

Consultations under section 13 and 17IA of the Water Industry Act 1991 on proposed modifications to the licence conditions of 17 water companies and Bazalgette Tunnel Limited (trading as Tideway) to include the Board leadership, transparency and governance objectives

About this document

This document invites comments on our proposal to modify conditions of appointment (licences) of the 17 largest regulated water companies (appointees) in England and Wales and the only licensed infrastructure provider (Bazalgette Tunnel Limited, known as Tideway) (collectively referred to as 'companies' in this document).

We are proposing to insert a requirement into licences that companies must meet the objectives of the [Board leadership transparency and governance principles](#) which were published in January 2019 (the '2019 principles').

Under section 13 (or 17IA for Tideway) of the Water Industry Act 1991 (WIA91), we are able to modify the conditions of a company's licence if it agrees to the changes we are proposing to make.

This document and the attached appendices is a Notice under sections 13 and 17IA of the WIA91.

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1. Introduction

1.1 Background

We first introduced board leadership, transparency and governance principles for companies in January 2014. These principles aimed to give companies ownership and drive noticeable improvements in their governance arrangements. We expected companies to meet these principles on a voluntary basis through either complying with them or explaining why they had taken an alternative approach. When some companies¹ underwent structural changes, we took the opportunity to introduce a requirement into their licences that obliges them to meet the principles on a 'comply or explain' basis.

In July 2018 we reviewed the 2014 principles, considering the evolving corporate governance landscape and taking into account the position and role of regulated water companies. We [consulted](#) on consolidating the principles for regulated and holding companies into a single set of revised principles for regulated companies. Reflecting their importance, we proposed that all companies have a licence obligation to meet the principles.

In January 2019 we published our [conclusions](#) on revising the principles and an updated set of principles. We consolidated the "objectives" and "main principles" that we consulted on into a single set of overarching objectives. In order to better focus on what we are trying to achieve, we clarified that it is these objectives that companies must meet and provide explanations for how they have done so. We also published some draft text for the licence condition.

Since then we have engaged with companies on the draft licence obligation and made some changes to improve the overall structure and drafting of the condition. Almost all companies have now indicated their agreement in principle to the proposed licence condition and we are now requesting formal consent from all companies to proceed with the licence modification.

¹ Hafren Dyfrdwy, Portsmouth, Severn Trent, South West Water and Thames Water

1.2 Applicability to new appointees

As we explained in the [Board leadership, transparency and governance – principles](#), it may not always be proportionate for smaller companies (new appointees or NAVs) to meet the principles. We do therefore not propose to make a modification to the licences of these companies. However we expect them to demonstrate exemplary governance and to meet the principles wherever possible.

2. What are the changes that we are proposing?

2.1 Proposed new licence text

We are proposing to insert² into companies' licences a requirement to meet the four objectives of the board leadership, transparency and governance principles and to explain how they are meeting these objectives. These four objectives are set out in the [board leadership, transparency and governance – principles](#) document together with guiding provisions which accompany each objective.

We set out the proposed licence text in the box below. The requirement set out in paragraph x.1 is not a new requirement, and it already exists in all companies' licences. We consider that this is a core requirement which underpins much of what the objectives of the 2019 principles aim to achieve. Therefore we do not propose to remove or change this provision. Tideway has this requirement in a slightly different form to other companies. We propose not to change Tideway's requirement either and therefore the text in paragraph x.1 will not be inserted into Tideway's licence.

Proposed text for appointees

- x.1 The Appointee must, at all times, conduct the Appointed Business as if the Appointed Business were:
 - x.1.1 substantially the Appointee's sole business; and
 - x.1.2 a public limited company separate from any other business carried out by the Appointee.
- x.2 The Appointee must:

² This text will be inserted into Condition P for Hafren Dyfrdwy, Portsmouth, Severn Trent, South West Water and Thames Water and Condition I for other companies. The exact wording for insertion into Tideway's Condition K is set out in Appendix 2.

x.2.1 meet the objectives on board leadership, transparency and governance set out in paragraph x.3, and

x.2.2 explain in a manner that is effective, accessible and clear how it is meeting the objectives set out in paragraph x.3.

x.3 The objectives are:

x.3.1 The Board of the Appointee establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

x.3.2 The Appointee has an effective Board with full responsibility for all aspects of the Appointee's business for the long term.

x.3.3 The Board of the Appointee's leadership and approach to transparency and governance engenders trust in the Appointee and ensures accountability for their actions.

x.3.4 The Board of the Appointee and its committees are competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that address diverse customer and stakeholder needs.

