note that a requirement for the chair to be independent of management and investors appears to be inconsistent with broader FRC guidance. This requires the chair to be independent on appointment but does not count the chair among the independent directors thereafter. This recognises the unique position of the chair. They are of course expected to exercise objective judgment throughout their service having a detailed understanding of the business but in so doing inevitably will need to form effective working relationships with the CEO and other executive directors.

The key therefore is to have a sufficient number of suitable non-executive directors with the necessary skills, experience and knowledge who do meet the full independence requirements to act and influence independently and hold the board to account as a whole in discharging its obligations under the law and regulation. A particular aspect here is to ensure that no one individual or group of individuals is able to dominate board decision making. Our current arrangements are such that no group is larger than the independent non-executives.

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?

For the reasons articulated elsewhere we do not believe that an independent chair should be a licence condition.

Neither do we believe that additional mitigations are necessary, over and above the demonstration of good standards of governance overall, most particularly evidenced by high quality outcomes for customers and other stakeholders over the long-term.

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 do not think they offer companies enough autonomy and flexibility. We would prefer a requirement for companies to report against how they had sought to meet the main principles and their objectives in their governance structures.

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

We believe this is inappropriate and unnecessary in our case. We consider that the existing licence requirements, the duties imposed under the Companies Act and a strong principles-based approach to regulation will leave us better placed to adapt our governance approach to future circumstances and to continue to deliver high quality outcomes for customers and stakeholders.

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

We do not agree with the proposed licence change. Were a licence change to be made, we would prefer the grounds of appeal to be that Ofwat had not shown that the existing principles were against the public interest.

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

We are not aware of any at this point.

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

No. The requirement for independent directors to be the largest group on the Board we believe underestimates the power of independent non-executives as individuals and collectively.

Any independent director resignation can be expected to lead to significant scrutiny as to the circumstances of the resignation. It might give Ofwat reasonable cause to investigate these circumstances and whether there was any associated breach of regulatory requirements.

We also note that good governance itself may also be more difficult to achieve in practical terms if the number or people on a board increases materially.

Our current governance arrangements ensure that no individual or group is able to dominate board decision making and ensures that no group is larger than the independent non-executives.