A socially responsible water industry?

A case to answer in 2015

Peter Kenway and Adam Tinson

Table of Contents

Summary

A socially responsible water industry?

Our last report on the water industry in England and Wales for UNISON, published in 2013, concluded by asking a wide-ranging set of questions about this essential yet now very peculiar industry. Little has changed since then and all those matters are just as pertinent today. What this report does is to delve further into just some of them.

The matters it leaves aside are the more economic ones, about investment and debt. This doesn't mean they are not important: on the contrary, their very importance demands more attention than we can give them here.

The matters it takes up are those to do with social responsibility. The question this report asks is what would it take for the water industry to start to merit the label "socially responsible"?

Key findings

- Water and sewerage bills in 2014-15 are some 40% higher in real terms (after inflation) than they were in 1989-90, when water was privatised. Between now and 2020, water bills will rise in line with the index of inflation (CPI) that the government thinks should be used to measure real growth in incomes.
- Bills vary between regions, the South West having the highest average (£482 per year). The average in Scotland (£346), partly due to public ownership, is among the lowest.
- Bills also vary within regions in ways unrelated to usage. Although unmetered customers are more likely to be on a low income, average unmetered bills are at least £60 a year higher than average metered bills.
- 22% of households face water affordability problems (3% or more of income spent on water bills). Unmetered households are more likely to face such problems (24%) than metered households (18%). 8% of households face deep affordability problems (5% or more of income spent on water bills).
- By April 2015, 14 of the 18 largest companies will offer a social tariff. There is great variation among the eight in operation before then. Even the most generous of them (to cover 4%) falls far short of the scale of the affordability problem (22%). Two of the eight exclude unmetered customers.
- Half of the water industry by turnover is now ultimately owned by private equity consortia. The exact form and complexity of private ownership matters

because of what they mean for transparency, accountability and tax revenues. It is not that rules are being broken; rather that the rules are wrong.

- Just 17% of income generated in the water industry goes to wages. Thanks to this very low wage share, water would be well able to ensure that the lowest paid people working for it, directly or indirectly, were paid the living wage. Yet only two water companies are accredited living wage employers.

Conclusions

The focus of this report is on what it would take for this vital industry to meet the minimum standards for social responsibility. There are three elements to it:

- Address the problems of water unaffordability. With approaching one quarter of households facing such a problem, social tariffs benefiting 0.4% or even 4% of customers are nowhere near enough.
- Pay the living wage. With its incredibly low wage share of total income and lack of competition, no industry is better placed than water to pay the living wage, both to direct employees and subcontractors.
- Pay taxes where the income is earned; be transparent. Profits on water in England and Wales are earned here; taxes on them should be paid here. In an industry without competition, this industry should be a model of transparency.

These proposals add up to no more than a minimum standard for social responsibility. If not in the water industry, where?

1. Introduction

The focus of this report is the 10 Water and Sewerage Companies (WSCs) and the eight largest water-only companies (WCOs). In this report, these 18 will be referred to as the industry. There are another six WCOs but these are tiny and are often missing from industry statistics. The WSCs accounted for 92% of industry turnover in 2013-14.

The ten WSCs are Anglian Water, Dŵr Cymru Welsh Water, Northumbrian Water, Severn Trent Water, Southern Water, South West Water, Thames Water, United Utilities, Wessex Water and Yorkshire Water. The eight WCOs are Affinity Water, Sembcorp Bournemouth Water, Bristol Water, Dee Valley, Portsmouth Water, South East Water, South Staffordshire Water, Sutton and East Surrey Water.

The water industry in England and Wales was privatised in 1989. Its key features, and how they compare with Scotland and Northern Ireland where water remains in the public sector, are described in appendix 2.

All but two of these 18 companies were in existence at the time of privatisation. Of these 16, all ten of the large WSCs and three of the WCOs were plc's whose shares were listed on the London Stock Exchange. Two were privately owned companies. Another was the subsidiary of a foreign multinational.

