Britain's Yorkshire Water plans to off-load costs onto customers

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The privatised utility Yorkshire Water has announced plans to spin off the water business to a mutual, non-profit-making trust owned by its customers. The new business, called a “Registered Community Asset Mutual” (RCAM), will own the water and sewage infrastructure but will subcontract their operation back to former owners Kelda for the first five years. After that, the RCAM will be free to subcontract operations to whichever company offers the best rate.

The creation of an RCAM comes 11 years after the Conservative government first sold off the water industry as part of its privatisation programme and is being presented as a new form of public ownership in line with Prime Minister Tony Blair's “stakeholder” philosophy. Kelda has said that customers will own the water assets, that obtaining finance will be cheaper and water prices lower. The trade unions have supported this argument. Alex Thompson, national secretary of the water division of Unison, the main public sector union, said, “Unison supports in principle the creation of a mutual for the water assets and the return of these to the control of the water customers.”

In reality, water customers will have no more control over the water industry under RCAM's than under the previous privatised arrangements. Kelda's chairman John Napier stated emphatically that the deal was a means of “focusing aggressively on shareholder value”.

Kelda proposes to sell its water assets to the RCAM for £2.4 billion—an estimated value used by the Office of Water Services (Ofwat), the economic regulator for the water industry in England and Wales, that is well above the current stock market price. The sale will enable Kelda to pay off its £1.4 billion debt, leaving the company free to concentrate on its business in the US and facilities management. Shareholders will receive a £1 billion pay out. Not surprisingly, the City of London was ecstatic at the news. Shares in Kelda and other privatised water companies, which had fallen by 40 percent in the last year, rose at the prospect of offloading their regulated water businesses. The *Financial Times* congratulated Kelda and said, “From the shareholders' point of view, spinning the water and waste water assets into a mutual, financed by debt, is all gravy.” Shareholders have received £351 million in dividend payments and, until recently, had watched the price of their shares rocket.

The new mutual will have to raise large sums of money on the bond market to finance the deal and use its future income from customers to service the debt. It will have to raise additional finance to fund the investment programme required by the European Union to restore drinking water quality and clean up rivers and beaches. Apart from the Kelda shareholders, the real beneficiaries of the deal will be the bondholders, not the customers who will have to pay for it all.

The water industry's problems with financing come from its nature as a “mature” industry with a stable demand. Water, like all industries requiring a costly infrastructure to deliver a service—such as gas, electricity, telecoms and rail—is highly capital intensive. This makes it difficult to recover costs, meet investment demands and make a rate of return on capital *unless* prices are allowed to rise. And Ofwat has given the water industry a licence to print money. Prices have risen more than 60 percent above inflation to cover the cost of the investment programme. Surplus revenues were used to finance generous dividends and unsuccessful takeovers, as the privatised water utilities also sought profits in unregulated activities. Consequently, the industry had cut back on investment and borrowed heavily to finance its regulatory commitments.

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One of the main justifications for privatisation was that the capital markets would fund the much needed investment to upgrade the crumbling water and sewage infrastructure that the public sector could not afford. Yet, in the summer of 1995, the public water supply in West Yorkshire failed and was only maintained by a massive road-tankering operation to maintain supplies for three months. The Northumbrian water supply failed during Christmas 1995 when the main pipes froze. Leakage's rose to 33 percent as companies cut back on maintenance of the underground network.

In the first five years after privatisation, only 8.6 percent of water pipes and less than 1 percent of critical sewers were renovated or renewed. Since then, the improvement has been even more marginal. At this rate, it would take more than 100 years to replace the water pipes and five centuries for the sewers. The rat population is increasing rapidly and untreated sewage is leaking into the groundwater via cracked sewers, threatening public health and the future delivery of services.

Meanwhile, thousands of workers have been laid off in the industry. Hundreds of thousands of customers have been disconnected for non-payment of bills, something that was illegal before privatisation. Meters have been installed and low-income families have had to ration their water use to prevent incurring high bills and shutoffs.

Increasing public outrage over water shortages, leakages and “fat cat” pay-outs to company executives and shareholders forced Ofwat to reduce the rate of price increases and insist that the companies carry out the investment programme. Last year a price cut was announced. In response the industry has sought to find ways of evading the regulator, hence the move to a new form of ownership. The move by Yorkshire Water to create an RCAM will saddle the new utility with massive debts to finance the repurchase of what was once a publicly owned asset. For companies such as Kelda, it really is a case of “heads I win, tails you lose”.

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