

# Water and England: The Future is not what it used to be

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# Chapters

- History of the sector
- How the sector currently works
- The bodies involved
- The sector in practice
- The future
- Conclusions

# History of the Sector (1) – State Control

- Originally water was supplied by independent private entities with no universal strategy or standards
- Overall services taken over by local authorities during the Victorian era to ensure control of such a vital resource was in the hands of public bodies
- This takeover created;
  - Some authority controlled companies;
  - Some larger inter-municipal operators; and
  - A handful of strictly regulated private companies who supplied water only and had no role in wastewater.
- This system remained in place until 1973 when the Water Act radically changed the water sector.

# History of the Sector (1) – State Control

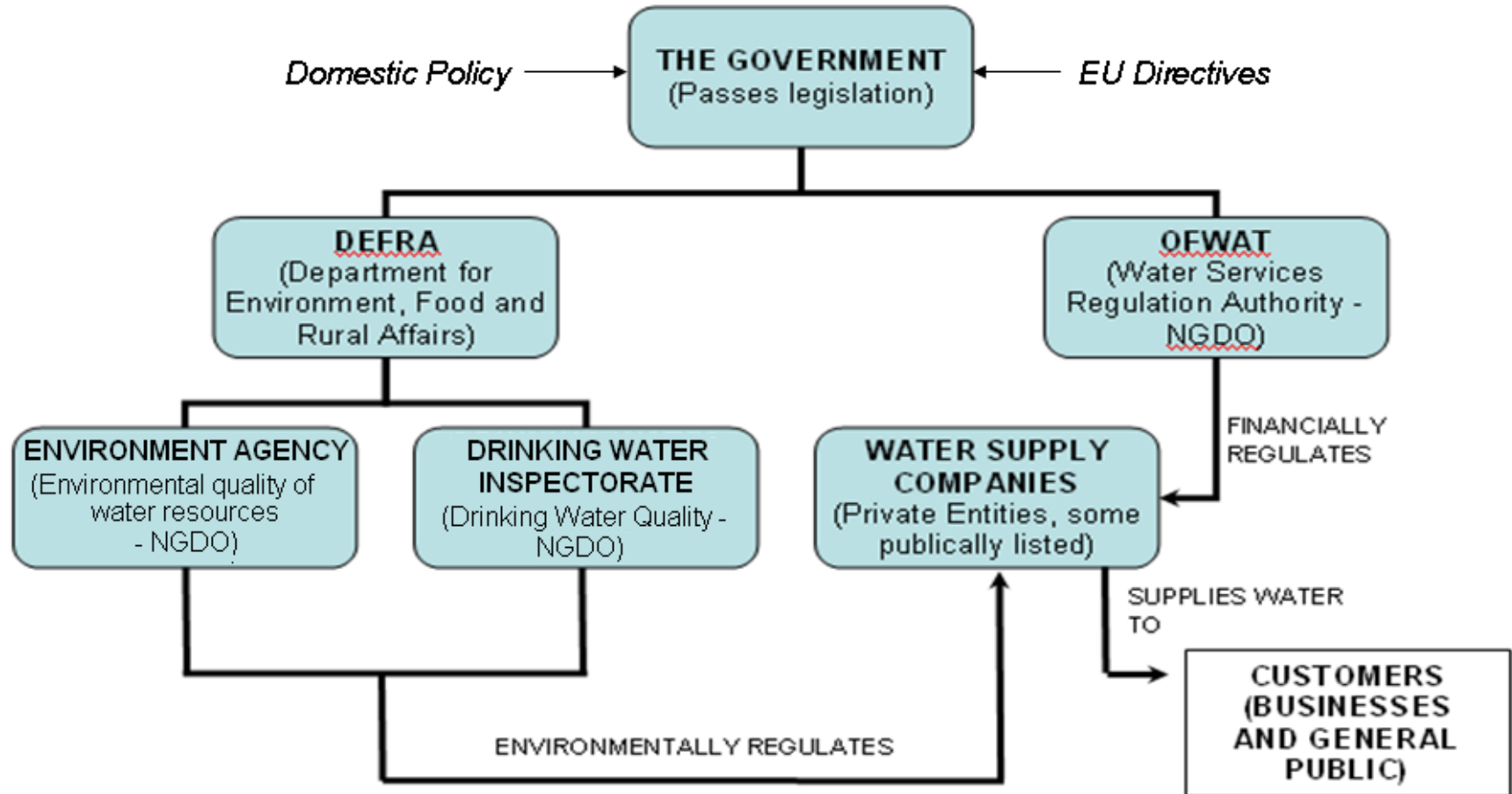
- **The Water Act 1973**

- By 1973 there were 198 water authorities and 1300 sewerage and sewerage disposal authorities. There were also a large number and variety of different owners and controllers, making co-ordinated strategies extremely difficult.
- The Act;
  - transferred control of the sector to the central government, to enable better co-ordination of policy;
  - Created 10 Regional Water Bodies, each covering a river basin area and responsible for their region's;
    - Water quality;
    - Water supply; and
    - Sanitation.
- Members of the public were still allowed to attend board meetings so that the bodies stayed in contact with the end consumers.