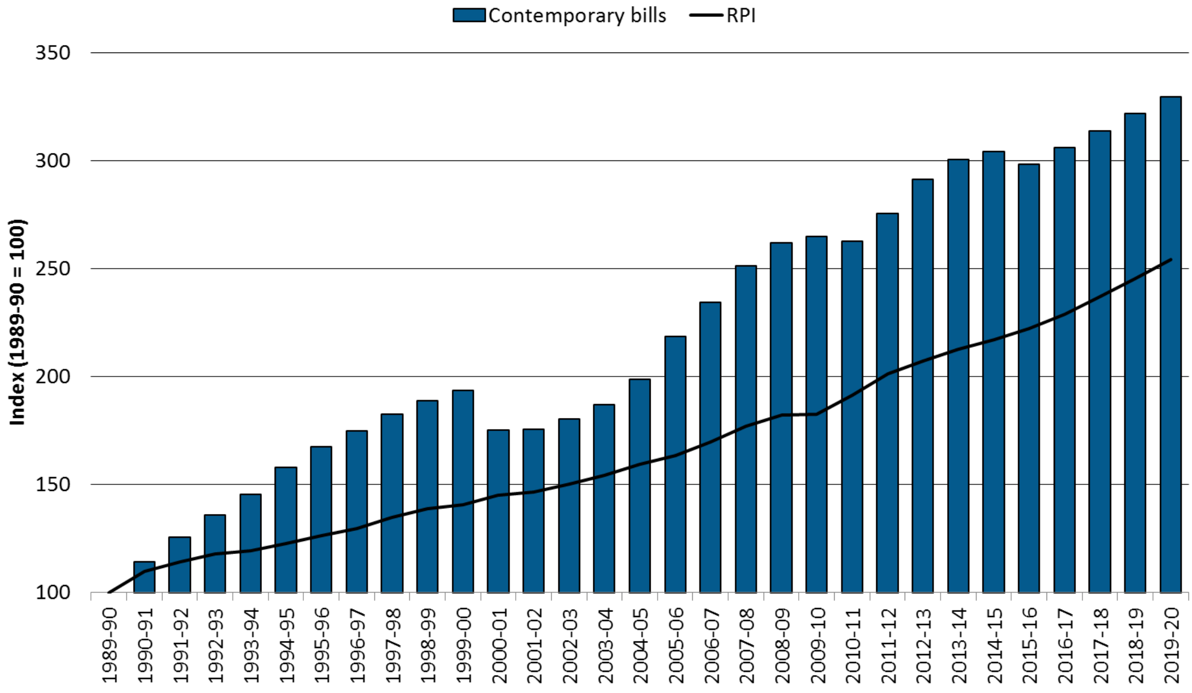
The mix created at privatisation lasted until the early 2000s. In 2001, Welsh Water, which had gone through various corporate hands since 1996, became a wholly-owned subsidiary of Glas Cymru, a not-for-profit company operating only in water. Within the industry, Dŵr Cymru Welsh Water (DCWW), the sixth largest by turnover, is unique. Although a not-profit, it is not quite a mutual, being owned by neither its employees nor its customers.

The big change in the early 2000s was the transformation of many of the plc's into private companies, often owned by private equity consortia. Southern Water (seventh largest) was the first to go eventually joined by Thames, Anglian and Yorkshire (the first, fourth and fifth largest). The second, third and ninth largest (United Utilities, Severn Trent and South West) remain stock exchange listed.

2. Water and sewerage bills

2.1 Household water bills to 2020

Figure 1: average household bills and retail prices (RPI) since privatisation



Source: Ofwat, ONS.

Figure 1 compares how water bills and the retail price index (RPI) have risen since privatisation. It includes the projection based on the latest price settlement to 2019-20, using inflation estimates from the Office for Budget Responsibility.

