



Jeremy Pelczer
Chairman, non-executive

Statement by the Chairman on corporate governance

We have spent considerable time as a Board this year focusing on reviewing and addressing the matters raised by our regulator’s consultation on Board leadership, transparency and governance. We continue to be supportive of our regulator’s initiatives in this area, and have provided our indicative consent for Ofwat’s updated objectives in this area to be incorporated into our licence.

While as a Board, and a Company, I believe we are very well positioned to address these questions, we nonetheless take very seriously the consultations in these areas introduced by our regulator, and have taken direct steps to ensure we continue to maintain trust, show leadership and ensure transparency in all matters for the benefit of our customers and other stakeholders.

For example, page 90 of this annual report contains the annual statement requested by our regulator to explain the Company’s vision, direction and performance from the Board’s perspective. This statement also includes more transparent reporting on how we adhere to Ofwat’s 2014 principles in this area and, importantly, provides a view of where we stand as a Board and Company in relation to Ofwat’s updated governance related principles which apply from 1 April 2019 onwards.

In the prior year the Board also established a Governance committee to consider all governance matters, and in particular, guidance from Ofwat and the Financial Reporting Council (FRC). I am pleased to note that one of the key outputs from this Committee was the ‘Keeping it clear’ document which we published in November 2018, which provides a clear and straightforward view on how the Company is financed and governed, together with providing clear insights on dividends and executive pay. Board minutes are now also being published on our website.

In addition, we engaged an external facilitator this year to evaluate the Board’s performance. While this review concluded that the Board and its committees were operating effectively, a series of key actions arising from the review have been included in this report.

The fourth year of progress in delivery of the commitments we made to customers in our last Business Plan (which covers 2015-2020) has also received close attention from the Board. There has been encouraging progress made in fulfilling these commitments – particularly with respect to reducing leakage and increasing resilience - but the Company still has improvement to make on overall customer satisfaction (as measured by Ofwat’s Service Incentive Mechanism) where recent results, albeit improved, have not met our aspirations. Importantly this year, to address this matter, the Board has approved significant investment to implement a new customer relationship management (CRM) and billing system, which will provide much better functionality that will really enhance our ability to sustainably improve our service to customers.

The Board has also been heavily involved in the Company’s PR19 Business Plan submissions in the year, providing significant time, debate and challenge to the four key themes of customer service, affordability, resilience and innovation, and using expertise and experience from outside the water industry to challenge management thinking and proposals. This has also included performing a satisfactory review of the financeability and long-term financial resilience of the Company’s plans.

The Board is only able to address such full and challenging agendas through the dedication and wide experience that Board members bring to our discussions. I would like once again to thank my fellow directors for their continued strong commitment to maintaining the highest standards appropriate to the nature and ownership of the business. It remains greatly appreciated.

Jeremy Pelczer
Chairman
15 July 2019

continued

The Board's code on principles of good governance

The Board has a code on principles of good governance and assesses compliance with the code on an annual basis. The Board takes its obligations for good corporate governance extremely seriously and applies standards appropriate to the nature and ownership structure of the business. These standards are kept under continuous review and will be amended in line with business developments and to reflect best practice.

The code is based on five principles which are detailed below alongside the annual assessment of compliance.

Acting as if it is a separate plc

The Board will govern the Company in accordance with the standards applicable to an independent company listed in the UK, focusing exclusively upon the long-term interests of the Company. Subsequent principles in this code define what this overall principle means in particular areas.

The Board considers that it complies fully with the principle of governing the Company in accordance with the standards applicable to an independent company listed in the UK.

The Board has defined matters it reserves to itself and has full powers to make decisions on behalf of the Company. The Board has established Committees to consider key aspects of corporate governance, and has also maintained a Governance committee which has considered Ofwat's Board Leadership, Transparency and Governance (BLTG) consultation, together with updates to the Code and related guidance from the Financial Reporting Council (FRC). Final decisions affecting the Company have continued to be made by the Board.

Transparency

The Board will comply with the Disclosure and Transparency Rules and seek to explain the way in which the Company is governed in an open, accessible and balanced manner. This will include the relationship of the Company with any associates, including holding companies.

The Company has made disclosures in this Annual Report which meet the requirements of the April 2016 edition of the UK Corporate Governance Code. The terms of reference of its Board Committees are published on the Company's website. The relationship of the Company with its associated companies is set out on page 20. The Board therefore considers that it has achieved full compliance with the Disclosure and Transparency Rules required by the UK Corporate Governance Code.

