



YorkshireWater

Board leadership, transparency and governance consultation
Ofwat
21 Bloomsbury Street
London
WC1B 3HF

Yorkshire Water
Western House
Halifax Road
Bradford
West Yorkshire
BD6 2SZ

By email: FinanceAndGovernance@ofwat.gsi.gov.uk

21 August 2018

Dear Sir or Madam

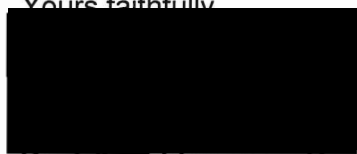
Consultation on revised Board Leadership, Transparency and Governance principles

Thank you for the opportunity to contribute to your consultation on proposals to update the existing Board Leadership, Transparency and Governance (BLTG) principles.

We acknowledge this consultation is part of the important wider programme of work to help improve public and stakeholder trust and confidence in the sector in England and Wales. We also believe it is timely to review the BLTG principles against the evolving corporate governance landscape in the UK. We would make particular reference to the Financial Reporting Council's review and consultation on proposals to revise the UK Corporate Governance Code, which recently published its outputs.

We are supportive of many of the principles set out in the consultation paper and would be willing to work with you further on these. We have, however, highlighted some concerns in our detailed response which are contained within the attached Table 1.

Yours faithfully



Director of Finance, Regulation and Markets

Enc.



Table 1

Yorkshire Water response to the consultation on revised Board Leadership, Transparency and Governance principles.

Section 1 – Introduction and objectives	
Q1.	<i>Do you agree with the objectives for the principles we have set out (in Table 1 of this chapter)?</i>
A1.	<p>We are supportive of the principles regarding:</p> <ul style="list-style-type: none"> • Purpose, values and culture; • Board leadership and transparency; and, • Board effectiveness. <p>We are also broadly supportive of the standalone regulated company principle, for further comment in relation to this principle please see our response to A6.</p>
Q2.	<i>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?</i>
A2.	Yes.
Q3.	<i>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?</i>
A3.	We agree with the 'comply or explain' approach proposed. We would welcome a discussion with Ofwat on how it would review any explanations of deviations made by companies, and whether it plans to put in place a dispute resolution procedure for the scenario where it considered an explanation of a company's different approach did not meet the spirit of the relevant principle. Please see our response to Question 11 regarding the appeals mechanisms associated with the proposed licence requirements.
Section 2 – Proposed principles	
Q4.	<i>Do you agree with our proposed principle for purpose, values and culture?</i>
A4.	Yes.
Q5.	<i>Do you agree with our proposed board leadership and transparency principle?</i>
A5.	Yes.
Q6.	<i>Do you agree with our proposed principle for the stand-alone regulated company?</i>
A6.	The revised principle for the stand-alone regulated company contains much that we can support.

	<p>Sub-measure iv. requires clarity on the reference to conflicts of interest resulting from significant shareholdings, for example where an interest occurs that may not be aligned with that of the company for a specific matter, then the relevant director should declare it and excuse themselves from voting on that matter. This should not affect the overall business of the board. However, this could, in practice, become a significant issue and it is for this reason we have suggested further clarity is required.</p> <p>We also note that our structure is working very well as evidenced in the 2017 Company Monitoring Framework Assessment, where Yorkshire Water was the only company assessed as exceeding expectations and it has evolved to include shareholder directors at the company level. We believe it is important that shareholders maintain a meaningful role on a board as participation has real value to the company. Furthermore, we note the potential conflict between Ofwat's revised principles and the Companies Act 2006 relating to directors' duties.</p> <p>We reserve our position in this regard subject to the precise wording of the drafting of the principle</p>
Q7.	<i>Do you agree with our proposed board effectiveness principle?</i>
A7.	<p>We support in general the revised board effectiveness principle proposed.</p> <p>For complex businesses with specialised regulatory requirements and customers and stakeholder interests to protect, water company boards rightly require a balance of skills, independence, knowledge and experience. Non-executive directors also require the time to fully understand the business and its operating environment to enable them to provide the appropriate challenge. We support the continuation of the sub-measures on board performance evaluation and new board appointments. We do not object to the formalisation of the current practice where the final candidate for a new non-executive board member appointment to meet with Ofwat ahead of being formally appointed.</p> <p>We support the continued focus on the level of independent membership of the audit, nomination and remuneration committees.</p>
Q8.	<i>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?</i>
A8.	We support the principle for an independent chair however please see our response to Question 10 and 13 with regards to whether this should be a licence obligation, be that stand-alone or at all.
Q9.	<i>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)?</i>
A9.	In several areas, the new proposed principles are an evolution and rationalisation of the existing BLTG principles.