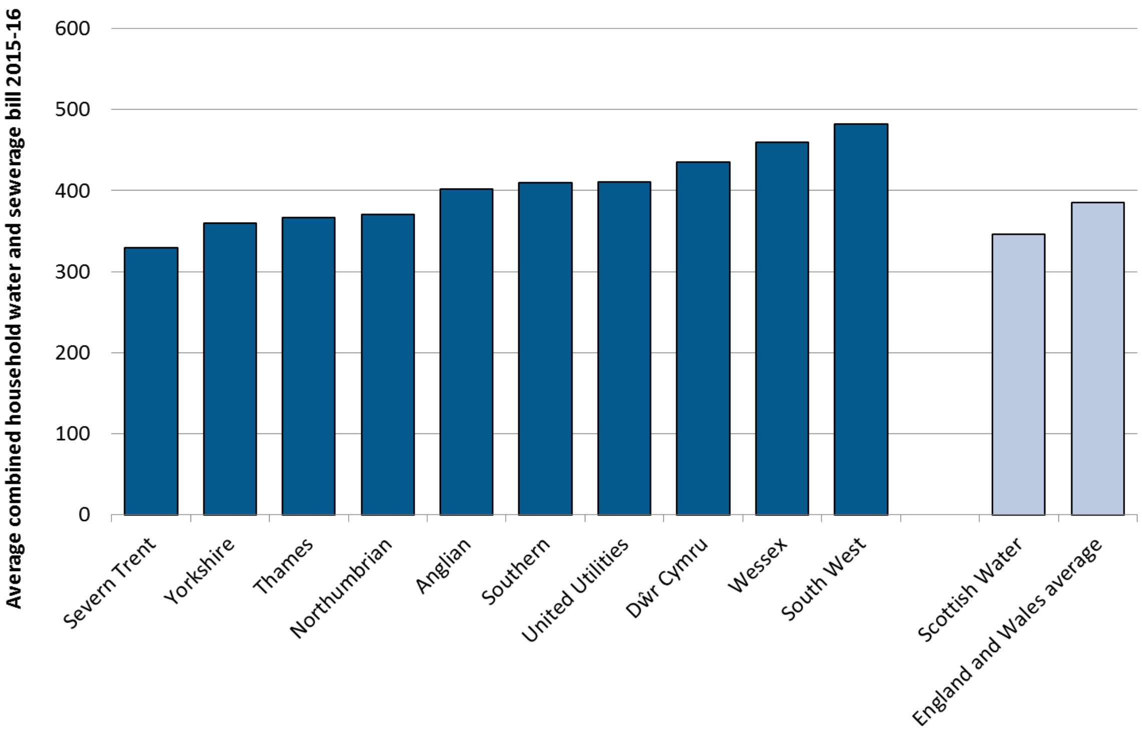
The long term picture is of water bills increasing faster than prices overall: in 2014-15, bills are just over three times higher than at privatisation, whereas prices are around 2.2 times higher. At £385, the water bill in 2014-15, is therefore some 40% higher after inflation than in 1989-90. The recent price settlement has held down future rises, with bills in 2019-20 expected to be around 30% higher after inflation than in 1989-90.

When Ofwat announced the price settlement to 2020, it said bills would be £20 lower in 2019/20 after RPI inflation than now. But when it comes to good things like earnings, the government now prefers the consumer price index (CPI) which goes up more slowly than RPI. Measured against CPI, the next five years look less good with bills after inflation falling by just £2 between 2014-15 and 2019-20.

With our last report finding that profits make up around 30% of the average bill, can the level of water bills be justified?

2.2 Variation in household bills

Figure 2: water and sewerage companies' average household bill: 2015-16



Source: Ofwat, Scottish Water.

Figure 2 shows the average household bill for each WSC in England, Wales and Scotland. They range from £330 per year for Severn Trent to £482 for South West. Bills vary for a number of reasons – for example, the south west has a long coastline to keep clean. Scottish Water has an average bill of £346, £39 lower than the England and Wales average. Answerable through Scottish government ministers, Scottish Water is more open to pressure from customer and public opinion. Although lower now, Scottish bills had previously been higher in order to pay for investment.

Bills vary within water regions depending on whether households have water meters. In 2013/14, unmetered bills were higher on average by 17%. The premium is highest for South West (almost double the metered bill). According to the Family Resources Survey, 40% of households had water meters in 2012/13. Lone parent families were the least likely to have a meter (32%) and pensioners the most likely (52%). Only 33% of social rented sector tenants had a meter (33%). Metering has been growing only slowly. A 2011 report foresaw the proportion rising to around 50% by 2015.[1]

