

Response Form – "Rules on Remuneration and Governance" consultation

Please send your responses to: RemunerationGovernanceRules@ofwat.gov.uk by 19 November 2024

Name / Organisation: Bristol Water Challenge Panel

Sector: Water only Company, brand of South West Water

Date: 19 November, 2024

Rule: Performance related executive pay (PRP) prohibition

Question 1: Do you agree with our proposal in terms of which individuals the Rule would apply to? And what considerations do you think should be considered in designing the application of the Rule to different types of performance related pay?

Response:

A set of Rules based on encouraging water directors to change their company's culture to better align with customer expectations, especially as they change over time is an admirable objective. The best companies in the world are responsive and anticipatory of customer needs and wants, enabling them to provide the most apt products, services, customer service and more to their customers and likewise overcoming the offerings of their competitors. This closeness to customer needs, preferences, demands and preferences develops from the values of the business or service provider and how these values are translated in to practice on a minute-by-minute, daily, periodic or strategic timeframe. Companies or organisations serving diverse populations achieve excellence by being able to balance the needs of differing demographics or customer segments in a way that is fair, justifiable and acceptable to the widest number of individuals. When standards are met, it is acceptable to reward the performance of those driving through strategies, operational problems and/or making investments in assets. These statements apply to those companies regulated by Ofwat.

There are times, however, when encouragement is not sufficient to achieve regulatory standards where taking proportionate action may be required. Companies that act wilfully or intentionally, out of negligence, ignorance or lack of care or concern, for greed or other ill will should meet with Rules that can address the matter. Most

British companies, due to legislation in the Companies Act and other established laws, do comply with the standards expected of them. PRP is already an integral part of a company's corporate governance and is determined by their Remuneration Committees. Compliance with regulatory requirements is normally one of the performance indices in operation. Hence, the Rules under consultation will most likely apply to a small number of offenders.

The consultation, perhaps necessarily, strikes a punitive tone particularly as for at least two asset management periods the emphasis has been towards an economic system of water supply with less emphasis on asset investment. It could be improved by having a greater balance between positive and negative regulatory outcomes; a reference to historical assets and infrastructure; comparisons with comparable companies in the sector; with a greater emphasis on the need for flexibility around the causes of, and mitigations for, such breaches.

The unintended consequence may well be the creation of corporate cultures that are bullying, authoritarian and downright unpleasant places to work, leading to a lack of motivation among staff and the consequent inability to care about customer needs, experiences and priorities.

The standard does not take into account the age of the asset, pipes or network; the economic implications of replacement compared with repair when a longer term solution may be more cost effective in the long run; the pace of technological change or implementation of innovations that may have uncertain outcomes due to their novel nature (such as nature-based solutions using wildlife such as beavers to slow run-off); whether the cost is borne by current or future customers, the company and its shareholders.

It is unclear whether the standard refers to common outcomes, whether they are focused on the performance by a company on one or more outcomes and what the test will be to determine which one or ones will matter.

What will the threshold be for aged assets or legacy issues? When does the clock start – at privatisation, the current asset management period or a run-up to the next asset management period with time (and the regulatory financial envelope) to establish a baseline?

How will the breach be defined – length of pipe or other measure? What if the precise length of the measure is unknown as the location of many aged pipes could well be unknown.

What extenuating circumstances may apply? Again, there is a difference between poor management of an asset, deliberate lack of addressing a problem or where a range of polluters may be responsible for a spill (the EA recently published a chart setting out the percentage of spills arising from sewage outflows, agricultural, highways and other sources with water companies being a small fraction of the pollution).

Question 2: Do you agree that PRP should be prohibited if a company has been fined by Ofwat for a breach of a principal duty? Are there any alternatives or additions you would suggest for the "consumer matters" standard?

Response:

Given that the standards relate to 1) consumer matters, 2) the environment, 3) financial resilience of undertakers and 4) criminal liability of undertakers, the categories are far too broad and ill-defined at this point in the consultation.