We have decided to include the full text of the objectives on the face of the proposed licence condition to enhance clarity. This is a change from the proposed text which was included in [Board leadership, transparency and governance – conclusions on revising the principles](#) in January. The approach of including the objectives in the licence condition means that that revisions to the objectives would be subject to the usual licence modification process under the WIA91.

2.2 Existing conditions

2.2.1 Companies with an existing requirement to meet the principles

As explained above, five companies (Hafren Dyfrdwy, Portsmouth, Severn Trent, South West Water and Thames Water) have a requirement to meet the principles in their licences. This requirement was introduced into these companies' licences in connection with the 2014 principles. The 2014 framework was based on principles with supporting expectations which companies could meet by either complying or explaining why an alternative approach was appropriate. This differs from the new framework where companies must meet the objectives, which are supported by guiding provisions.

We propose to replace these companies' existing requirement with the new licence wording to ensure consistency across all companies. Because we are proposing to include the objectives on the face of the licence condition there will no longer be a provision for these five companies to ask us to refer any revisions to the principles to the Competition and Markets Authority for determination. Instead any future changes to the objectives would be subject to the usual licence modification process by agreement.

An illustrative example of the requirements which we are proposing to remove for these five companies is set out in Appendix 1.

2.2.2 Other companies

Those companies which do not have an existing requirement to meet the principles, have some other requirements relating to governance and conduct in their licences which we are proposing to remove. These are set out in detail in Appendix 1.

We consider that these requirements overlap with the 2019 board leadership, transparency and governance framework and proposed licence requirement to meet the objectives within that framework. These existing requirements are sufficiently covered and enhanced by the new framework and we consider the new framework does not fundamentally alter the expectations on companies and is a more proportionate and appropriate way of achieving their aims.

3. What is the impact of our proposals?

The proposed modification will mean that a company must meet the four objectives of the board leadership, transparency and governance principles and explain in an effective, accessible and clear manner how it is meeting the objectives.

If a company fails to do either or both of these things this could constitute a breach of its licence. Our [approach to enforcement](#) document provides the framework for addressing non-compliance with licence conditions, including dealing with temporary non-compliance, in a proportionate and targeted way. While companies are responsible for meeting the objectives, we would expect to have dialogue with companies where they may fall short.

[Board leadership, transparency and governance – principles](#) sets out how we will review how companies have met the objectives. It contains the overall principles framework, of which the objectives are a key part, including the role of the guiding provisions. For the avoidance of doubt we recognise that all provisions will not necessarily be met in all cases. There may be limited (temporary or more permanent) circumstances where a company's approach is not in line or even conflicts with a provision. Where this is the case, companies should fully explain how their arrangements overall successfully deliver the objectives.

We consider that detailed reporting requirements are best conveyed outside the licence itself and have therefore not attempted to set these out in the licence text. As we said in our January 2019 [conclusions on revising the principles](#), companies should ensure they explain how they are meeting the objectives in their annual reporting and elsewhere so that customers and other stakeholders are able to hold them accountable. In doing so, companies should report each year how they have met the objectives in the previous reporting year. As we have done previously, we will incorporate this in our annual information notice which sets out our expectations for companies when producing their annual reporting.

We would also expect companies to ensure key information is kept up to date and made available throughout the year to demonstrate how they are meeting the objectives. This should also ensure companies are well placed to meet the objective on board leadership and transparency – particularly that their approach to transparency engenders trust and ensures accountability.

4. Reasons for making changes

We explained in our January 2019 [conclusions on revising the principles](#) the reasons why we considered that introducing a licence requirement was necessary.

