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**“Providing Water in Wales: is there a Third Way?
The Welsh experience with public
and private utilities and the emergence of the not-for-profit mode”**

Mark Drakeford
University of Wales, Cardiff

**School of Geography and the Environment
University of Oxford
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Mark Drakeford is a Senior Lecturer in Social Policy and Applied Social Studies at the University of Wales, Cardiff. He has a long-standing interest in the provision of basic utility services under privatisation, particularly in the Welsh context. He was the secretary to the Local Government Anti-Poverty Forum Commission of Inquiry into Utility Poverty (1996 - 98) and the specialist adviser to the House of Commons Welsh Affairs Inquiry into Social Exclusion in Wales (1999 - 2001). He is currently seconded to work as the Cabinet special adviser on health and social policy at the National Assembly for Wales. Among his main publications are: "Water regulation and pre-payment meters", in Journal of Law and Society, 25 (4), pp 558-602; "Social Work with Minorities in Europe", in Social Work and Minorities, Routledge, 1998; Social Movements and their Supporters, Macmillan, 1997; (jointly with M. Vanstone [Eds.]) Beyond Offending Behaviour, Ashgate, Aldershot (1996).

For enquiries on this paper, contact Mark Drakeford:

markdrakeford@supanet.com

Introduction

An adequate supply of clean and affordable water is one of the most basic household essentials. Whether organised on a public or private basis it is also, as a Dwr Cymru Customer Report puts it (Customer Services Committee 1994), one which, 'our customers have no choice but to rely on Dwr Cymru.' The shifting boundary of ownership within the industry is the basic subject matter of this paper.

It is important, at the outset, to say something of the importance which has always been attached to water in Wales. The distinguished Welsh historian, Kenneth O. Morgan (Morgan, 1982: 334) goes so far as to suggest that:

One resource above all captured the public imagination – water. Far more than coal, steel, or even oil, it animated public controversy. The economic, ecological, and political aspects of harnessing the abundant water supplies of Wales led to a fierce public outcry, often with nationalist implications.

Water in Wales continues to attract such a level of public and political interest for a number of reasons. Some of these are historical. The urban valley communities of

South Wales, where population growth occurred during the nineteenth century at a rate unparalleled in national history, were an inevitable prey to water borne disease. The connection between water and health in that regard, and the vital role of collective action in bringing about public health improvement has been a taken-for-granted part of Welsh discourse ever since and remains, perhaps, best summed up in the 1930s novels, *The Stars Look Down* (1935) and *The Citadel* (1937) by A. J. Cronin, recording his experience as a Tredgar G.P. and Medical Inspector of Mines. A combination of socialist politics and civic pride played an important role in the increasing municipalisation of water supply in Wales in the years prior to nationalisation.

The rise of nationalism, specifically, and a political national consciousness more generally in Wales in modern times is inextricably linked to the decision to flood a number of rural Welsh-speaking valley communities during the 1950s and 1960s, in order to provide water to the English urban conglomerations of Liverpool and Birmingham. There emerged what Morgan (1982: 335) describes as ‘the extraordinary fact that there was no local or other authority in Wales which could influence the decision of the Liverpool corporation at all: Liverpool could even chose to resell the water it imported from Wales’. The development led to the high point of public control of water supplies in Wales. In 1971 the Welsh Council, a distant forerunner of the modern Assembly, called for a Water Development Authority for Wales. It was intended, says Morgan (1982: 335), ‘to provide a comprehensive overview of the use of water resources, and to safeguard specifically Welsh interests. It should have powers to control flooding, build new reservoirs and more generally to try to balance out the various interests of different communities.’ The Conservative Government of that

period accepted the recommendation and announced the creation of such a Welsh authority.

In more recent times, as recorded below, the actions of the privatised *Dwr Cymru* have added new dimensions to this old controversy. The shifting boundary in water ownership is not, of course, anything new. A local government survey conducted at about the time of the first World War still found 2,160 water undertakings, well less than half of which - 786 - were municipally owned (Ofwat: 1993a). Even in 1963, nearly twenty years after the 1945 Water Act of the nationalising Attlee Government, 29 private companies still provided approximately one quarter of the water supply in England and Wales. It was not until the Water Act of 1973 that the ten multi-purpose water authorities which were later to be privatised came into being. With some further relatively minor amendment in the 1983 Water Act, the stage was set for privatisation.

The water industry in Wales and England was privatised in 1989, while remaining in public hands in both Scotland and Northern Ireland. The policy shared the basic unpopularity which surrounded the privatisation of all public utilities but differed from electricity and telecommunications – and to a lesser extent, gas – in remaining unpopular thereafter (see, for example, Taylor, 1991; Heath and McMahon 1992). On a monopoly basis, and with very little commercial risk, approximately 20 million domestic consumers were supplied by the privatised companies thus created.

The basis of the Thatcherite approach was, I would argue, essentially Schumpeterian in its belief that the intrinsic merits of private ownership were sufficiently intense to relegate all other considerations – affordability, health and customer protection – to little more than side-issues.