Greater clarity is needed on the scope of each of the four categories. They overlap as, for example, consumers are concerned about the environment, whether it is the safety of the water on their local beach, nature-based solutions to reduce flooding or reaching Net Zero. Likewise, press coverage, media campaigns, ill-informed supposition and more regarding spills or overflows can adversely affect corporate credit ratings and hence the financial resilience of undertaker. Quarter Two C-Mex perception scores have dipped for Bristol Water (a water only brand) due to a myriad of reasons; some of which are probably due to recent campaigns regarding sewage and overflow spillage despite these not being within the purview of the company.

The sensitivity or threshold for withholding PRP is not set out in the paper. How is this threshold set and how does it increase or decrease? Consumer demands may be fickle or inconsistent across the country. Demand, which may require reservoirs or other means of increasing the water supply despite the scarcity of this natural resource, may exceed a reasonable cost to bill payers or realistic timeframe over which to achieve the standard. How is reasonable determined and defined? The dynamic

nature of any standard makes its implementation unpredictable and therefore in negative cases less acceptable. Who is the arbiter in these cases? How is fair, reasonable or proportionate defined?

Companies should be encouraged to benchmark against standards such as UK Customer Satisfaction Index or other well-known standards.

Tactical consumer matters could include access to recreational or leisure activities on appropriate company land; increases of biodiversity; information or knowledge for educational programmes in schools, colleges and universities; establishment of graduate leadership or apprenticeships, particularly for under-represented groups such as women, minoritized people; the establishment of public water fountains; skills partnerships with like-minded utilities companies; involvement with regional skills or social mobility initiatives; involvement with business organisations such as chambers of commerce, professional groups; partnerships with debt or vulnerability groups, local charities, medical charities, police; among other programmes. The Bristol Water Social Contract pioneered a range of initiatives, some of which have become business as usual.

Question 3: Do you agree that PRP in any given year should be prohibited where the company has had a serious pollution incident in the previous calendar year? Are there any alternatives or additions you would suggest for the "environment" standard?

Response:

Greater nuance is required regarding the awarding of PRP in the year where a serious pollution incident has occurred. A single serious category 1 incident in itself is awful and no one would wish this to go unchallenged or to become normalised. Carelessness is not an excuse! Companies should be encouraged to benchmark themselves against widely used standards, such as the UN Sustainability Goals or Environment Social and Governance standards, etc.

However, the establishment of the case for extenuating circumstances should be considered, perhaps based on the historical record of such an unusual nature of the event. As above, extenuating circumstances, historic and current performance, comparison with others in the sector, clarity around thresholds and their sensitivity would be most welcomed. The prioritisation of which assets to address first, either due to their alignment with customer priorities or to volume or intensity or to invest in

a different aspect of the company not within the standard concerned, may affect company decisions. How these priorities are balanced needs clarity, as it could lead to negative unintended consequences.

The definition of fair, reasonable, proportionate needs clarification.

As for the payment of PRP, best practice indicates that PRP should be paid in retrospect, say four to five years afterwards where appropriate, to allow for any investigations, root cause analyses or assurance to be carried out. Please note that some individuals in companies have voluntarily not taken PRP due to them because of poor performance related matters. This applies to the Chief Executive of the Pennon Group.

Any foregone PRP, for whatever reason, should be ringfenced to improve good causes or socially positive schemes. Such tactical environmental matters could include an increase in biodiversity on company land; tree planting or regeneration projects on company or community land; promotion of water resource conservation (say at public events such as county shows); practical programmes to encourage the public to implement water saving programmes (say the use of water butts to manage potential floods or to use in gardens); establishment of grey water solutions (say, to flush toilets); food growing workshops or other outreach programmes; wildlife-focused projects (say, growing elvers for release into the wild); partnerships with nature, wildlife or environmental groups; partnerships with Net Zero, B Corp or other environment focused bodies; partnerships on farming techniques resulting in less run-off, drought resistance or water management; among other programmes. The Bristol Water Social Contract pioneered a range of initiatives such as those above, some of which have become business as usual.