Board and senior management skills

The Board will maintain an appropriate balance of skills, experience, independence and knowledge of the Company and will consider these factors in making appointments and in assessing Board performance.

The Board's Nomination Committee considers the composition of the Board and the skill and experience required from new appointments. The current Board contains members with a mix of experience and expertise and significant experience of other plc and leading companies' Boards. All new directors receive appropriate induction. The Board has utilised an external facilitator to formally review its performance during the course of the year and reports on its conclusions on page 45. The Board considers that it complies with the principle of maintaining an appropriate balance of skills, experience, independence and knowledge of the Company.

Independent representation

The Board will ensure that directors independent of management and shareholders are the single largest group on the Board and any of its Committees.

The Board has three non-executive directors who are independent of management and shareholders, one of whom has been appointed as the senior independent non-executive director able to act inter alia as a channel for Board communication with regulators. The Board also comprises two executive directors, two shareholder representatives and a chairman who had a connection with a shareholder prior to his appointment (the Board has continued to find him independent of character). Independent non-executive directors continue to form the largest single group on the Board.

Board committees

The Board will maintain as a minimum Nomination, Audit and Remuneration Committees on which independent non-executive directors will form a majority, and also has Energy, Pensions, Governance and Financing committees which have independent non-executive director attendance and chairs.

The Company's ultimate holding company in the UK also applies a code on governance which is published on page 49.

The Board considers it has fully complied with the main principles of the UK Corporate Governance Code (the 'Code') and its application. Any reasons for not applying specific provisions of the Code, are described in the following sections.

Consideration of Ofwat's Board Leadership, Transparency and Governance (BLTG) objectives

The Board has been heavily involved in the current year in responding to Ofwat's governance-related consultation. Ofwat's conclusions in this area complement the Board's code on principles of good governance as noted above, and the Board has been highly supportive of Ofwat, ensuring that the following key actions have been taken with respect to the consultation.

Consideration of Ofwat's comments on 'future reporting' with respect to BLTG matters within this Annual Report

Ofwat's updated BLTG objectives and reporting came into effect from 1 April 2019. For 2018/19 reporting Ofwat has noted that companies should report against the principles that were in place at the time (the 2014 principles).

The Board has however taken into account Ofwat's request to consider 'future reporting' on BLTG matters within this year's Annual Report, as noted in the table below:

| Ofwat considerations for 'future reporting' on BLTG matters | Board response |
|---|---|
| Provide up-to-date, self-standing reporting to clearly explain how the Board's governance approach has met BLTG objectives | The Regulatory Reporting section of this report (pages 90 to 94) now incorporates further information on how we believe our governance approach meets the BLTG objectives |
| Ensure clear articulation of all matters reserved to Board, shareholders and holding companies, and how the regulated company Board still retains full control of the business performance and strategy | Our disclosure on such reserved matters on page 40 within this report has been expanded to be clearer to address these points and be more transparent on the full control the regulated Company's Board has on performance and strategy |
| Further explanation of alternative arrangements or actions that allow sufficient independent management when a non-independent chair is in place or where there are other matters that may have impaired director independence in the year | As articulated on page 38, we believe that our chair is independent. However, we have expanded disclosure in this area to articulate clearly supporting mechanisms we have in place to ensure Board and chair independence (page 44) |
| Adopt early the requirement to provide an annual Board statement in the Annual Report to explain how the company has set its aspiration and performed for all its services | A separate Board statement is now included at the start of the Regulatory Reporting section of this report, as detailed on page 90 |
| In addition, include a section in the Annual Report that details how the Board believes it has met the 2019 objectives already - or has incorporated steps in the next year - to meet such objectives. This will include specific reference to underlying provisions for each objective | Within the separate Board statement from page 91, a table has been included to describe how the Board believes it is meeting the BLTG 2019 objectives |

Ofwat's proposed licence modifications

Ofwat has stated its intention to insert specific conditions into companies' licences (or update current licences) for meeting BLTG objectives. While the formal statutory consultation is in progress at present, the Board has already provided indicative consent to Ofwat to incorporate these BLTG objectives in our licence.

Role of the Board

The Company is controlled through its board of Directors. The Board's main role is to ensure that the business is run properly in accordance with its regulatory and other obligations for the benefit of its customers and to create long-term value for shareholders. In fulfilling this role, the Board approves the Company's strategic objectives and ensures that the necessary financial and other resources are made available to enable management to meet those objectives. The Board, which meets at least six times a year, has reviewed and agreed a schedule of matters reserved for its approval.

