



Speech

Given by Jonson Cox CBE, Chair
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Where the water industry has come from, hopes for where the water industry is heading

I shall leave here almost exactly ten years to the day since I received the offer to join Ofwat. I remember it, because I was given all of 48 hours to prepare for the Select Committee hearing!

A decade at Ofwat

My six guiding themes:

- Start with the customer
- Focus on the environment
- Financing of water companies
- Reform of Ofwat
- Fair outcome from regulatory review
- Effective leadership and governance

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At that hearing I sketched out six themes for Ofwat. I thought it might be worth revisiting those themes; they've guided me well and have been tested, implemented, and developed by my able colleagues.

The worry list in 2012 was not insignificant: the performance of the sector, the dynamic between regulator and regulated and concerns about the next regulatory review.

We'll go at pace through the six key themes, which were later published, in 2013, 'Observations of the regulation of the water sector' and have remained fundamental since.

Customers

Customer trust is hard won
and easily lost

We've seen some progress on
customer service, innovation
and transparency

But there is a road left to travel



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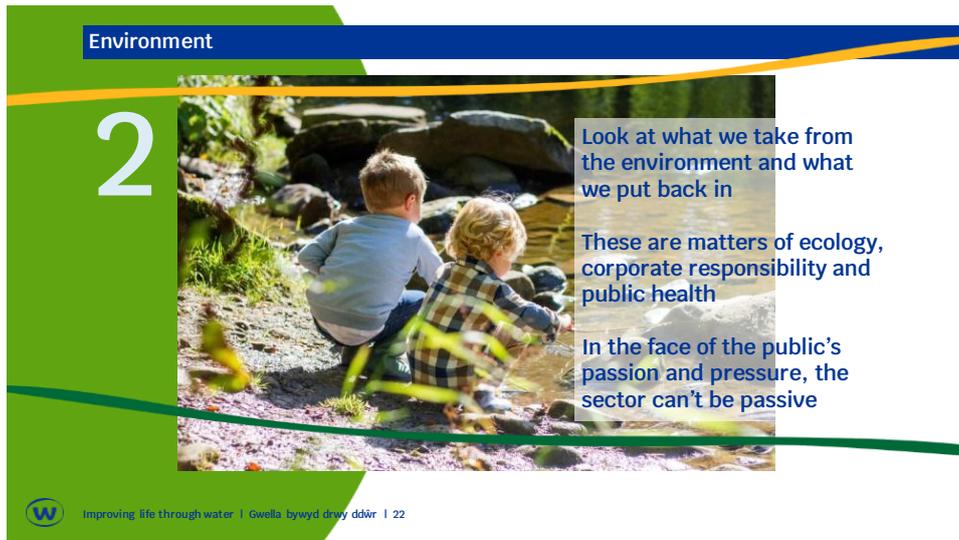
First, was the need to **start with customers**.

When I ran, successively, two water companies, I thought we really cared about customers and really were delivering a step change in service. That was a foundation stone for me in business and it would remain so in regulation.

But putting on an independent hat it looked different. In late 2012, customers were having a tough time. Cumulative inflation was high (3 years at 5%), energy costs were rising, and inflation had increased the equity value of regulatory asset base very substantially. The brunt of customer ire was taken by the six big energy retailers, from which their reputation has never recovered, in my view. Sound familiar? Plus ça change? Just a warmup for where we are now.

I cited the need to look at customer service relative to performance in competitive sectors, for more transparency and multi-channel engagement, and the need for innovation. I am pleased to see many improvements in that space.

The mantra that customer trust is hard won and easily lost remains valid today. That's why, just a few weeks ago, my colleague David Black wrote to companies about factoring in permit failures and river health in making remuneration decisions.



My second theme was a **focus on the environment**. I majored on two aspects: water resources and flooding. We had just endured a 16-month drought through to early 2012, followed, from March 2012, by the wettest 12 months since records began. An important priority was securing the reliable water sources future generations need – something the National Infrastructure Commission (NIC) subsequently endorsed in their work.

I am pleased with the progress underway on water resources, not least through our inter-company programme known as RAPID (and for which the principal credit must go to our previous Chief Executive, Rachel Fletcher).

Creating more water supply is also about cutting wastage through leakage. Our 2019 focus on leakage showed just what could be done, when the sector achieved half of our 15% five-year target in just one year.

There will be more action to further cut leakage because it is an essential show of leadership to get customer support for their behaviour change. We have one of the highest per capita consumptions in Europe. PCC, while increased through the pandemic, is an issue on which progress remains a priority

Water resources was a necessary focus at the time. Environmental challenges have evolved and there is now great pressure and attention on wastewater, river health and achieving net zero.