In the absence of competition, the Conservative government looked to regulation to fill the gap. In doing so, Maloney and Richardson (1995) suggest, a shift had taken place from 'the private management of public business to the public management of private business'. OFWAT, the Office of Water Industry Regulation was thus created with a primary duty to ensure the profitability of the water companies and a secondary duty to protect the interests of customers. This hierarchy of obligations contains within it the kernel of the most fundamental change which privatisation can be said to have brought about in terms of water supply. Within the relevant literature, this is most often referred to as a new paradigm in which 'public goods' have been 'commodified' - that is, placed on the same basis as any other goods or services which are traded within the market-place. Guy et al (1997: 203) explain the change in this way: 'the key shift instigated by the privatisation and liberalisation of the utility markets has been the replacement of the ethic of public service - the ideal of affordable, reliable, universal access to utility services at constant tariffs for all, irrespective of income or location. Replacing this has been the goal of profitability. The overriding aim of British utility companies today is the maximisation of profits for shareholder and (increasingly global) financial investors.'

The shifting boundary between public and private ownership of water is thus one which brought fundamental alterations in its wake.

The Conservative years.

In the years immediately after privatisation, a series of concerns came rapidly to the fore which maintained the controversial reputation of water matters in Wales.

Prices

Water prices have risen far more since privatisation than any other of the privatised household utilities. A House of Commons research paper published in December 1998 (House of Commons 1998: 16) suggested that, 'Since privatisation, the average combined (water and sewerage) bill for households billed on both measured and unmeasured bases has approximately doubled in cash terms, increasing by 46% in real terms.'

Rising water prices hit low income households hardest and with proportionately greater impact than on people with higher incomes. Using average OFWAT figures, the National Consumer Council (NCC 1994) suggested that whereas a household on Income Support in 1989/90 had to spend 2.5% of disposable income on water this would have risen, by 1994/5, to 3.2%. A lone parent with an 8 year old child spent 4% of disposable income on water in 1989/90 and would spend 5% in 1994/5. The combined bills for water and sewerage have been estimated by Ofwat (Ofwat 1993b) as rising to take as much as 14% of the income of a single pensioner on income support by 2004 – 5.

Not only were prices rising, but they were doing so with increasing variation in prices between one water company and another since privatisation. Ofwat's 1999 price review document, for example, suggests that actual household bills for water and sewerage, in 1998 - 99 varied between £158 and £73 in relation to the most expensive and cheapest water companies and £102 and £229 in relation to company charges for sewerage. While privately-set prices vary between one part of the country and another, publicly-set benefit rates remain the same for all. A report from the Policy Studies Institute (Kempson and Bennett 1997) concluded that, 'differences in the amounts which

people living in different parts of the country have to pay for basic services are significant and seem to be widening'. It found the highest charge for water to be £6.33 a week and the lowest £2.06. The highest charge for electricity was estimated at £5.99 a week and the lowest £5.04. In relation to these two privately run enterprises alone, therefore, a cash difference of £5.23 each week could exist between families in similar circumstances and with identical disposable incomes provided by the state.

To summarise: water costs have risen rapidly since privatisation. Such costs fall particularly heavily on those groups within the population whose need for water is greatest and these groups, in turn, are also more likely to have to rely on state benefits for their maintenance. State benefits, however, have proceeded in exactly the opposite fashion to water costs. Inadequate at the outset, benefit levels have failed to keep pace with water prices and now cover less than half the weekly cost of supply.

Debt and disconnection

From the outset water debt and disconnection have been a constant source of concern to the privatised companies. The scale of the problem is well illustrated by Herbert and Kempson (1995) who report that, 'during 1994 almost two million households in Britain defaulted on their water bills - nine per cent of all households in the country according to our household survey. And at the end of the year more than a million (five per cent) were currently behind with their payments.' According to Middleton and Saunders (1997: 108), 'more than a million households were behind with their water payments at the end of 1994: a year when nearly two million households defaulted on their bills. Between 1993 and 1994, more than three million pre-summons notices were

issued by the water companies in England and Wales. These figures represented an increase of 900 per cent between 1990 and 1995.’

In the years immediately after privatisation, companies attempted to respond to problems of non-payment through a vigorous application of their powers to disconnect those in debt from their domestic supply. The figures rose sharply. In the Dwr Cymru case, for example the number increased from 1,243 in 1989/90 to 2,938 in 1991/92. By 1992/3 the company had the second highest proportion of disconnection per 10,000 households billed of all the major companies, with a rate 21.46 against a national average of 9.51 (BMA, 1994: 20/21). Unsurprisingly, the juxtaposition of poor people having to go without water, and an industry making ever-growing profits proved a public relations disaster.

In the space available here, only one development of the Conservative period can be discussed in any detail – the introduction of prepayment methods of purchasing water. Prepayment meters – or Budget Payment Units – are focused upon here because they represent an initiative which proceeded entirely from within the privatised industry itself. The Units provided a means which allowed a customer to purchase a supply of water for a certain period of time – typically a week – rather than a volume of supply. Householders were provided with a ‘smart’ card or key which had to be taken to a charging point where it could be encoded with the credit which activated the unit located at the individual’s home. Failure to purchase sufficient credit resulted in water being cut off. In the event of such ‘self-disconnection’ – as it became known in the industry - consumers remained liable to pay for the period of time during which they were unable to receive a supply of water. To re-activate a water prepayment device,

following a period of self-disconnection, therefore, became a potentially costly and difficult business.