The matters reserved for Board approval are:

| | |
|---|--|
| <p>Strategy and management:</p> | <ul style="list-style-type: none"> • Responsibility for the overall management of the Company • Approval of the Company's long-term objectives and commercial strategy • Approval of business plans and other major submissions as part of regulatory price reviews • Responses to Draft and Final Determinations of regulatory price reviews • Approval of the annual operating and capital expenditure budgets and any material changes to them • Oversight of the Company's operations ensuring competent and prudent management, sound planning and compliance with statutory and regulatory obligations • Review of performance in the light of the Company's strategy, objectives, business plans and budgets and ensuring that any necessary corrective action is taken • Approval of annual reports to Ofwat, annual price rise submissions, and any other major submissions to Ofwat, including appeals against significant regulatory decisions, including applications for interim price determinations • Extension of the Company's activities into new business or geographic areas • Any decision to cease to operate all or any material part of the Company's business |
| <p>Structure and capital:</p> | <ul style="list-style-type: none"> • Changes relating to the Company's capital and financing structure • Major changes to the Company's corporate and funding structure • Changes to the Company's management and control structure • Any changes to the Company's regulatory structure |
| <p>Financial reporting and controls:</p> | <ul style="list-style-type: none"> • Approval of the half-yearly report and any preliminary announcement of the final results • Approval of the Annual Report and accounts, including the corporate governance statement and remuneration report • Approval of the dividend policy • Declaration of the interim and final dividends • Approval of any significant changes in accounting policies or practices, including tax matters • Approval of treasury policies including foreign currency exposure and the use of financial derivatives |
| <p>Maintenance of a sound system of internal controls and risk management:</p> | <ul style="list-style-type: none"> • Receiving reports on, and reviewing the effectiveness of, the Company's risk and control processes to support its strategy and objectives • Undertaking an annual assessment of these processes • Reviewing the principal risks affecting the Company, and the mitigating actions • Approving an appropriate statement for inclusion in the Annual Report |

Approval of significant projects and contracts above agreed levels:

- Major capital projects (above the levels of authorisation delegated to management)
- Contracts which are material strategically or by reason of size, entered into by the Company in the ordinary course of business, including new borrowing facilities
- Contracts of the Company not in the ordinary course of business, including any material foreign currency transactions and acquisitions or disposals
- Investments in other businesses, including the acquisition or disposal of interests of shares of any company or the making of any takeover offer

Board membership and other appointments:

- Changes to the structure, size and composition of the Board, following recommendations from the Nomination Committee
- Ensuring adequate succession planning for the Board and senior management
- Appointments to the Board, following recommendations by the Nomination Committee
- Selection of the Chairman of the Board and the Managing Director
- Appointment of the Senior independent director
- Membership and chairmanship of Board committees
- Continuation in office of directors at the end of their term of office
- Continuation in office of any director at any time, including the suspension or termination of service of an executive director as an employee of the Company, subject to the law and their service contract
- Appointment or removal of the Company secretary
- Appointment, reappointment or removal of the external auditor, following the recommendation of the Audit Committee

Remuneration:

- Determining the remuneration policy for the directors, Company secretary and other senior executives
- Determining the remuneration of the non-executive directors, subject to the articles of association

Delegation of authority, including Board committees and division of responsibilities between the chairman and the managing director:

- The division of responsibilities between the Chairman and the Managing director which should be in writing
- Approval of terms of reference of Board committees
- Receiving reports from Board committees on their activities

Corporate governance matters:

- Undertaking a formal and rigorous review of its own performance, that of its committees and individual directors
- Determining the independence of directors
- Considering the balance of interests between shareholders, employees, customers and the community
- Review of the Company's overall corporate governance arrangements
- Receiving reports on the views of the Company's shareholders

Approval of policies:

- Code of conduct and business ethics
- Health and safety policy
- Environmental policy
- Corporate social responsibility policy
- Charitable donations policy

Other matters, including:

- Approval of any circulars, prospectuses or listing particulars
- Approval of press releases concerning matters decided by the Board
- The making of political donations
- Approval of the appointment of the Company's principal legal advisors
- Prosecution, defence or settlement of litigation above £1 million or being otherwise material to the interests of the Company
- Approval of the overall levels of insurance for the Company including directors' and officers' liability insurance
- Major changes to the rules of the Company's pension scheme, or changes in the fund management arrangements
- This schedule of matters reserved for Board decisions

As noted above, this comprehensive list of reserved matters provides the Board of the regulated water company with full control of both business performance and strategy. No matters are reserved solely for the shareholders, and none of the matters above are reserved to any intermediate holding company.