You're going to hear more about our focus on wastewater treatment, FFT, storm overflows – and the ideas and energy needed to meet public expectations in due course. We look forward to the plans on storm overflows which we have requested. Despite the rolling focus on it for months, that we have to ask for it is quite telling.

On net zero, I applaud the sector's firm ambitions on operational net zero. There are 7.5 years left until we reach that deadline, and I can say that we are also looking to the Government's 2035 aspiration that covers operational and embedded emissions.



My third theme was the **financing of water companies** where I questioned the sustainability of financing, with several companies' equities having shrunk below 30% of company financing compared to Ofwat's notional and prudent structure of 40%.

Some of you newer to the sector may wonder why we make so much of this. There was no sharing of financing gains between customers and investors. Some investors focused on the prospect of securing very attractive gains from aggressive financing models with annual dividend yields as high as 27%, and some companies reporting dividends in the mid-teens. Compare this to Ofwat's guidance for a reasonable base dividend yield of 4% for 2020-25.%.

It was no surprise that management time ended up disproportionately, and unacceptably, focused on financial returns –rather than where it needed to be on securing fair returns based on delivering for customers and the environment.

The introduction of ODIs and PCs were integral to change.

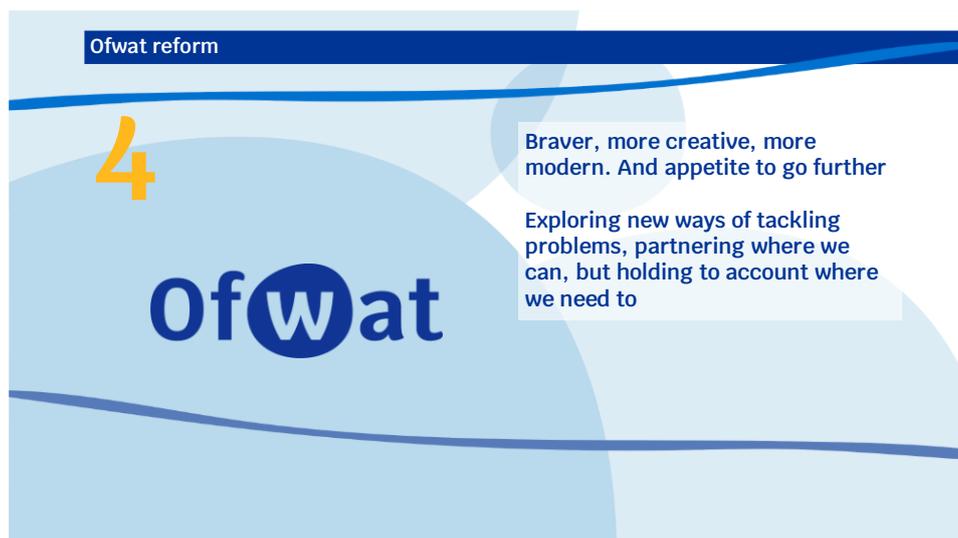
The biggest casualty so far has been Southern Water, where our intervention led to what Moody's has called a virtual special administration, enabling a massive injection of £1bn of equity into the group. Such is the price of failing to deliver. As the financial noose tightened, it is indisputable that customers suffered. And that's why our financial resilience agenda looking to require companies to maintain a higher investment grade credit rating and introduce cash lock-up conditions, matters.

By contrast and comparison, we see some of the top performing companies, the likes of Severn Trent and a few others, showing what it is possible to achieve, by focusing on delivering for customers and also raising new equity.

I divert for a moment to the state of comparative competition between companies, which has always been fundamental to Ofwat's regulation. Back in the 2000s and early 2010s, you could reliably predict who would rank well or badly: Wessex, Anglian and Yorkshire among the top; Severn Trent was stubbornly in the third quartile, and UU and Thames could be assured of a bottom quartile position.

I wanted to see more dynamism in the sector with poor companies pulling themselves up and stronger competition for the top places. I'm pleased Wessex and Anglian have maintained strong operating records, but it's been a delight to see Severn Trent really climb to a sector leading position, and, after years in the waiting, UU pulling up to gain a fast-tracked position, too.

It goes to show that there is now more dynamism in the ranking of companies - a good thing.



Fourth, was the need for the evolutionary **reform of Ofwat**. My colleagues in Ofwat have made real progress here. Today we are an organisation that is braver, more creative, more modern in its approach and well regarded in the regulatory community. This change has been led by Cathryn Ross, Rachel Fletcher and now David. The changes delivered are a testament to the team of committed, skilful public servants working for Ofwat.

