

UK water companies fined millions after fiddling accounts

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Companies supplying water to more than half the population in England and Wales have been fined millions of pounds this year, after fiddling their accounts and cheating customers.

The industry watchdog Ofwat has fined Thames Water, the UK's largest water company, £12.5 million (US\$25 million) and Southern Water £20 million (US\$40 million), accusing the companies of “misreporting” regulatory data, which allowed them to raise prices by more than they should have done. Southern Water directors have agreed to pay up (a Serious Fraud Office investigation has been dropped), but Thames Water directors are contesting the penalty.

Ofwat chairman Philip Fletcher said, “From the evidence we have seen it is clear that Thames Water has failed to meet the Guaranteed Standards Scheme performance standards. The failures were within the company's control, and some customers have not received the standard of service to which they are entitled. As a result customers' interests have been damaged.”

“It is extremely disappointing that we have had to take this action against Thames Water for its customer service failures, coming on top of the company's breach of its leakage target. This is a clear warning to Thames Water that it must be focused on delivering the services that customers have paid for,” Fletcher added.

Ofwat CEO Regina Finn said, “Southern Water deliberately misreported its customer service performance to Ofwat and systematically manipulated information to conceal the company's true performance over an extending period of time.”

Finn added, “The magnitude of this fine reflects the magnitude of the offence—deliberately misleading the regulator, failing of the Southern Water board of directors to pick up the deception, the resulting poor service to customers and damage to the regulatory regime, in general.”

Ofwat will probably seek compensation from the UK's second largest water company, Severn Trent Water, next year for similar offences. However, the regulator is waiting until criminal proceedings against the company are

completed following a two-year long Serious Fraud Office investigation into claims that data relating to the amount of water that leaked from its pipes had been falsified. Ofwat uses leakage figures to assess a water company's performance and to determine how much they can charge customers. Severn Trent Water has already been ordered to repay £42 million it overcharged customers after lying to Ofwat about the company's level of income and bad debt.

Ofwat is also investigating a fifth company, Three Valleys Water, after “irregularities” were found in data relating to the billing of customers with water meters. And United Utilities has been fined £8.5 million for cheating its customers by a different method—paying high prices to its unregulated sister companies and then arguing that bills should be higher. Fletcher said that over a 10-year period, United Utilities water division would have overcharged its customers by about £80 million.

It is unlikely the latest scandal would have come to light if it had not been for Severn Trent employee, David Donnelly, blowing the whistle on the false data being given to Ofwat and in the process exposing the cosy relationship that existed between the regulator, the company and its auditors.

Donnelly had worked for Severn Trent since 1975 and became a financial analyst. He has always admitted that he falsified the figures, but said he acted under pressure from senior management and that many people were aware of what was going on. According to Donnelly, the figures allowed the company to impose an extra price rise on its customers, equivalent to £50 million in two years, or £17 per customer.

Donnelly raised his concerns in early 2004 with the directors of the parent company, Severn Trent Limited, who asked the Forensics section of its auditors PricewaterhouseCoopers (PwC) to investigate. In May 2004, Donnelly reported Severn Trent to Ofwat. However, in November 2004, the company concluded that the accounts were satisfactory and customers were not overcharged. Ofwat later revealed that two of the usual PwC auditors were on the forensics team and that it was a “surprising

omission” that some of Donnelly’s staff were not interviewed during the investigation. It also complained about the initial lack of cooperation with the parent company.

Donnelly went public in the *Daily Mail* in November 2004, feeling that the company and Ofwat were trying to bury a scandal that threatened to further undermine public confidence in the privatised water companies and the regulatory system. Severn Trent chairman Sir David Arculus embodied this relationship. He was also chairman of the Labour government’s Better Regulation Taskforce, where he became architect of the “Regulation—Less is More” programme and president-elect of the Confederation of British Industry.

It was only in January 2005 that Ofwat finally began its own investigation. The Labour government mounted a damage-limitation exercise by giving Ofwat the power to levy a financial penalty not exceeding 10 percent of a company’s turnover. (Bear in mind, 10 percent of Thames Water’s regulated turnover last year was £140 million, yet its operating profit was nearly £430 million).

Ofwat published its *Interim report on allegations made against Severn Trent Water* in March 2006. It found no basis for Donnelly’s claim that directors of Severn Trent “directed the deliberate miscalculation and that knowledge of it was widespread,” but it did conclude the company had provided regulatory data which was “either deliberately miscalculated or poorly supported,” leading to bills being higher than was necessary. Its mealy-mouthed conclusion—it could not be otherwise without implicating Ofwat itself—was that the “culture” in Severn Trent Water “led to data being submitted that was not accurate or well supported and that was influenced by a desire to present a particular position or achieve a particular outcome. We consider that Severn Trent Water’s approach fell significantly below the standard we expect.”

Throughout the period, Donnelly was vilified. He was forced on sick leave soon after he raised his concerns and then spent two years on half-pay with a disciplinary charge of gross misconduct hanging over him. The disciplinary hearing document said, “Whilst Donnelly has claimed that such disclosures are protected pursuant to whistle-blowing legislation, he did not raise such allegations as a genuine whistleblower and in good faith to seek to right what he perceived to be a wrong, but rather to further his own purposes.”

“The very fact that I am charged with manipulating the accounts is a very strange form of vindication,” Donnelly retorted. “After all, the only one to gain from twisting the regulatory submissions was Severn Trent Water—I certainly did not. What purpose could I possibly have in doing this?”

Donnelly eventually came to an early retirement agreement with Severn Trent in August 2006, but it involved a clause forbidding him speaking about the case. He said he was unlikely ever to work again adding, “Once you have blown the whistle, you are all alone. The accusation is made that you are feathering your nest and it is hard to fight.”

Most of the Severn Trent board left, too, but they have done rather better for themselves. Arculus became chairman of mobile phone operator O2, and CEO Robert Walker became chairman of the retailer WH Smith.

The overcharging affair is the latest in a string of scandals hitting the water and sewerage industry since the Thatcher Conservative government privatised it in 1989. Profits and dividends have soared. Severn Trent posted a record £150 million in the six months up to September this year, with shareholders receiving a seven percent rise in dividends and Thames Water announced a 50 percent leap in its profit. Profit margins are typically 40 percent—four times the international average. At the same time, water bills have increased by 7 percent this year—well above inflation—making the average bill £312 in England and Wales. Customer complaints rose by nearly one third from 185,466 in 2005/2006 to 240,799 in 2006/2007, an increase of nearly 30 percent with Thames Water, Severn Trent and United Utilities were responsible for more than three quarters of the complaints. In addition, there has been a public outcry about high levels of water leakage, lack of water during last year’s drought and continuing sewage pollution.

Ofwat claims the fines will be paid by shareholders, but nobody believes it. One way or another, customers and workers will end up paying them. In April 2007, within months of finally accepting limited responsibility for the overcharging scandal, Severn Trent said today it would cut 10 percent of its workforce—nearly 600 jobs—over the next five years.



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