Roles and responsibilities

The division of responsibilities between the Chairman and Managing director is clearly defined and has been approved by the Board. The table below details their individual roles and responsibilities and highlights the specific duties of our Senior independent non-executive director and our Company secretary.

Chairman – Jeremy Pelczer is responsible for:

- The effective operation, leadership and governance of the Board
- Ensuring the effectiveness of the Board
- Setting the agenda, style and tone of Board discussions, including ensuring a focus on strategic and business critical decisions
- Ensuring all directors make an effective contribution to the Board through debate and discussion, balancing the executive, independent non-executive and shareholder-nominated non-executive contributions
- Ensuring directors receive accurate, timely and clear information

Managing director – Anthony Ferrar is responsible for:

- Development of strategic plans for consideration by the Board
- The performance of the Company in line with the strategy and objectives agreed with the Board and under powers delegated by the Board
- Ensuring the Board is supplied with information relevant to its role
- Leading executive directors and senior management in dealing with the operational requirements of the business
- Providing clear and visible leadership in business conduct

Finance and Regulation Director & Company Secretary – Paul Kerr is responsible for:

- Under the direction of the Chairman, ensuring effective information flows to the Board and its committees, and between senior management and non-executive directors
- Advising the Board, through the Chairman and Managing director, on all governance matters
- Securing, where appropriate, independent professional advice for directors at the Company's expense
- Facilitating induction activities for new directors and assisting with their agreed development needs
- Managing key financial and regulatory accounting, reporting and control matters, together with ensuring adherence to statutory and regulatory requirements

Senior Independent Non-Executive Director – Murray Legg is responsible for:

- Acting as a 'sounding board' for the Chairman and as an intermediary for other directors
- Acting as lead contact for the independent non-executive directors with Ofwat
- Leading the Board's annual assessment of the Chairman's performance

Composition of the Board

The Board benefits from the varied skills and experience of its independent non-executive directors and Chairman.

With respect to succession, the Board is pleased that the Chairman will serve a third and final three-year term from March 2019, which will mean compliance with the Code in terms of his overall tenure as Chairman not exceeding nine years, and that Murray Legg and Jon Woods commenced serving their second three-year terms as independent non-executive directors, effective from 1 October 2018 and 1 March 2019 respectively.

In addition, Seiji Kitajima replaced Yoichi Sakai as one of the Company's shareholder-nominated non-executive directors, after his pre-appointment interview with Ofwat. Ryu Nishida, the Company's other shareholder-nominated non-executive director, whose original three-year term on the Board was due to end in March 2018, remained on the Board until May 2019. His successor on the Board, Kenji Oida, was formally appointed on 1 May 2019. Ahead of his formal appointment, Mr Oida met Ofwat representatives as part of the well-established protocol in place for such appointments to the Board.

On 27 March 2019 Managing director Anthony Ferrar informed the Board of his intention to retire this year and a process is underway to appoint his successor.

Finally, the Board is pleased to note the appointment of Paul Kerr as Finance and Regulation Director and Company Secretary, after an appropriate handover period with his predecessor, John Chadwick, who retired in September 2018.

Independent non-executive directors

The independent non-executive directors constructively challenge and help develop proposals on strategy and bring strong, independent judgement, knowledge and experience to the Board's deliberations. The Board considers that they have always been of sufficient calibre and number to ensure that their views carry significant weight in the Board's decision making.

The Company has found that the composition of the Board, with its mix of executive, independent non-executive and shareholder nominated non-executive directors, has proved effective in ensuring that all stakeholder interests can be addressed and decisions taken by the Board on all matters of strategy, policy and planning affecting the business.

Significant commitments of the directors held outside of the Company are disclosed prior to appointment and any changes are disclosed over the duration of the appointment. Current appointments are disclosed on page 33. All directors are required to allocate sufficient time to the Company to discharge their responsibilities effectively and the position in practice is reviewed as part of the annual review of Board effectiveness.