One never reaches the end of that journey, and there always is more ground to travel. I believe my successor is coming into an organisation that is up for evolution and growth.

A decade ago when you asked about regulatory reform the answer was always competition. We were about to see the opening of the business market to competitive supply – and it remains a disappointment, but not unpredicted, how little innovation there has been.

We have harnessed competition in a different way, building on the success of the Thames Tideway Tunnel (TTT) model. We see real opportunities with the direct procurement avenue and are working behind the scenes with some companies with some expected major announcements that hopefully will come through soon.

I should applaud UU for the way it has embraced the DPC model and we hope the other pathfinder projects, such as Welsh Water's will do so too.

Six key themes: upcoming regulatory review

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More open and honest dialogue and focusing on price review as part of longer journey

Taking the best bits of past reviews and building

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Fifth, a **fair outcome from the upcoming regulatory review**. I know we are way more organised for PR24 than we were for PR14 back in 2012! There is always some grit between regulator and regulated and to an extent, it is necessary at times.

In terms of the future, Aileen has already touched on our aspirations for PR24 and I see this next price review as a staging point on a longer-term journey, building on the best parts of PR14 and PR19, but giving more continuity into PR29.

Effective leadership and governance

Wanted to play our part in empowering you

Vision was for higher calibre Boards, with more focused and intelligent scrutiny of their businesses – leading to reduced regulatory burden

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Finally, the last theme, was ensuring **effective leadership and governance** of the sector – something which became known as our BLTG agenda.

Ofwat had its own board improvements to make back in 2012. I want to thank all my board colleagues over the last decade for their unstinting contributions.

A wide range of people I spoke to back then, including management teams and investors by the way, raised serious concerns about board leadership and governance in companies. I had seen some of this first-hand myself.

What intrigued me was whether with better boards, could we – as a de-regulatory move – get boards to do a better job of scrutinising all parts of a company and, as a result, see the regulatory burden reduce?

In effect, I wanted boards of a higher calibre and to ask more of them in terms of posing challenges and questions about the running of the businesses. There has been a substantial change on that front.

I also want to pay tribute to the engagement there now is between companies' chairs and NEDs with Ofwat which helps us all. When I was a CEO in the sector, the CEO had a tightly held grip on the relationship with the regulator which sometimes became limiting.

The company-CEO: Ofwat-CEO remains the prime inter-relationship, but it's complemented by Chair: Chair relationship.

Openness in that relationship about emerging issues, management problems, licence non-conformance – have enabled us at Ofwat to be supportive when difficulties in companies arise. And it maintains our joint objective of trust and confidence in the way companies operate. I have enjoyed regular visits to, I think, almost every board in the sector.

The future: trust and confidence

Fundamental challenge is trust – on environment, for communities and as public service provider

By being proactive, open, diverse, embracing reform and showing what responsible business can do

I hope and believe you, the sector, can rise to the challenge. I am rooting for you to do so



As I offer my parting reflections and hopes, I am struck that the world looks so different, and yet there are two things that are disarmingly familiar.

1. As always, colleagues in water companies rise to operational challenges. At the start of the pandemic, there was understandable worry about whether water companies could deliver. I had no doubts: the sector would rise to the operational challenge and it did.
2. However, it is also clear that so many of the fundamental issues for the sector come back to the same theme: trust. Trust to look after the environment; trust to do the right thing by communities; trust to act with suitable responsibility for a public service monopoly provider.

In the BBC's recent series on the Blair-Brown years, there was one scene that I recalled vividly.

Just after the landmark '97 election. It was six months for me after joining Yorkshire Water. The incoming Labour Government imposed a £5bn windfall tax on utilities after 18 years of 'excess profits. There was a sense that these utility providers were not trusted – or to be trusted. They did not understand the public mood and were out of kilter with society's expectations. It was a price that investors had to pay.

When I watched that scene, and the political calculations around those corporate behaviours and the public reaction – maybe it is not a surprise it still had resonance some 25 years on when I think about our rivers.

My view is that for all its strengths – and brilliant people, too – the sector can be too slow, too insular, and at times too complacent to claim its rightful place as a responsible business and trusted sector. We need to be ahead of public opinion.

And really, that is all I've tried to do as chair of Ofwat. I've raised challenges, pushed boundaries, tried to look around corners, taken some initiatives.

I haven't always got it right; of course not. But I hope and believe we are in a better state today than we were a decade ago.

And as I leave Ofwat, I do so with a real sense of hope of what this sector can deliver for customers, communities, and the environment.

I know you can rise to the challenge and I will be rooting for you to do so.