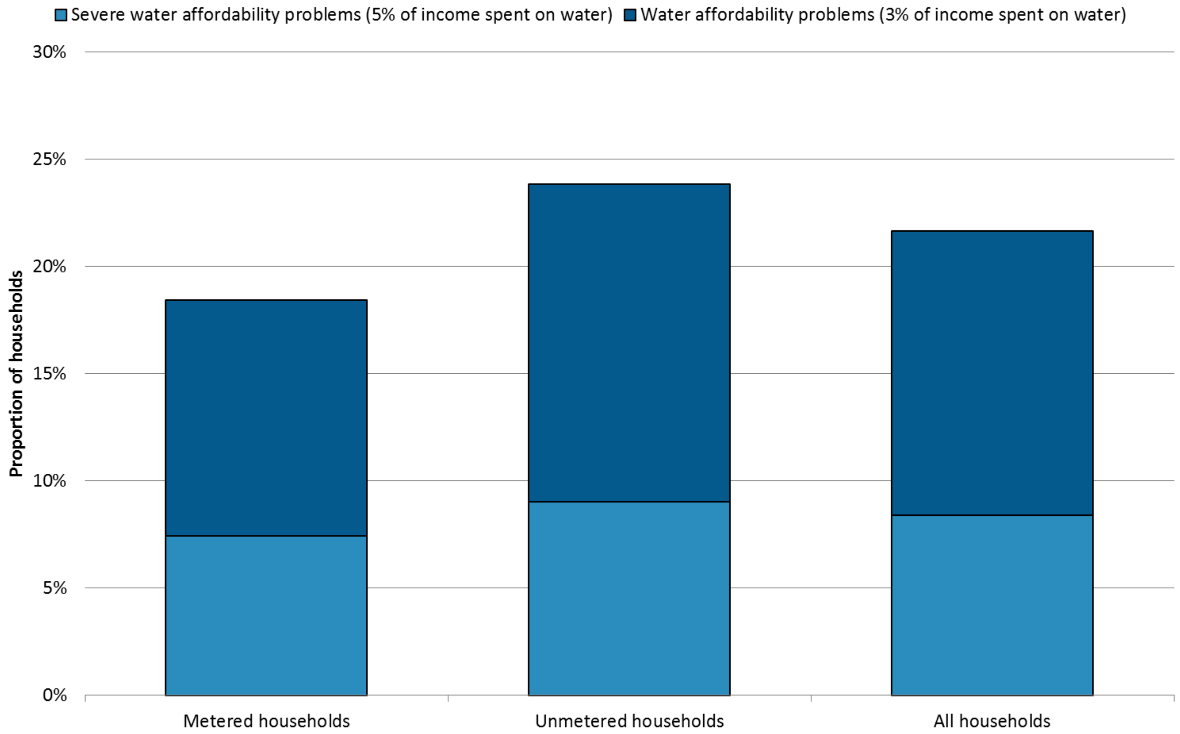
The variation in water bills between regions is well-known whereas the variation within regions is not. If it is not based on usage, is it reasonable? If it is linked to metering, is metering accessible to all who want it?

[1] http://www.bbc.co.uk/news/business-28879168; http://www.ofwat.gov.uk/future/customers/metering/pap_tec201110metering.pdf

3. Affordability problems

3.1 Who experiences affordability problems?

Figure 3: households facing problems of water affordability: 2012-13



Source: Family Resources Survey, DWP. The data is for 2012-13.

Figure 3 shows water bills as a proportion of household income after housing costs separately for those with and without water meters. Those who spend more than 3% of their income are said to have an affordability problem (sometimes referred to as ‘water poverty’). Those spending more than 5% have a severe affordability problem.

22% of households had an affordability problem and 8% had a severe affordability problem. Affordability problems are more widespread among unmetered (24%) than metered households (18%). Severe affordability is more evenly spread (9% and 7%).

These differences reflect several factors including higher average bills for unmetered households. Unmetered customers are also more likely to have lower incomes. 57% of poor households have water affordability problems; 59% of those with water affordability problems are also poor. Some 3.6m poor households have a water affordability problem while 2.4m have an affordability problem but are not in poverty.

Proposals to address problems of affordability must be commensurate with the scale of the problem and must apply to unmetered as well as metered customers.

3.2 WaterSure and companies offering social tariffs

Figure 4: companies already offering or about to offer a social tariff: 2015

Already offering a social tariff (8)	Offering a social tariff from April 2015 (6)	Introducing social tariffs later or not at all (4)
Affinity, Anglian, Bristol, DCWW, South West, Sutton and East Surrey, Thames, Wessex	Northumbria, Severn Trent, South East, Southern, United Utilities, Yorkshire	Dee Valley, Portsmouth, Sembcorp Bournemouth, South Staffordshire

WaterSure is a long-standing nationwide scheme which applies to certain vulnerable customers in metered households. It applies to all companies. The scheme is limited to those on particular means-tested benefits who also have either three children in full-time education or a medical condition which requires high water use. The scheme caps the annual water bill at the average metered bill for the region.