The Chairman is not listed as independent as he was nominated by Sumitomo Corporation on their acquisition of the Company, but the Board has continued to find him independent of character. This independence of character, action and decision-making, exemplified in the manner in which the Chairman conducts himself as part of the Board, is complemented by the powers reserved to the Board as noted above, together with the inherent strong independence based on the composition of the Board. The Chairman has noted that, upon completion of his third and final term, a chair will be appointed who is independent upon date of appointment, in accordance with the UK Corporate Governance Code and Ofwat underlying provisions to their BLTG objectives.

The Chairman meets with the independent non-executive directors at least twice yearly without executive directors present and outside of the Board environment. The directors have a right of access to the advice and services of the Company Secretary and have the opportunity to take independent, professional advice in the course of their duties at the Company's expense.

Day-to-day conduct of the Company's business is entrusted to the executive directors and their senior management colleagues. The Board receives monthly management reports and operates a system of review against strategic objectives and targets.

The non-executive directors are not employees of the Company.

Evaluation of Board performance

The review of Board effectiveness for 2018 was facilitated externally by Independent Audit Limited during April and May 2019 with the results presented to and discussed at the Board meeting in June 2019. The exercise was conducted using a self-assessment questionnaire developed by Independent Audit Limited with input from the Chairman and Company Secretary. This was completed by each member of the Board, together with other members of the executive team/senior management who regularly attend Board meetings. The feedback provided by the completed questionnaires was then collated and analysed by Independent Audit Limited and summarised in a report presented by them to the Board. This report reflected the key feedback themes and included suggested actions for consideration by the Board. The Board agreed to take these actions forward as the basis of a plan of work for delivery in 2019 to enhance the effectiveness of the Board. Independent Audit Limited have no other connection with SES Water.

All the actions from the previous effectiveness review have been completed as noted below:

| Board effectiveness review action points | Board response |
|--|--|
| Formal review of Board powers on an annual basis | Formal review was conducted in September 2018, as detailed above |
| Continuation of an annual Board strategy day, with a review in the coming year to ensure appropriate time is being allocated to strategic matters | Board strategy days have continued in 2018/19, covering a variety of strategic matters of importance to the Company |
| Additional interaction with the Board and the workforce on Company strategy as part of the Company's PR19 business planning work | Board interaction with the workforce continues via regular site visits, and will be complemented in 2019 via interaction of an independent non-executive director with the employee-representative council |
| Increasing the number of deep dive sessions at Board level on key Company risks | Several Board deep dive sessions have occurred in the year, including focus on drought plans and cyber security |
| Additional training slots for non-executive directors within the Board programme for the year | Completed, with training provided as deemed appropriate to individual non-executive needs and skill sets |
| Increasing the frequency of the Pension Risk Management Committee meetings in the year | Completed, with the committee meeting five times in the year |
| An expansion of succession planning review by the Nomination Committee to go beyond executive and senior manager levels to business-critical roles across the business | Completed, with the Nomination Committee considering succession planning at the Senior management Team level during the year |
| A review in the upcoming year to consider an external facilitation of Board effectiveness | Completed utilising Independent Audit Limited, with relevant actions points noted below |

Key actions arising from the current year external Board effectiveness review included:

- Continued focus on spending more time discussing strategy, particularly 'big picture' issues, including opportunities and risks associated with new technology
- Further focus on risk deep dives, particularly on how different risks across the Company are connected
- Greater focus by the Audit Committee on internal audit arrangements and external auditor performance
- Possible use of external advisors for the Remuneration Committee and further focus on executive succession planning by the Nomination Committee.

No changes were made to the terms of reference of the Board's formal committees, which the Board considered were operating effectively. The latest versions of all committees' terms of reference are available from the corporate governance section of the Company's website.

Training and development

Directors are primarily responsible for their personal development and for compliance, where appropriate, with the continuing professional development requirements of their respective professions. The Board also receives regular updates on legislative, regulatory and other governance developments, including briefings from external specialists as appropriate. In addition, the Board periodically visits the Company's water treatment works and enquires into operational policies, practices and procedures.