# History of the Sector (2) – Privatisation

- **The Water Act 1989 and Privatisation**
  - In 1989 the sector was privatised. It was believed that a publically regulated but privately run sector would:
    - Increase competition;
    - Increase capital investment; and
    - Increase efficiency
  - The Ten Regional Water Bodies were privatised and became the water companies that appear at the top of customer's bills.
  - The Government created Ofwat to serve as the economic regulator and the National Rivers Authority to ensure the quality of water in the river basins. The responsibilities of the latter have since been transferred to the Environmental Agency.

# How the sector currently works



# The bodies involved (1) - Public

- **Government**
  - Passes legislation, sometimes based on EU Directives such as the Water Framework Directive, regarding the water sector.
- **DEFRA (Government Department) acting through:-**
  - **Environment Agency** (NGDO) to control pollution and ensure environmental quality of water sources; and
  - **Drinking Water Inspectorate** (NGDO) to ensure quality of drinking water.
- **Water Services Regulation Authority, aka Ofwat (NGDO)**
  - Independent economic regulator charged with ensuring fair price for consumers, competition, and required investment by the private sector

# The bodies involved (1) - Public

- **Ofwat (cont.)**

- Ofwat is in charge of capping the Water Companies' revenues using RPI – X formula, to ensure they do not abuse their position.
- This formula takes the rate of inflation, measured by the Consumer Price Index and subtracts expected efficiency savings (X). The system is intended to provide incentives for efficiency savings, as any savings above the predicted rate X can be passed on to shareholders until the price caps are next reviewed.
- The “X” figure also encourages competition by serving as a proxy for competitors as it is calculated based on the performance of all the companies.
- Ofwat is also required to ensure that the companies invest in the infrastructure in their area. Every five years a company must present:
  - A concrete five year plan for investment in the network; and
  - A conceptual twenty-five year plan for future investment.

# The bodies involved (2) - Private

- **The Water Companies**

- The Private Water Companies were created in 1989 to supply water and wastewater services to the public, including the treatment side.
- They currently have a 25 year concession for their geographical area, creating regional monopolies.
- Their revenue comes from directly charging the general public for the supply of their services. This is usually a fixed charge agreed with Ofwat, but in some cases it can be metered.

# The Sector in Practice

- **Public demand vs Private demand**
  - Shareholders and owners want profits, public want performance.
  - When Ofwat announced plans to block substantial price increases with a view to cutting the average household bill in its Draft Determination this year share prices of some companies fell by up to 7% that same day.
  - On 26<sup>th</sup> November this year, Ofwat announced plans whereby UK Households will see a £3 fall in average water bills to £340 before inflation over the next five years. This was down from the original proposal of a £14 cut, although broadly charges remained flat under this proposal. Some companies, such as Thames Water and South West Water, were allowed to increase their charges and their share prices increased accordingly.
- **Five Year Plans**
  - A short term plan is insufficient for the necessary massive capital works projects required to:-
    - Meet EU standards (Water Framework Directive);
    - Mitigate the risk of flooding;
    - Tackle climate change and carbon emissions; and
    - Improve the efficiency of the network.
  - Current twenty - five year plans are only rough projections, not concrete long-term schemes.

# The Sector in Practice

- **Competition**

- Generally speaking, people cannot choose their water supplier as they are geographically determined.
- When Ofwat sets revenue caps the “X” value for efficiency savings in the RPI-X formula acts as a proxy for a competitor, as “X” is based not only a firm's past performance, but on the performance of other firms in the industry.
- Recent Cave Report recommends lowering market entry costs, allowing the introduction of specialist companies (some sewage specialists, some supply specialists etc). It also advocates further sector division, however this would require new legislation to remove the existing water companies' concessions.

# The Sector in Practice

- **Division of Responsibilities**

- Three groups of bodies interconnected:-
  - DEFRA (acting through EA/DWI) impose standards for environmental water/drinking water quality based on legislation;
  - Ofwat ensures the investment in the network necessary to meet those standards; and
  - Water companies invest in infrastructure to ensure that standards are met.
- DEFRA, along with the Department for Communities and Local Government, also has responsibility for flood control and mitigation.
- Theoretically the bodies are closely interconnected and work in harmony to produce an integrated and effective system.