Since 2012, water companies have also been able to establish their own social tariff scheme, although they are under no compulsion to do so. Under the current system, companies wishing to introduce a social tariff scheme must first consult their customers. One company (Sembcorp Bournemouth Water) has decided against introducing a scheme after its customers rejected the idea.[2]

Social tariffs can take several forms, including a discount on bills, reductions on a certain amount of metered use or rebates. Eligibility is normally based on income or receipt of certain social security benefits. Some companies rely on the WaterSure criteria. Current government policy means that funding for social tariffs must be through cross-subsidy from other non-eligible customers, which the government suggests should generally be below 1.5% of the average annual household bill.[3] As well as social tariffs, some companies also offer low income consumers advice or referrals for advice as well as debt restart schemes.

Why shouldn't poorer households be entitled to financial assistance wherever they happen to live?

[2] Ofwat, 2014 price review risk-based review – recommendation to Ofwat's Board on Sembcorp Bournemouth Water's business plan categorisation, 2014.
[3] Defra, Company Social Tariff Guidance, 2012.

3.3. Details of current social tariff schemes

Figure 5: details of the eight social tariff schemes in effect in March 2015

Company	Details	Metered only or both?	Number expected by 2019-20 (% of customer base)
Affinity	Flat bill tariff for low income or means-tested benefits	Both	30,000 (2.2%)
Anglian	Lower volume charge for means-tested benefits	Metered	N/A
DCWW	£262 cap for those meeting WaterSure criteria	Both	80,000 – 100,000 (3.2% to 4%)
South West	15%-50% discounts depending on extent of low income	Metered	8,000 (1%)
Sutton and East Surrey	25% discount for low income elderly, disabled or parents of young children	Both	5,000 (1.9%)
Thames	50% discount for those meeting WaterSure criteria and whose bill exceeds 3% of income	Both	37,000 (0.4%)
Bristol, Wessex	Assessment by Citizens Advice and a payment amount set	Both	22,000 (1.3%)

Figure 5 presents the main details of the eight social tariff schemes offered by companies in March 2015. Social tariffs vary in terms of breadth (how many people can be covered) and depth (how generous the scheme is to individual recipients). The trade-off between these two, as well as the variation in current schemes, makes it hard to make a definitive judgement as to the "best" scheme.

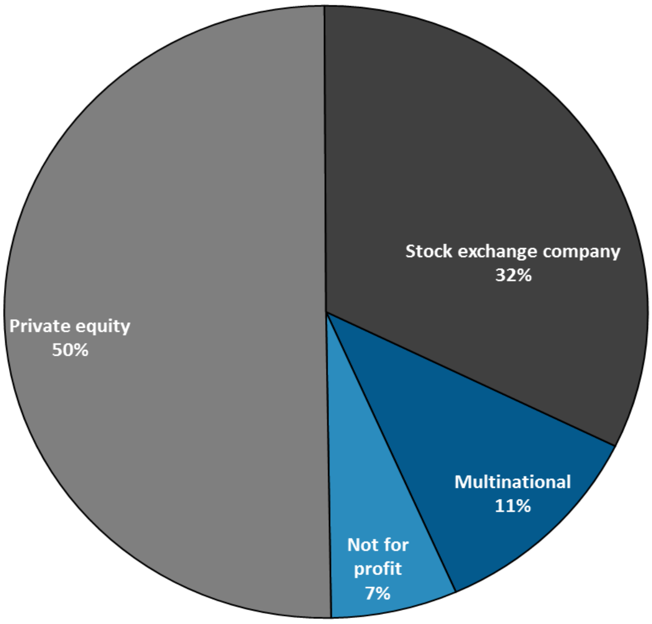
None of the schemes offered at the moment even come near to matching the level of the severe affordability problem (8%). There is also a big difference in coverage among the schemes, from Thames' 0.4% to DCWW's 4%. Two of the eight schemes also exclude unmetered customers.

The social tariffs on offer fall far short of answering unaffordability. Even if they were more ambitious, they may need to be part of a broader affordability programme. The variation between different companies shows that there is great scope for much improved tariffs in some cases.