Board effectiveness

The Board met six times during 2018/19. Committees met as required and considered regular and ad hoc business. Attendance at meetings by directors is summarised below.

| Directors | Board | Audit Committee | Remuneration Committee | Nomination Committee |
|-----------------|-------|-----------------|------------------------|----------------------|
| Jeremy Pelczer | 6/6 | N/A | N/A | 5/5 |
| Murray Legg | 6/6 | 4/4 | 3/3 | 5/5 |
| Dave Shemmans | 6/6 | 4/4 | 3/3 | 5/5 |
| Jon Woods | 5/6 | 3/4 | 2/3 | 4/5 |
| Ryuichi Nishida | 5/5 | N/A | N/A | N/A |
| Yoichi Sakai | 4/4 | N/A | N/A | N/A |
| Anthony Ferrar | 6/6 | N/A | N/A | 5/5 |
| John Chadwick | 3/3 | N/A | N/A | N/A |
| Seiji Kitajima | 2/2 | N/A | N/A | N/A |
| Paul Kerr | 5/5 | N/A | N/A | N/A |

Please note that Seiji Kitajima replaced Yoichi Sakai in February 2019 and Paul Kerr replaced John Chadwick as a Board member in September 2018.

The Board has also established ad hoc committees to consider key risk items, including the strategy for power purchases (an Energy Strategy Committee), for managing the Company's exposure to risks associated with the defined benefit pension scheme and its closure to future accruals in the year, (a Pension Risk Management Committee) and for considering the way in which the Company should be financed in the future (a Financing Committee). In addition, there is a Governance Committee to consider both recent requirements from Ofwat and the FRC in the area of BLTG. These committees are chaired by the Senior independent non-executive director and comprise non-executive and executive directors, with such other senior executives and external advisors as appropriate.

System of internal control

The directors acknowledge that they are responsible for the Company's system of internal control. Such a system is designed to manage rather than to eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement.

The Board has reviewed the effectiveness of the Company's system of internal control, including control of financial, operational, and compliance matters and risk management. It confirms that the Company has complied with its own system of internal controls, detailed below, and that this system meets the requirements of the UK Corporate Governance Code for the year ended 31 March 2019.

The Company's system of internal control is founded upon the following key features:

Control environment

The directors have put in place an organisational structure with clearly defined lines of responsibility and delegation of authority. The Company has a clearly defined policy on whistle-blowing, which is detailed in the staff handbook, and includes access to independent and confidential advice. The Company's Code of Conduct and Business Ethics policy, which has been approved by the Board, has been drawn to the attention of all employees and published on the Company's intranet.

Risk management

Managing business risk to enable opportunities is a key element of all activities. This is done using a framework which provides a consistent and sustained way of implementing the Company's values. Business risks, which may be related to business systems, physical assets, people, finances or customers, are reviewed regularly by the Audit Committee and discussed by the Board.

An overview of key business risks and the mitigations the Company has established are presented on pages 28 and 29.

Information systems

There is a comprehensive budgeting system with an annual budget approved by the Board. At each Board meeting, monthly trading results, balance sheets and cashflow statements are reported against the corresponding figures for the budget and the prior year, and the forecast for the full year is reviewed.

Control procedures

There are clearly defined policies for controlling expenditure including appropriate authorisation levels. Larger projects and major investments require Board approval.

Monitoring system

The Company's internal financial, operational and compliance control systems have been reviewed in the context of evolving legal and regulatory requirements and additional assurance procedures have been agreed and implemented. The Company consulted on a draft targeted assurance plan for 2018/19 and has published its final assurance plan on its website. The Audit Committee has reviewed the application of this targeted assurance plan and has reported its conclusions to the Board. The Committee has also considered the need for a dedicated internal audit function in the light of the development of the Quality and Compliance function since its establishment in 2014. Having agreed a programme of internal audit work to be undertaken by a combination of internal and external resources, the Committee has concluded that a separate internal audit function continues not to be needed at the present time. The monitoring and control arrangements operated in the year are considered good, with only minor potential enhancements identified.

Taxation strategy

SES Water regards full compliance and responsible conduct in all aspects of its tax matters as a fundamental part of being a well-run and respected business.

This taxation strategy, which has been approved by the Board, is designed to ensure that the Company:

- Only undertakes tax planning activities that seek to comply with both the spirit and the letter of the law
- Avoids any action or behaviour that might be interpreted as aggressive tax avoidance
- Maintains an open, transparent and professional relationship with HMRC, reflecting mutual respect and a collaborative working relationship
- Maintains an effective governance and risk management framework that ensures these objectives are implemented in practice.

We consider that these objectives will ensure full compliance with the HMRC framework for co-operative compliance.

The Company recognises that the majority of the benefit to be gained from reducing taxation liabilities will, under the regulatory process for controlling charges to our customers, ultimately benefit customers through reduced bills rather than benefit shareholders. The Company considers this an integral part of the incentive-based regime for monopoly service providers in England and Wales.

