

Ofwat
By email

Friday 5th May 2023

To whom it may concern,

Re: Protecting customer interest on performance related executive pay: proposed guidance

Blueprint for Water, part of Wildlife and Countryside Link¹, welcomes the opportunity to respond to the Ofwat proposed guidance on protecting customer interest on performance-related executive pay.

In our response to the PR24 methodology consultation, we stated our agreement that performance-related pay should take account of company performance in delivering obligations and commitments to customers, communities and the environment.² We strongly agree that demonstrably aligning incentives and outcomes to these areas is vital to sustaining (or in many cases, rebuilding) the trust of customers and wider society. We also agreed that policies for performance-related pay should demonstrate clearly a 'substantial link' to stretching performance delivery in these areas.

However, we argued that given both the current dire state of the water environment, and the significant rise in customer expectations for the environment, that this approach to performance-related pay should be much stronger. Water company bosses received £24.8m, including £14.7m in bonuses, benefits and incentives, in the period 2021-2022, in spite of ongoing poor environmental performance – for example, in 2022 alone untreated sewage was released from Storm Overflows in England for over 1.75 million hours, despite the fact that Storm Overflows are only permitted to discharge during extreme rainfall events.^{3 4} Customer concerns around key issues such as sewage pollution and drought are rising, yet trust in the water industry is rapidly declining.⁵

It should not be profitable for companies to pollute, to fail to meet environmental legislation, and for water and sewerage infrastructure to not be fit for purpose. It should also not be permissible for the water industry to pass the cost of legal compliance onto customers where they have already been funded to deliver this. As such, we argue that performance-related pay awards in the water industry

¹ [Wildlife and Countryside Link](https://www.wcl.org.uk) is a coalition of 70 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.

² Blueprint for Water. (2022).

https://www.wcl.org.uk/docs/WCL_PR24_Methodology_Consultation_Response_08_09_2022.pdf

³ The Guardian. (2022). <https://www.theguardian.com/business/2022/aug/19/bonuses-for-water-bosses-in-england-up-20-last-year-despite-sewage-failures>

⁴ Environment Agency. (2023). <https://www.gov.uk/government/news/environment-agency-publishes-event-duration-monitoring-data-for-2022>

⁵ Ofwat.(2023) 'Trust in Water'. <https://www.ofwat.gov.uk/trust-in-water/>

must be dependent on the delivery of statutory obligations and commitments, and stretching performance delivery for customers, communities and the environment.

We therefore welcome the proposed guidance from Ofwat on performance-related pay. It is positive to see Ofwat reaffirming the importance of transparency, and the clear expectation that performance-related pay should “demonstrate a substantial link to stretching performance delivery for customers and the environment”. We also welcome proposals for the following factors to be included in Ofwat’s review of company approaches to executive pay;

- Alignment to delivery for customers and the environment – we agree that the criteria for awarding performance-related pay in the year should demonstrate a substantial link to stretching delivery for customers and the environment. However, we suggest that stretching delivery should be a **requirement** for performance-related pay awards, rather than asking companies to only demonstrate a ‘substantial link’.
- Stretching targets – we agree that award decisions for the year should be based on stretching targets. However, we suggest that it should be the role of Ofwat to determine what constitutes ‘stretching’, rather than this being left to companies to determine.
- Overall performance – we agree that award decisions for the year should take into account overall performance delivered for customers, communities and the environment. We suggest that there are additional factors Ofwat should consider in judging overall performance, discussed further below.
- Deferral, malus and clawback – we agree that deferral, malus and clawback should be considered by Ofwat in reviewing performance-related pay. For example, with respect to deferring awards pending the outcome of ongoing enforcement action, this will be relevant to all Water & Sewerage Companies in relation to the ongoing investigation into potential breaches of permit conditions at over two thousand Wastewater Treatment Works.

There are further factors Ofwat should consider in reviewing the overall performance of companies; for example, 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; a 1-star rated company should expect to award less in performance-related pay than a company with a higher rating.

We would also welcome further detail setting out how the proposed guidance will be implemented. For example, in reviewing company approaches to performance-related pay, will Ofwat set a specific standard or requirement that companies need to achieve for each factor? How will this standard be determined? Will each factor be considered as one of many to be weighed up, or will companies be expected to meet requirements for all the factors? If the former, how will different factors be weighted in Ofwat’s review? Further detail is also needed to ensure transparency of Ofwat’s decision-making process in other areas of the proposed guidance. For example, how will Ofwat determine what constitutes a ‘substantial link’ between the criteria for performance-related pay and stretching delivery for customers and the environment? These details should be clarified in the PR19 2022-2025 and PR24 2025-2030 reconciliation rulebooks. Ofwat should also publish data on pay and rewards openly and transparently on its website so customers can easily access this information.

Whilst the proposed guidance is welcome, we argue that Ofwat could take an even stronger approach to performance-related pay. We acknowledge Ofwat's position that "Each company is responsible for setting performance related executive pay and related policies and for decisions pursuant to them". Ofwat has set out guidance and expectations to inform company approaches, with disclosure on remuneration under s35A of the Water Industry Act 1991 enabling Ofwat to determine whether that guidance has been adhered to. However, beyond this, we were pleased to see Ofwat exercising its new power under the Environment Act⁶ to modify company licences with regards to dividend policy. We suggest that these powers should be part of Ofwat's regulatory toolkit for PR24 and future price reviews with regards to PRP, and should be utilised promptly with respect to setting out specific requirements on PRP if the new guidance is found to be insufficient. This corresponds with the recommendation made by the EAC in their 2022 report on water quality in rivers⁷, and would better reflect both the current poor state of the water environment and increasing customer expectations for action.

Finally, we accept that there are limitations to the levers that Ofwat have in relation to pay and rewards compared to the wider company-level levers that could be applied with the aim of incentivising improved environmental performance (for example, such as around the allowed return). As such, we would welcome Ofwat looking at these aspects alongside PRP, with the aim of ensuring that all potential avenues are utilised to secure greater prioritisation of environmental performance across the sector.

We would be pleased to discuss any of these points further.

Many thanks, and kind regards,



Ali Morse
Water Policy Manager, The Wildlife Trusts, and Chair, Blueprint for Water

This letter is supported by the following Blueprint for Water members:

- Angling Trust
- Friends of the Earth England
- RSPB
- The Rivers Trust
- WildFish

⁶ Part 5 of the Environment Act 2021 amended the Water Industry Act 1991, creating the power to modify company licences without company consent.

⁷ Environmental Audit Committee. (2022). 'Water Quality in Rivers'
<https://committees.parliament.uk/publications/8460/documents/88412/default/>