Question 4: Do you agree that the standard for financial resilience should be a minimum required credit rating and if so, at what level? Are there any alternatives or additions you would suggest for the financial resilience standard?

Response:

The timeframe for non-payment of PRP within one year following a breach of standards could be rather short. A more usual timeframe is to delay payments in cases of any infringement of the standard for four or five years, whether the individual

remains in the employ of the company concerned or not, to allow for any investigations, root cause analyses or assurance to be carried out.

Consumers are predominately ill informed regarding the financial arrangements for companies and consequently may be unaware of the implications of their demands, regardless of how sensible or beneficial such demands may be. Calls for on-payment of dividends, for example, may have the unintended consequence of impacting on a company's funding objectives. Similarly, customers that have attended company roadshows or programmes regarding business planning, performance or other matters have a greater understanding of why, how, when, how frequently companies carry out their business activities. This greater understanding of how the industry works measurably changes their overall impression of chief executive and executive board as has been seen through events facilitated by the Bristol Water Challenge Panel and the WaterShare+ Group Panel.

With regard to the options being considered, PRP prohibition for companies not achieving the minimum lowest investment grade issuer credit rating available (ie BBB-/Baa3 with negative outlook) is our preferred option, if one must be chosen. However, a company's Remuneration Committee would normally take seriously any fall in its credit rating.

However, the potential to obtain funding due to regulatory risk, uncertainty, potential to vary unpredictably, negative publicity all could have an impact on the company's credit rating, leading to a negative unintended consequence.

Question 5: Do you agree that this Rule standard should cover all criminal convictions? Please explain the reasons for your view.

Response:

Applying the standard for all criminal convictions may well be too broad for the purpose of this Rule. To take away someone's livelihood is a serious matter that requires an investigation into whether there is a case to answer and that, subsequent to an investigation being held, a ruling to be made and made available to the company and public.

The breadth of the rule requires further definition. For example, speeding is dangerous, serious, can cause death and is a criminal offense. Whether and how this particular example should be contained in the Rule is questionable.

Proportionality is a factor that should be considered and reflected in the Rule. For example, the treatment that OFWAT uses should be part of an aligned and integrated system of rules where the Remuneration Committee maintains responsibility and accountability, and weighs up any mitigations that may have arisen.

However, there are environmental, health and safety, drinking water quality convictions that should be within the Rule and prohibit PRP. Normalising such criminal offences should be discouraged.

It may be worthwhile exploring whether there are mitigating circumstances and a threshold for the potential crime and the subsequent withdrawal of any PRP. For example, some areas have concentrations of lead pipes and funding to replace these pipes has not been allowed within the asset management period. Residents living in houses with lead pipes, however, may consider the health or drinking water quality substandard and worthy of initiating a criminal offense. The mitigating circumstance of an action plan to rectify external and internal lead pipes could be taken into account.

Question 6: How can Ofwat best address the risk of the time lag between an incident and conviction?

Response:

The timeframe for non-payment of PRP within one year following a breach of standards could be rather short. A more usual timeframe is to delay payments in cases of any infringement of the standard for four or five years, whether the individual remains in the employ of the company concerned or not, to allow for any investigations, root cause analyses or assurance to be carried out.

It should be noted that the Chief Executive of South West Water voluntarily refused to accept PRP due to spillages from sewage outflows that broke the law.

Question 7: What type of arrangements (e.g. clawback) should companies be required to have to recover PRP payments when a Rule breach occurs?

Response:

Customers may well expect there to be clawback arrangements in place for a decade or until investigations, processes and systems have run their course. However, there could well be tax implications and six years could be an appropriate time which aligns with taxation rules.

Question 8: What do you think should be considered an exceptional circumstance for when PRP could still be paid despite the company appearing to breach one or more of the Rule's standards?