The Company operates solely in England and its customers are all based here. All of the Company's profits are taxable in the UK.

The Company's effective cash tax rate on reported profits will vary from year to year – and from the standard rate of UK corporation tax – due to the availability of tax deductions for capital investment and pension contributions. These deductions arise from the tax incentives for capital investment and employee retirement provisions that have been maintained by the Government explicitly to encourage such investment. The Company considers that utilising such incentives is entirely consistent with being a well-run and respected business.

Tax risks are encompassed within the Company's general risk management framework (described on pages 28 to 29). In any particular year the principal tax risks arise from changes in legislation or the interpretation of taxation law in practice, leading to higher taxation liabilities than have been allowed for in prices charged to customers.

In addition to corporation tax, the Company makes further contributions to national finances in the form of business rates, employers' national insurance contributions, environmental taxes and other regulatory levies, including charges for abstracting water from the natural environment.

Fair, balanced and understandable assessment

The Board has given careful consideration to whether the Annual Report and accounts, taken as a whole, is fair, balanced and understandable in accordance with the requirements of the UK Corporate Governance Code. The preparation of this document is overseen by the executive directors with input from senior executives from across the business. The whole report has been reviewed in detail by the Audit Committee, which has noted the close personal involvement of directors who are involved in the day-to-day operation of the business and therefore well-placed to ensure the accuracy of matters reported, and the thorough assurance processes which underpin the reliability of key performance information. The Board is therefore satisfied that the document meets the requirements of the UK Corporate Governance Code in this respect.

Going concern

The Company's activities, together with the factors that are likely to affect its future development, performance and position, are set out in the Strategic Report on pages 24 to 29.

The financial position of the Company is set out on pages 70 to 72. Note 17 of the Financial Statements on pages 86 to 87 sets out the Company's position in relation to risks associated with financial instruments, credit and interest rates and describes the Company's risk mitigation measures.

The going concern basis has been adopted for preparing the financial statements. The directors have considered the financial position of the Company and concluded that it will be able to meet its liabilities as they fall due for the foreseeable future. For these purposes, the foreseeable future is taken to mean a period of at least 12 months from the date of approval of this Annual Report. The directors' conclusions on the going concern basis also considered completion of the renewal in July 2019 of the Company's revolving credit facility at market rates.

Long-term viability statement

The directors have assessed the viability of the Company to March 2030, taking account of the Company's current position, performance and the potential impact of the principal risks documented in the Strategic Report. Based on this assessment, the directors have a reasonable expectation that the Company will be able to fulfil its obligations, including meeting its liabilities as they fall due, over the period to March 2030.

In making this statement the directors have considered the resilience of the Company's financial position based on its projections as incorporated in the PR19 Business Plan (updated through the resubmission to Ofwat's initial assessment of our plan).

The directors have tested the Company's ability to withstand the impact of scenarios as suggested by Ofwat, including a:

- Failure to deliver regulatory performance commitments equivalent to 3% of the allowed return on regulatory equity in any one year
- 1% inflation increase and 1% inflation decrease over five years
- 5% increase in bad debt
- 2% increase in interest rates
- 10% totex overspend over five years
- Combined scenario of 10% increase in both operating and capital expenditure, annual penalties for failure to deliver regulatory performance commitments of 1.5% per annum, and penalties equivalent to 1% of turnover.

The directors have also tested the Company's ability to withstand the impact of certain Company-specific scenarios, including:

- A cyber attack that results in a fine of 4% impact of revenue
- A water quality failure
- Loss of high quality staff
- Operating expenditure underperformance
- Failure of our AMP 6 efficiency programme
- Risk with respect to our bond sinking fund requirements
- Additional pension costs on the defined benefit scheme
- Redemption costs associated with our long-term bond
- Combined scenarios for the above cyber attack, operating expenditure underperformance and failure of our AMP 6 efficiency programme.

The directors have determined that the period to March 2030 is an appropriate period over which to provide this viability statement as it is consistent with our recent Business Plan submissions, and takes into account the Company's current liquidity position and committed borrowing facilities, its potential mitigating actions including increasing both borrowings and equity, in addition to suspension of dividends. The directors have also considered the Company's ability to access current and future sources of debt funding, based on recent transactions, current arrangements and discussions with financial institutions. In addition, the above scenarios are in line with the recent Business Plan submission and resubmission, and the directors continue to consider such scenarios relevant for the Company, given that they are reflective of the key risks separately documented within the Strategic Report of this Annual Report. The directors consider the above stress testing scenarios stretching for the Company, based on the fact that these scenarios represent the higher category of risks for the Company.