We consider that it is no longer sufficient that the important issue of the standards of board leadership, transparency and governance which companies adhere to is dealt with by principles that sit outside the licence framework. There is an imperative to include a licence condition to prompt a step change to ensure that boards give regular consideration to how the objectives are best served and delivered.

Additionally, we consider the licence obligation for all companies is necessary to ensure consistently high standards of board leadership across the sector and so that the objectives of the principles will continue to be met as boards and investors change over time.

In our view, a licence obligation to meet the objectives is a better long-term tool for driving accountability and responsibility for delivering our underlying objectives than the current approach.

5. Next steps

Most companies have already indicated their agreement in principle to the proposed modifications. We look forward to receiving formal agreement from all companies by 14 June 2019 to the proposed modifications to ensure consistency across the sector so that all companies are held to the same, high standards. Subject to agreement, we aim to amend licences in the summer.

6. Responding to this consultation

We invite stakeholders to comment on our proposed modifications by **14 June 2019**. Companies should also indicate their agreement or otherwise of the proposed modification by this date. You can email your responses to FinanceAndGovernance@ofwat.gsi.gov.uk or post them to:

Finance and Governance
Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA.

We will publish responses to this consultation on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information³, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the General Data Protection Regulation, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our [Privacy Policy](#).

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory 'Code of Practice' which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

³ See [General Data Protection Regulation definitions](#)

Appendix 1 – existing licence conditions proposed for removal

We set out below the existing licence conditions that we propose to remove from companies' licences and replace with the proposed condition set out earlier in this document.

Appointees with an existing obligation to meet the principles

This is an illustrative example only. The exact wording of the condition which we are proposing to remove varies between companies.

Condition P

- 2.1 The Appointee must, at all times, conduct the Appointed Business as if the Appointed Business were:
 - (a) substantially the Appointee's sole business; and
 - (b) a public limited company separate from any other business carried out by the Appointee.
- 2.2 The Appointee must meet the corporate governance principles issued by Ofwat and revised from time to time.
- 2.3 The Appointee will demonstrate, in an appropriate manner, how it is meeting the principles referred to in paragraph 2.2.
- 11.1 Where the Authority gives notice to the Appointee that a revision is to be made to the corporate governance principles referred to in paragraph 2.2 the Appointee may, by notice given to the Authority within one month of such a notice, require the Authority to make a reference to the Competition and Markets Authority for it to determine whether the revision is reasonable and appropriate for the purposes of this Condition.
- 11.2 Where the Authority has made a reference to the Competition and Markets Authority pursuant to paragraph 11.1, the revision which is the subject of

the reference shall not take effect unless the Competition and Markets Authority determines that the revision is to take effect, in which case the revision shall take effect on such a date as the Competition and Markets Authority may determine.

Appointees without an existing obligation to meet the principles

This is an illustrative example only. The exact wording of the condition which we are proposing to remove varies between companies.

Condition I

- I26 The Appointee shall, at all times, conduct the Appointed Business as if it were substantially the Appointee's sole business and the Appointee were a separate public limited company. The Appointee should have particular regard to the following in the application of this Condition:-
- I26.1 the composition of the Board of the Appointee should be such that the directors, acting as such, act independently of the parent company or controlling shareholder and exclusively in the interests of the Appointee;
 - I26.2 the Appointee must ensure that each of its Directors must disclose, to the Appointee and the Water Services Regulation Authority, conflicts between duties of the Directors as Directors of the Appointee and other duties;
 - I26.3 where potential conflicts exist between the interests of the Appointee as a water and a sewerage undertaker and those of other Group Companies, the Appointee and its Directors must ensure that, in acting as Directors of the Appointee, they should have regard exclusively to the interests of the Appointee as a water and a sewerage undertaker;
 - I26.4 no Director of the Appointee should vote on any contract or arrangement [or any other proposal] in which he has an interest by

virtue of other directorships. This arrangement should be reflected in the Articles of Association of the Appointee;

I26.5 the Appointee should inform the Water Services Regulation Authority without delay when:

I26.5.1 a new Director is appointed;

I26.5.2 the resignation or removal of a Director takes effect; or

I26.5.3 any important change in the functions or executive responsibilities of a Director occurs.