4. Companies and performance

4.1 Different kinds of private ownership

Figure 6: Share of £11.6bn water industry turnover by company type: 2013-14.



Source: Water company Profit and Loss Accounts, Water UK. The data is for 2013-14.

Figure 4.1 shows the share of turnover according to the type of private ownership, namely stock exchange plc's (32%), multinational subsidiaries (11%), not-for-profit (7%) and private equity (50%). As the first two differ little, that leaves three, very different, types of private company operating in the water industry. By comparison, five of the big six energy companies are private equity; the other, SSE, is a plc.

Ownership matters for what goes with it. Plc's must meet stock exchange rules and are subject to the financial markets; private equity is freer. The not-for-profit operates only in the water industry and has a simple company structure; private equity is often more complex, with multiple layers within and beyond the UK. Complexity opens up legal opportunities to reduce tax liabilities, costing the public purse a lot of money.

One way for water companies to show they are meeting a minimum threshold for social responsibility would be to follow SSE's example and sign up for the 'Fair Tax Mark'. This is an initiative that provides a quality standard for companies which are open and pay an amount of tax appropriate to their level of economic activity.

As water consumers have no choice, the government and the regulator must insist on the highest standards of transparency and accountability. Major public utilities in a regulated industry should be paying their fair share in tax

4.2 Earnings, low pay and the living wage

Figure 7: total employment costs as a share of GVA (the "wage share"): 2013

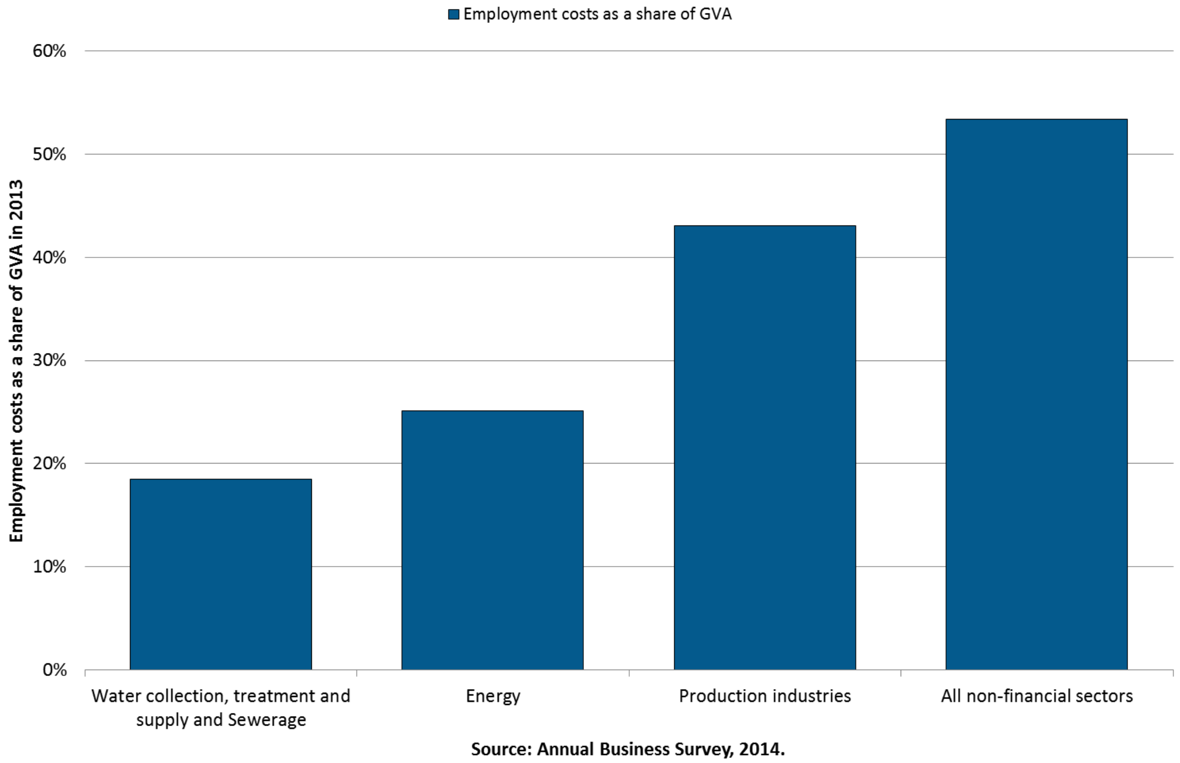


Figure 7 shows wages as a share of the total income generated (gross value added) in the water industry and three comparators. This "wage share" is an indicator of the headroom available to raise pay, the lower the share the greater the headroom and vice versa. At 17%, the wage share in water is less than half the 43% production industry average and only two thirds of the capital intensive energy industry.