Response:

It may well not be an exceptional circumstance for PRP to be paid where there is a breach of one or more standards. What is unclear at this point is the threshold for circumstance, how it is measured, over what period of time the infringement occurred, whether there are mitigating circumstances and actions in place, etc.

Rule: Fitness and propriety

Question 9: Do you agree that the types of standards proposed above (under Standards for Consideration) could be suitable for the proposed fit and proper persons test? What other (if any) criteria should be considered?

Response:

The first five bullet points listed are normally regarded as 'best practice' in any company's recruitment programme. Therefore the fit and proper persons test should apply to the chief executive and executive and non-executive board members. The ability to draw in others should be used sparingly and only where intentional and knowing actions have been carried out. A wise company will establish training programmes for prescribed posts to ensure compliance.

Conflicts of interest, current or past, should be declared and noted in Minutes and the individual should exclude themselves from the discussion where a conflict occurs.

It should also be remembered that a valued part of corporate governance is that Non-Executive Directors are appointed specifically as independent individual who bring a range of different skills and diverse experiences to the discussion of Boards of Directors.

It should be noted that all conflicts of interest neither can be ruled out nor are they entirely detrimental. For example, Jonson Cox, a former Chairman of Ofwat was a former Chair of a water company and reportedly had multi-million pound links to the industry and Cathryn Ross, a former Chief Executive of Ofwat became the interim Chief Executive of a Thames Water and is currently its Strategy and External Affairs Director. Many senior staff regularly move between regulation in one sector of utilities to another or to and from corporations providing utilities services.

Question 10: Do you agree with the proposal that the fit and proper persons test should be applied at this stage to chief executives and other individuals who are appointed as directors to the board, including both executive directors and non-executive directors? If not, please explain why.

Response:

There needs to be a run up to applying the fit and proper persons test to all chief executives and executive and non-executive boards to enable a shadow test and appropriate training to be established.

Question 11: Do you agree with the approach that companies should as a minimum provide assurance to Ofwat through their annual reporting process? What other mechanisms of assurance and information provision could be considered for monitoring compliance of the rule?

Response:

Companies should provide annual assurance to all regulators and inform customers through its website and annual publications as well as through independent customer challenge groups (ICGs).

Rule: Consumer involvement in decision-making

Question 12: Do you agree with the core principles proposed for effective consumer representation? Please explain the reasons for your view and tell us if you consider there are any other core principles that should be included.

Response:

The rule requiring greater consumer involvement in a water company's decision making is valid and should be multi-layered. Such layers should include expert groups, such as ICGs like the Bristol Water Challenge Panel and WaterShare+, as well as on-line and face-to-face panels and specific groups based on a given characteristic (such as vulnerability, pensioner, those with a certain medical condition, etc). Each layer should have a specific purpose or role, for example, in assuring the company hears the voice of the customer or that the customer can inform the company of their interests and concerns.

The outcome-based approach described on page 24 of the consultation document is, with the exception of ICGs, reactive in its role.

However, there are different ways for an ICG to operate. The Bristol Water Challenge Panel and WaterShare+ Group Panel monitor on an ongoing basis the performance of South West Water; news and reports that might impact on the company; media and person to person communications; documents published by the regulators and responses to such consultations; requesting from the company information on the handling of incidents and compilation of action plans and more. In this sense, our ICG is proactive and has the ear of the chief executive, executive board and the corporate board and its sub-committees (such as the PR 24 Committee which received papers on our activities alongside papers presented for the board to consider). In addition the company brought to WaterShare+ its remuneration plans and organisational charts in advance of their implementation. It is a trusted and confidential way of working where the independence of the Panels can enable them to agree or disagree with the papers presented to us.

Question 13: Do you agree the consumer rule should require companies to take appropriate account of consumer views in these areas, or if any of them should be limited or otherwise defined? Please explain the reasons for your view and tell us if there are any other areas that should be included.

Response:

The definitions of relevant decisions being divided into the development of company plans and strategies; retrospective reflection of company performance and shorter-term reactive decision making with a material impact on consumers are appropriate, but not exhaustive in their scope.