# The Sector in Practice

- **Implications of divided responsibility**

**Practical Example: A combined sewer overflows as a result of excess surface water, resulting in flooding.**

- Practical difficulties –
  - DEFRA are in charge of flood prevention but have no control over the sewers so they cannot tackle the problem at its source.
  - Ofwat are in charge of investment in the sewers but do not have a mandate for flood control, and neither do the private companies.
- Legal difficulties - who is responsible when this kind of flooding occurs?
  - Are Ofwat to blame for not ensuring investment in a proper drainage network?
  - Are DEFRA to blame for not having a plan of action relating to overflowing combined sewers?
- Investigation into the July 2007 UK floods found that responsibility for a single crisis was spread between DEFRA, Local Government, the private Water Companies and Ofwat.
- In its November report, Ofwat announced earmarked £1.1 billion to help prevent sewer flooding.

# The Sector in Practice

- **Innovation**

- Cave Report demanded a more concentrated by Ofwat to ensure that Water Companies are making an effort to tackle climate change.
- Issues include;
  - The chemical reactions of all common treatment processes for wastewater and drinking water produce CO<sub>2</sub>
  - 3-4% of energy usage in the UK comes from the water sector
  - Annual carbon footprint of water usage in a four person house can be equivalent of driving a family car nearly 8075 miles.
- However, with no direct competition to encourage them, and a fear of experimenting with such a vital resource, some accuse the water companies of being too “conservative.”
- If a water company makes the headlines, they’ve usually done something wrong! The preference, therefore, is to play it safe, leading to innovation only where it is necessary.

# The Future

- **Pricing measures**

- More widespread water metering
  - Ofwat is encouraging people to switch, claiming that customers save up to 10% off their annual bill by only paying for water they use rather than a fixed charge, however:-
    - Water companies and in some cases the customer must pay for the water meter; a cost neither wants to pay; and
    - Some have stated that the meters are of more benefit to the Water Companies as people will use less water, increasing profit margins.
- Tackling bad debtors
  - Ofwat is encouraging Water Companies to tackle people who are unable or refuse to pay their bills.
  - Currently it is illegal to cut off or limit a persons water supply, so any changes would require an Act of Parliament.

# The Future

- **Future Investment**

- Ofwat wants over £20bn to be invested in the water network over the next five years in a bid to improve service and also bring reservoirs and basins up to EU Standards.
- Thames Water, for example, has five major projects in the pipeline, including replacing the Victorian water mains in London and the creation of new sewer tunnels under the Thames.
- However, with charges remaining broadly flat for the next five years under Ofwat's November 2009 plan questions have been asked as to where this extra investment is going to come from if companies cannot increase their charges? Even with the increases allowed the prices Ofwat has decided at still an average of 10% lower than what was demanded by the water companies

# Conclusions

- **Successes**

- £70bn has been invested since privatisation, well above what the government was investing before. In the first six years of the private sector there was £17bn of investment, contrasted with £9.3bn in the preceding six years.
- Water leakage across the network has dropped 35% since the mid 1990s.
- The quality of the rivers has been improved significantly. The River Thames, for example, is now home to wildlife again despite being a dead river at the time of privatisation.

- **Criticisms**

- Leakage is still a problem. Thames Water were heavily criticised in 2006 for imposing a hosepipe ban when they were losing 1/3 of their water supply through leaks.
- Concerns about Private vs Public demand are still as prevalent now as in 1989.
- Innovation to find solutions to climate change is not moving as fast as many would like, especially with treatment works having to work harder to meet EU water quality standards.

# Conclusions

- **Is Ofwat achieving its goals?**

- **Increasing competition**

- Regional monopolies still exist
- RPI – X is not a true proxy for real competition

- **Increased investment**

- More money is flowing, but five year plans are too short and narrow for consistent and effective investment schemes.
- Consistently increasing profits by the private sector has led to criticism that Ofwat is not doing enough to ensure that investment is made. Severn Trent's unveiled a 51% annual profit increase only 24 hours before Ofwat's most recent ruling.
- Ofwat's decision to only cut average bills by £3 instead of the originally proposed £14 has been seen by some as bowing to the pressure of the water companies rather than putting the public first

- **Increased efficiency**

- Overall service has shown improvement, with less leakage and more effective water treatment, but Private Sector's interests are still seemingly incompatible with the public's.

# Conclusions

- At privatisation, the water companies inherited a sector suffering from a lack of investment. Some of the issues this caused are still present in the current vastly changed circumstances
- Today, they face challenges in terms of controlling carbon emissions and meeting strict standards of water quality.
- Notwithstanding these challenges, they must nevertheless satisfy their shareholders (or equivalent bodies) who will be seeking a profit from their investment.
- So, given the conflicts of interest in the private sector and the seemingly inadequate control mechanisms in the public sector we must ask;
  - Is the so called “British” model of water privatisation fit for purpose in the light of the climatic, economic, environmental and social conditions existing and anticipated in the UK today?
  - Can a privately owned sector regulated by a number of different bodies *ever* produce a system fit for the demands of the 21<sup>st</sup> Century in the UK?

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