



Department
for Environment
Food & Rural Affairs

The Rt Hon Michael Gove MP
From the Secretary of State for Environment, Food
and Rural Affairs

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Jonson Cox
Chairman, Ofwat
21 Bloomsbury Street
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18 April 2018

Dear Jonson,

Thank you for your letter outlining the further measures that Ofwat will take to address our concerns about the financial practices being used by some water companies.

Privatisation has unlocked significant investment in water and sewerage infrastructure, bringing a range of benefits to customers and the environment. However, the use of aggressive financial engineering by some companies has eroded the public's trust in the sector.

I am fully supportive of all your proposals and agree that water companies should share with customers any additional returns above and beyond the financing costs assumed by Ofwat. It is right that companies providing a monopoly public service balance customer interests against those of shareholders.

Your continued efforts to improve the transparency of the water sector, in particular around dividend policies and the setting of executive pay, are warmly welcomed. You are right to say that customers deserve to understand how executive pay reflects the service that companies have provided. You are also right that boards must take account of employee interests alongside dividend payments and remunerating executives, which will help to properly protect employee pension schemes.

This aligns with the government's aim to improve corporate governance and transparency. For example the government is introducing legislation to require quoted companies to publish the ratio of CEO pay to the pay of their average workforce. I would like to see privately owned water companies publish this information voluntarily.

I also welcome your proposals to make changes to water company licences, to put customers at the heart of water company activity and to provide better protections for the regulated part of the business.

You have the government's full backing. I hosted a roundtable with chief executives from most of the English water companies on Monday and was pleased to hear all companies say they were fully on board with Ofwat's proposals. They committed to action in a range of areas, including tying executive pay and dividends more closely to performance improvements, sharing with customers additional gains from high gearing, and closing offshore financial structures in the coming months. They also committed to helping deliver the government's ambitions in its 25 year plan for the environment, balancing these

priorities with much needed investment in long-term resilience and ensuring bills remain affordable for customers.

I therefore hope that you can implement your proposals in full without the need for government intervention or legislation. However, if you find that water companies are not fully and promptly cooperating with your proposals, we are ready to revisit how government can give Ofwat stronger powers to amend licences, through legislation if necessary. Moreover if you find there is any need for government intervention or legislation beyond your current proposals, we will carefully consider any further recommendations.

These proposals complement the efficiency and service performance improvements that you are already requiring companies to make in the next price review period.

With every good wish,

A handwritten signature in black ink that reads "Michael Gove". The signature is written in a cursive style with a large initial 'M' and a long, sweeping tail on the 'G'.

Michael Gove