For example, the Bristol Water Challenge Panel focuses on

- The performance of the Bristol Water brand against the Outcome Delivery Incentives and Performance Commitments, ensuring that customer priorities and preferences are met during the current Asset Management Period and reviewing customer engagement research in person and online.
- The performance of the Social Contract between Bristol Water and its customers which sets out a range of novel and innovative education, environmental, waste and other programmes and its integration into business as usual within South West Water.
- Facilitating an annual meeting to enable customers to raise their concerns face to face with the Chief Executive and Directors of South West Water.
- Providing scrutiny of the Water Resources Plan and Drought Plans (until the merger with South West Water where this role is performed by WaterShare+).
- The assurance provided by the independent assurance firm Jacobs.
- Implementation of the Vulnerability and Affordability Plans.
- Monitoring progress on the UK Customer Satisfaction Index.
- Receiving incident management updates and subsequent action plans as they arise.
- Presentations of the Bristol Water Board (and now to the South West Water Board post-merger).
- Conduct deep dives into performance, incidents, the social contract. It also visits assets to gain an understanding of operational matters.
- Presenting case studies on performance, whether for exceptional or dreadful incidences.

While CCW may provide a view and be able to research aspects of consumer wants, needs and what constitutes best practice, it does not have on the ground breadth to be able to implement or innovate. Equally, while it may perform a great function in the water sector, it is limited in its being cutting edge across all industries. That Bristol Water benchmark against the UK Customer Satisfaction Index enables it to gain exposure to customer service beyond the water or utilities sectors. Certainly this should be the goal of Ofwat to be expansive in its thinking rather than constricted by limiting its search for best practice or comparative research within the sector to one body.

Concern was expressed that role of CCW is dealing with consumer complaints. It was considered that it was not sound governance to suggest that it should have additional and ancillary roles such as those suggested in connection with the establishment of new customer panels covering each water company.

For example, Independ was commissioned by the ICGs to conduct an analysis of ICGs from a totally independent perspective. Universities and other bodies also have knowledge gained from within the UK and elsewhere that can enhance thinking, provide experience, provoke innovations and more. It is disappointing that such a

great reliance is being placed on CCW. CCW can, however, provide beneficial insight and share experience among ICGs on a range of subject matters.

Question 14: Do you agree with our proposal to take an outcomes-based approach to this element of this Rule? If not, please explain why.

Response:

If an outcomes based approach enables Ofwat to categorise the types of customer views it values, it should also be clear that its suggestion is indicative rather than exhaustive. Consumer priorities and expectations will change as time goes by and the best companies are nimble enough to adapt to customer needs and meet them. Hence, it is not reasonable to think that an exhaustive list can be compiled. However Ofwat should also be a learning organisation, able to identify best practice and select those aspects that can be disseminated to be so. An over-reliance of what CCW can provide likewise limits the level of ambition that can be found in other utilities, service providers and great companies worldwide. Within the UK there are other specialist consumer organisations, research think tanks and examples of excellence that can raise the horizons and ambition within the water sector.

Question 15: Are there any other mechanisms or channels for the consumer voice that should be considered? Please explain the reasons for your view and tell us whether there are any consumers under our definition who may need a different type of approach.

Response:

INDEPEND, an independent research company, carried out research into the way ICGs brought customer views, preferences, enabled company accountability and more, particularly to improve the regulatory system, how such groups were constituted, how their effectiveness was measured, governance and recruitment of panel members. The report 'Influencing Without Power' refers.