The assessment criteria the directors have used for testing the potential financial impact of the scenarios, both before and after mitigating actions, is the Company's ability to comply with the financial covenants associated with the £100 million index-linked bond. These covenants generally impose tighter financial constraints than the metrics used by the independent credit rating agencies, who publish their own assessments of the Company's credit strength. Annual compliance with financial covenants is subject to external assurance and certificates of compliance with the broader covenants of the £100 million index-linked bond are issued annually to the independent Controlling Finance Party.

The underlying assumptions within this Long-term viability statement are consistent with those assumptions utilised in the recent PR19 Business Plan submission. Such assumptions, together with data input, were subject to the Company's well-established internal procedures for managing data quality and assurance. In addition, the Company used a range of suitably qualified external assurance providers to give additional comfort to the data and underlying assumptions which were incorporated into the Business Plan, and hence this Long-term viability statement. In particular, a leading accounting practice confirmed the reasonableness of the key assumptions made in preparing the inputs into the data tables that underpin the Business Plan and therefore this Long-term viability statement. The directors reviewed the assurance activities as part of their approval and concluded that appropriate assurance activities had been undertaken that were consistent with SES Water's latest Company Monitoring Framework assessment.

Based on the above scenarios and assessment criteria, the Company remains financially resilient (and has sufficient headroom to raise additional debt within its covenants) to address all scenarios with the exception of the extreme scenarios (combined scenarios and a 10% total overspend). In the latter scenarios, maintaining financial resilience would be achieved through a combination of suspending dividend payments and direct equity injections. Given that this additional headroom might be needed because the probability of more than one event or combination of events occurring increases with the long time horizon being considered, the directors have a signed undertaking from our two main shareholders to provide financial support in the scenarios described to ensure that the Company is able to continue financing and providing services to customers. The directors have also drawn comfort from the longer-term protections which exist under the regulatory regime which enables companies to seek to re-open price determinations in circumstances having a substantial adverse effect upon a Company's ability to continue financing its functions and which places a duty on Ofwat to ensure that efficient water supply companies are able to finance their functions.

SUMISHO OSAKA GAS WATER UK LTD (SOGWUK)

Code of corporate governance principles

As the ultimate holding company of Sutton and East Surrey Water plc (the 'regulated company'), we recognise that the principles which govern our code of corporate governance (the 'Code') should: i) take into account the areas where our activities may have the greatest direct impact on the regulated company; and ii) complement the corporate governance principles of the regulated company.

Accordingly, we have established this 'code of corporate governance principles' to address these considerations as well as regulate and enhance our activities in terms of transparency, risk management and long-term decision making.

1. We shall ensure that our holding structure is transparent and explained in a clear way. This structure, together with any changes, shall be demonstrated and explained in the Annual Report of the regulated company each year
2. We shall provide clear information on our debt and equity structures. This structure, together with any changes, shall be demonstrated and explained in the Annual Report of the regulated company each year
3. We shall be transparent in declaring the interests of our directors. We shall demonstrate this transparency by having a clear internal process for disclosure and publishing a list of such interests in the Annual Report of the regulated company each year
4. We shall disclose and explain any matters at the regulated company level which are reserved for our Board in the Annual Report of the regulated company each year
5. In carrying out our activities we shall ensure that we fully understand and take into account, particularly at Board level, the duties and obligations of the regulated company contained within statute and its licence. In particular, we shall refrain from any action which would cause the regulated company to be in breach of any of its obligations
6. In order that the regulated company may assess any potential impact on its activities and its exposure to risk, we shall provide the regulated company with any information that it reasonably requests about the activities of our wider group. Further, we shall proactively disclose to the regulated company any issues or information that may have a material impact on its activities
7. We recognise the importance of supporting the regulated company in a way that allows it to run its business as if such company were an independent public listed company
8. We recognise the importance of supporting the regulated company in order that it can make strategic and sustainable decisions in the interests of the regulated business for the long term
9. We shall regularly review this Code to ensure that it meets the standards of current best practice. Any changes to this Code shall be reported in the succeeding Annual Report of the regulated company.

Approved by the Board of Directors in June 2014.