Section 3 – Proposed licence changes	
Q10.	<i>Do you agree with our proposal to insert a requirement in companies' licences that they must meet the principles?</i>
A10.	<p>We are supportive of many of the principles but do not agree that they should be embedded in a legal framework. We consider that a general licence requirement is unnecessary to ensure compliance, lacks the flexibility to reflect evolving best practice and requires a significant re-writing of the current licence to avoid duplication and inconsistency.</p> <p>Yorkshire Water strives to adhere to best practice in corporate governance and compulsion through a licence requirement is unnecessary to ensure compliance. The structure already in place in Yorkshire Water is extremely effective. As was noted in the Company Monitoring Framework Assessment in 2017, Yorkshire Water was the only company assessed as exceeding expectations in the “compliance with our principles of board leadership, transparency and governance” category. This category considers, amongst other areas, if there is “evidence that the board of the regulated company has full control over the company, including its long-term strategy, and is fully focused on its obligations”.</p> <p>Having a licence requirement would decrease flexibility, as any future changes to the proposed principles would be subject to a modification process and appeal mechanism.</p> <p>Yorkshire Water would consider that any licence requirement that mandated compliance with “principles from time to time” would not meet the requirements of fairness, certainty and good process. As described in our response to Question 12, any new licence requirements would need to fit with current overlapping provisions of the licence making the process complicated and perhaps giving rise to unforeseen consequences and issues.</p> <p>The most effective way of addressing the undisputed need for compliance with the principles would be through authoritative guidance from Ofwat.</p>
Q11.	<i>Do you agree with our proposal for an appeal mechanism and a change process in the proposed licence condition to meet the principles?</i>
A11.	As we do not agree with the proposal for a licence condition we have not responded to this question.
Q12.	<i>Are there specific instances where individual companies' licence conditions might conflict or overlap with the revised principles?</i>
A12.	Yes. By way of example, paragraph 6 of Condition F (in particular paragraph 6A.5A) and paragraph 1(2)(c) of Condition P of our licence overlaps with the revised principles.
Q13.	<i>Do you agree that we should insert a requirement in companies' licences that independent non-executive directors should be the single largest group?</i>
A13.	We support your views on the need for independent challenge and judgement on boards and the various benefits that independent directors clearly bring. We support

	<p>the principle that independent non-executive directors should be the single largest group however we do not think it is necessary for this to be in the licence. As the consultation acknowledges, increasing the number of independent non-executive directors does not by itself, lead to a better functioning board. We believe that the benefits independent directors bring are not achieved through numbers alone but is reliant more generally on the quality and robustness of the challenge and judgement they provide. It would therefore be more appropriate for any requirement as to their numbers to be addressed outside of the licence as there may well be instances where it is not practicable or indeed in line with good governance procedures for non-executive directors to be the single largest group. Please see also our response to Question 15 particularly the reference to the potential for unwieldy board sizes which must be considered and particularly, the implementation of such a condition in practice.</p>
Q14.	<p><i>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?</i></p>
A14.	<p>Yes, we agree with your proposal to use the criteria for independence as set out in the UK Corporate Governance Code. As stated in the consultation, this is a widely applied, accepted and understood test.</p>
Q15.	<p><i>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?</i></p>
A15.	<p>Please see our response to Question 13. We agree with your comment that there is a place for investors on regulated company boards but that any requirement for a majority of independent directors could lead to unwieldy board sizes. This has the potential to decrease board effectiveness. We therefore do not believe that there should be a requirement for independent non-executive directors to be the majority on the board.</p>

End