The checklist for an effective ICG challenge is set out on the chart below

Behaviours

- Company: welcoming 'uncomfortable' challenge

- ICG: acting as a critical friend, not just a critic
- Both: having honest conversations as issues arise

Governance

ICG Terms of Reference include

- A clear remit: set out a common objective for the company and the ICG that is outcome-focused and customer-centred
- The ICG's source of authority and role: set out the source of the ICG's authority to act, along with a high-level view of what effective delivery looks like
- Board accountability: make clear how the Board will discharge the ICG related part of its accountability for customer challenge

Operational

- Right mix of members
 - – subject expertise
 - – quality of challenge
 - – constructive approach
- Independence guarded
 - – processes and behaviours established
 - – written down
- Providing relevant information
 - – appropriate level
 - – comparative data
 - – wider perspectives
- Resourced appropriately
 - – sufficient time to scrutinise
 - – appropriate secretariat support and timely updating of online material
 - – sufficient engagement from the Management Team and technical experts

[The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise. The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise. The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise.]

The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise.

- The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise.
- The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise.
- The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise.
- The ICG will be a critical friend, not just a critic, and will have honest conversations as issues arise.

- Support from executive team to respond to the ICG and to listen and respond to panel discussions and scrutiny
- Provision of an independent secretariat and report writer to assist the ICG in maintaining Minutes, writing reports, arranging meetings. Any input from the company is simply to provide correct data and company information
- Access to assurance reports by the independent technical assurer
- A dedicated independent non-executive director able to attend ICG meetings
- Closed sessions for ICG members prior to and after each meeting

With regard to the open recruitment of Chairs and their Deputies, there are a number of excellent executive search organisations capable and competent at the recruitment of such roles. It is not necessary to have CCW oversight on the selection of these roles where there are other organisations whose whole business is dedicated to identifying candidates of the right quality and calibre.

Question 17: Do you agree that the Rule should provide options for water companies in terms of how they establish appropriate arrangements? And do you agree with these proposed mechanisms? If not, please explain why and if there are alternative mechanisms that should be considered.

Response:

The addition of consumer focus in governance frameworks is a beneficial addition to corporate governance. The Bristol Water Challenge Panel had access to the CEO and Board Members and, for a period, an Independent Non-Executive Director attended meetings and reported back directly to the Board on discussions held in the meetings. A dedicated point of engagement for the ICG is essential as is the ability of that individual to garner the support of senior executives. Such reach is required in order to respond to ICG requests, scrutiny and challenges.

Question 18: Do you agree with the proposed assurance mechanisms described? Do you have any other suggestions on assurance mechanisms for monitoring compliance?

Response:

The Bristol Water Challenge Panel publishes an annual report, which is available in print and online, and is circulated at public meetings around the geography of South West Water.

The Challenge Panel supports the move to receive the terms of reference of the ICG and how consumer views are being incorporated into company governance. Likewise, how compliance with these terms is carried out should be submitted to Ofwat. It is worth noting that the WaterShare+ Group Panel report on how customer preferences gathered from research and/or tested in scrutiny were sent to Ofwat and presented in person during the Draft Determination scrutiny session.

Question 19: Do you agree with the proposed means of raising concerns on behalf of consumers who do not consider the Rule is being adequately followed?

Response:

In addition to the suggestions in the consultation, both Bristol Water Challenge Panel and the WaterShare+ Group Panel facilitate annual customer meetings in four locations across the South west Water region. By presenting documents, such as the Annual Report on performance or Draft Business Plan, customers attending can both ask questions of the chief executive and executive team immediately, prior to the meeting or at a later date to suit the questioner. From AMP8 onwards, the practice of the Challenge Panel to such questions will be logged on the Challenge Log and responses tracked. In support of the senior staff are exhibition stands showing, for example, water saving devices (some available for free at the stand), drone technology, smart meters and more.

New appointees

Question 20: Do you have any views on whether the rules should apply to new appointees, and if so, whether the same or different rules should apply?

Response:

The Challenge Panel recommends that the rules applying to new appointees should come into force when the remaining appointees have been vetted and assessed. It is imagined that they may take some time to accomplish. From that point onwards, all members of the consumer panel or ICG should meet the new rules.

Responding to this consultation

We intend to publish responses to this consultation on our website at www.ofwat.gov.uk. Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our [privacy policy](#) explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.