The Appointee should notify the Water Services Regulation Authority of the effective date of the change and, in the case of an appointment, whether the position is executive or non-executive and the nature of any specific function or responsibility;

I26.6 the dividend policy adopted by the Appointee and the implications of sub-paragraph 6.12 of this Condition F; and

I26.7 the Principles of Good Governance and Code of Best Practice (or any successor document having a similar purpose and content) as may from time to time be incorporated into or approved for the purposes of the Listing Rules of the Financial Conduct Authority.

Condition P

1(2)(c) those persons providing the undertakings will ensure that at all times the Board of the Appointee contains not less than three independent non-executive Directors, who shall be persons of standing with relevant experience and who shall collectively have connections with and knowledge of the areas within which the Appointee holds the Appointment and an understanding of the interests of the customers of the Appointee and how these can be respected and protected.

Tideway

Condition K

- 2.2 The Infrastructure Provider should have particular regard to the following in the application of paragraph 2.1:
- (a) the composition of the Board of the Infrastructure Provider which should be such that the directors of the Infrastructure Provider act exclusively in the interests of the Infrastructure Provider and independently of the Ultimate Controller and any United Kingdom Holding Company of the Infrastructure Provider;
 - (b) the Infrastructure Provider must ensure that its Directors disclose, to the Infrastructure Provider and to the Authority, any conflict between a director's duties as such a director and any other duty held by that Director;
 - (c) where the interests of the Infrastructure Provider have the potential to conflict with the interests of a Group Company, the Directors of the Infrastructure Provider must have regard exclusively to the interests of the Infrastructure Provider in carrying out their duties;
 - (d) a Director of the Infrastructure Provider may not vote on a decision of the Board where that Director has an interest in the decision by virtue of another directorship. This arrangement must be underpinned by the Infrastructure Provider's articles of association;
 - (e) the dividend policy adopted by the Infrastructure Provider and the implications of paragraph 3 of this Condition; and
 - (f) the Principles of Good Governance and Code of Best Practice.
- 8.2
- (b) that the person giving the undertaking must ensure that, at all times, the Board of the Infrastructure Provider includes not less than three independent non-executive directors, each of whom must be a

person of standing and have relevant experience, and whom must collectively have:

- (i) connections with and knowledge of the services to be provided by the Infrastructure Provider; and
- (ii) an understanding of the interests of customers and how those interests can be respected and protected.

Condition M

4.2 The Infrastructure Provider must notify the Authority as soon as possible where:

- (a) a new Director is appointed to the Board of the Infrastructure Provider;
- (b) the resignation or removal of a Director of the Board of the Infrastructure Provider takes effect;
- (c) there is an important change in the functions or executive responsibilities of a Director of the Board of the Infrastructure Provider.

4.3 Any notification given pursuant to paragraph 4.2 must include any relevant dates, whether the position involved is executive or non-executive and the nature of any function or responsibility.

Appendix 2 – proposed licence condition for Tideway

This is the same as for appointees, with appropriate references to the “Infrastructure Provider” instead of the “Appointee”. Note we do not propose to alter 2.1 of Tideway’s condition K.

To be inserted in condition K

2.2 The Infrastructure Provider must:

- x.2.1 meet the objectives on board leadership, transparency and governance set out in paragraph x.3, and
- x.2.2 explain in a manner that is effective, accessible and clear how it is meeting the objectives set out in paragraph x.3.

2.3 The objectives are:

- x.3.1 The Board of the Infrastructure Provider establishes the company’s purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.
- x.3.2 The Infrastructure Provider has an effective Board with full responsibility for all aspects of the Infrastructure Provider’s business for the long term.
- x.3.3 The Board of the Infrastructure Provider’s leadership and approach to transparency and governance engenders trust in the Infrastructure Provider and ensures accountability for their actions.
- x.3.4 The Board of the Infrastructure Provider and its committees are competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that address diverse customer and stakeholder needs.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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