Against this background, introducing the Living Wage should be easy for the water industry. Less than 10% of employees in water were paid below the living wage in 2014, half the national average. To these low paid jobs must be added those done by external contractors (often including cleaning, catering and security). As many other public and private sector companies are already doing, water companies could require their contractors to pay the Living Wage. Currently only two of the 18 companies – South East Water and Yorkshire Water – are accredited living wage employers (although companies can be paying at least the living wage without being accredited). Both extend the living wage to third party contractors and suppliers as well as permanent employees.

Few if any industries are better able than water to ensure that the lowest paid people working for it, directly or indirectly, are paid the living wage.

Conclusion: a social responsible industry is the least we should expect

Last time round we said this – and we see no reason not to repeat it.

> "The water industry in England and Wales is subject neither to consumer (market) pressure nor to government control. There is no competition. Unlike energy, it is rarely subject to political or media criticism. Of course there is an industry regulator but 'capture' of regulators by those they are regulating is a well-known and serious problem. Over several years of moderately high inflation, water bills have been allowed to rise even faster.
>
> "Such concerns are compounded by the unusual nature of the UK water industry from an international perspective. Most water systems tend to be organised on a municipality basis, like the UK was before 1973, and particularly before 1945. The UK is also unusual in having a largely private sector dominated industry, France being the only other OECD country in this position."

The focus of this report, narrower than the last, has been on what it would take for this vital industry to meet even the minimum standards for social responsibility. In broad terms there are just three elements to it:

- ***Address the problems of water unaffordability***. With approaching one quarter of households facing such a problem, social tariffs benefiting 0.4% or even 4% of customers are nowhere near enough.
- ***Pay the living wage.*** With its incredibly low wage share of total income and lack of competition, no industry is better placed than water to pay the living wage, both to direct employees and subcontractors.
- ***Pay taxes where the income is earned; be transparent***. Profits on water in England and Wales are earned here; taxes on them should be paid here. In an industry without competition, this industry should be a model of of transparency.

These "demands" are about as mild as they could be. It is a measure of where this industry is at that SSE, the one plc among the big six energy companies, both accredited as a living wage employer and signed up to the fair tax mark, looks like a distant beacon of good practice. These proposals add up to no more than a minimum standard for social responsibility. If not in water, where?

Appendix: Water industry ownership across the UK

This is an edited version of a page from our 2013 report, *Water ownership: a case to answer*.

It was only in England and Wales that the water industry was privatised. Water and sewerage services continue to be provided by the public sector in Scotland and Northern Ireland.

England and Wales

- Ownership: private. The household names that are the English water companies are owned by either parent companies listed on the London stock exchange, multinational corporations or private equity consortia. Dŵr Cymru (Welsh Water) is different being owned by a not-for-profit company limited by guarantee (Glas Cymru). Glas doesn't have shareholders but members who are appointed by an independent board.
- Accountability: to Ofwat, the Consumer Council for Water, the Environment Agency and the Drinking Water Inspectorate.
- Charges: according to regulations set by Ofwat. The method is known as RPI + K, where RPI is the Retail Price Index inflation measure and K is some additional measure for investment and profit.

Scotland

- Ownership: public. Scottish Water is public corporation answerable through Scottish government ministers to the Scottish parliament.
- Accountability: to the Scottish Parliament, with performance monitored by the Water Industry Scotland Commission. There are also environmental agencies and Consumer Focus Scotland.
- Charges: set by the Water Industry Scotland Commission, to reflect objectives set by the Scottish government.

Northern Ireland

- Ownership: public. Northern Ireland Water is a government-owned corporation.
- Accountability: to the Northern Ireland Utility Regulator, which works with various environmental and consumer bodies.
- Charges: customers do not pay water charges, the company instead being largely funded by government subsidy.