Proposed modifications to strengthen the ring-fencing licence conditions of the largest undertakers

Blueprint for Water Response – September 2022

Wildlife and Countryside Link is a coalition of 65 organisations working for the protection of nature. Together we have the support of over eight million people in the UK and directly protect over 750,000 hectares of land and 800 miles of coastline.

Blueprint for Water, part of Wildlife and Countryside Link, is a unique coalition of environmental, water efficiency, fisheries and recreational organisations that come together to form a powerful joint voice across a range of water-based issues.

This response is supported by the following Link members:

- The Wildlife Trusts
- RSPB
- The Rivers Trust
- Angling Trust
- Surfers Against Sewage
- Institute for Fisheries Management
- British Canoeing
- Amphibian & Reptile Conservation

For further information, please contact Wildlife and Countryside Link:
Ellie Ward
Policy and Information Coordinator
E: eleanor@wcl.org.uk

Blueprint for Water welcomes the opportunity to respond to this consultation. Whilst the ring fence may at first appear to be a purely financial consideration, we recognise the importance of company resilience in terms of environmental and reputational resilience, and the interrelation between these aspects. As such, financial resilience & finance management is a topic of significant importance from an environmental outcomes perspective.

We support proposal 1 as a means of ensuring greater financial resilience in the sector and reducing risks around environmental backsliding in response to financial shocks. This is particularly relevant in the context of Ofwat's proposed expansion of environmentally related CPCs in PR24 and the need to comfortably finance any underperformance payments. We agree that companies should also be financially resilient to any fines that may be payable in relation to permit breaches. Requiring companies to plan and maintain headroom for any such breaches can be a useful means of focussing subsequent investment and operations on avoiding them.

We strongly support proposal 2 which will require that dividend policies and dividends declared or paid should take account of service delivery for customers and the environment. The Performance

Commitment framework is aimed at securing the outcomes that customers value, at a cost and over a timeframe that are considered reasonable to customers. Many of the commitments made to those customers are related to environmental outcomes. And yet, when these obligations are not delivered, it seems perverse that the environment suffers, and customers are deprived of the benefits that should have been delivered, yet investors bear little of the pain. This is unacceptable to stakeholders, and amending dividend policies is a central means by which this can be rectified.

Indeed, views expressed frequently by stakeholders, and by the public via social media, constantly criticise the sector for the scale of payments made in dividends whilst investment in infrastructure is considered to be lacking, and environmental damage is prominent. Linking dividend payments more closely to service delivery for customers and the environment recognises the significant shift in expectation of companies from their customers over this issue. We would welcome the following issues being set out by Ofwat in licence conditions, or if not possible, in related guidance to companies, and would expect as a result to see companies:

- **Setting out their performance / service delivery overall, including not only Performance Commitments but other considerations** - such as past underperformance, prosecutions and environmental fines, use of Voluntary Enforcement Undertakings and other regulatory interventions. In particular, the Environmental Performance Assessment undertaken by the Environment Agency could play a more formal role here; whilst we recognise that the assessment looks only at a small basket of measures, nevertheless these are recognised as core components of environmental performance by regulators and customers and are simple to understand - as such their importance should be reflected in dividend decisions; a company with a one-star rating should not expect to be able to pay the same level of dividend as a top performer.
- **Considering the relative importance of components of their delivery, and weighting them accordingly.** For example, dividends (as well as executive pay) should be curtailed where key deliverables are not met, even if other outcomes are. For example, **water efficiency** delivery could be considered as a key metric, given long-term projected supply shortfalls, and the importance of demand reduction in securing sustainability as well as tempering bill costs both directly (by lowering water and energy use) and indirectly (given the reduced or delayed need for capital investment). In the current cost of living crisis, this would seem a proposal in line with the industry's Public Interest Commitment. In addition, elements of performance around **water pollution** should be given a similar elevated status, given that concerns around water quality are totemic and reflect failing trust in the Industry.

Whilst we welcome other elements proposed by Ofwat that also appear set to improve company performance, it is the dividend component that we feel is most crucial. These changes will be most effective if accompanied by clear, transparent communications to customers, and clear accounting so that customers can be confident that poor environmental performance is impacting dividend payments. This is important to enable customers to hold companies to account.

A counter-argument often cited to such approaches is that poor returns to investors will increase the cost of borrowing and negatively impact customer bills or company outputs; however we would argue that linking payments to environmental performance should simply provide an added incentive for companies to improve their environmental outputs; we see this this not as an additional burden but as a means of tightening a system that has not yet fully delivered. If failure to deliver against environmental commitments limits payments such that shareholders are prompted to implore companies to do better, this is exactly the kind of shareholder intervention we would welcome. After all, as local monopolies water company customers are not able to 'vote with their feet' and leave their provider, so the role that shareholder pressure could play in encouraging environmental performance is all the more important.