In Wales, the Customer Services Committee 'welcomed the initiative' of Dwr Cymru in taking the lead in the nation-wide use of prepayment devices (Minutes of the Customer Services Committee, March 1995). The company's embrace of pre-payment methods was enthusiastic. In April 1994, 328 customers were paying for water in this way. At 31st January 1995, 1136 units had been installed, a 346% increase over ten months. By July 1995 the number had risen further to 2,400. Within a further eighteen months 17,800 units were in operation, more than the rest of the country put together, and the company reported that it expected that 20,000 customers would have moved to this method of payment by 31st March 1997, overtaking direct payment from benefit as the most likely payment method for those in significant debt.

As far as the companies are concerned, prepayment meters offered a number of key advantages. As Ernst (1994: 145) suggests: 'as well as giving customers in default the facility to remain on supply, pre-payment meters (ppms) have clear advantages for the utility companies. They provide a continuous revenue stream in advance of the consumption of energy, which contrasts with the way that revenue is raised from the bulk of consumers, and they give the utilities a secured way of retrieving debt with minimal costs'. As such, these systems allow companies to escape the opprobrium which disconnection brings while circumventing other existing legal means of dealing with debt recovery and allowing water companies to leap frog over other creditors.

For customers, however, the impact of pre-payment methods was more complex. Companies relied, for the most part, on survey evidence which they had commissioned, which suggested that such devices were 'popular' amongst users and provided only on

the basis of customer ‘choice’ – itself a more complex question than companies usually implied (see Drakeford 1997). Other surveys however, suggested that such satisfaction came at a high price. A MORI study, between March 1993 and July 1994, indicated that 80% of households with a pre-payment device had needed to use the emergency credit facility and 10% had their water supply ‘shut off’ completely for more than 24 hours because they had not recharged their water keys (MORI 1994). Notifications to local environmental health officers in the same area suggested that 273 of the 1,027 households with pre-payment devices had gone without water for 24 hours or more. A trial of prepayment water devices carried out by Severn Trent Water in 1996 showed that 49% of customers in the trial had been without a water supply after running out of emergency credit.. The journal, *Utility Week*, reported in September 1996 that two-thirds of households using water prepayment meters experienced 'self-disconnection' during the first year in use.

Taken together, the accumulating evidence suggested that poorest families were going without water in a way which no longer brought such information to public attention; the problem, as well as the industry, had been ‘privatised’ (Drakeford 1997,1998a).

Such was the disquiet at the spread of prepayment meters in the water industry that, in February 1998, a case for judicial review was taken to the High Court by a consortium of local authorities (for a fuller account of this episode, see Drakeford 1998b). The action was taken against the industry regulator, on the grounds that he had failed to prevent the companies from breaching their legal obligation to supply. The Judge, Mr Justice Harrison, found for the local authorities on all counts, declaring the prepayment meters illegal. The aftermath, including Dwr Cymru’s reluctant compliance

with the Court's judgement and the industry's attempt to circumvent the ruling through 'trickle-flow' and '2-in-1' meters are dealt with in a later section.

The conclusion which this chapter reaches at the end of the Conservative years in government is as follows: the privatisation settlement in the water industry had reached a point where the institutional system of checks and balances which was claimed to have been put in place at the point of privatisation had almost completely failed. The companies, the regulator, the customer services committees and – if less openly – the government were all supporters of pre-payment methods of making sure that no customer would be able to obtain a supply of water for which she or he would be unable to meet the bill.

New Labour

This chapter now turns to the actions and policy developments of the New Labour government of May 1997, as emerging gradually over its first two years in office. The basis of Labour's approach was summarised in the report of the Party's Policy Commission on the Environment (1994) *In Trust for Tomorrow* which declared that, 'We will ensure that the actions of water companies are under public control.' This simple statement embodied an essential distinction between *public ownership* and *public control*. The Labour Party, by the time of the 1997 Election, had abandoned its long-standing commitment to the first, in preference to the second. Within that general policy framework, a number of individual measures are now clearly in place, as the remainder of this chapter will demonstrate.

Labour launched an early review of regulation and consumer representation in all the privatised utilities. The result was summarised in the *Financial Times* (1998) as a

'damp squib', a verdict from which few dissented. The most substantial change was to place a primary duty upon the regulator to protect the interests of customers. Consumer representation in the water industry was to be placed on a statutory basis. Labour's proposals contained no concessions to the demand of water poverty lobbying groups that Committees should be partisan in favour of low income groups, including the representation of low income consumers on committees.

Water prices

The New Labour government came to office with a particular proposal to fund a major public programme - the New Deal - through a windfall tax on privatised utility profits. The formula finally arrived at was claimed, by the company, to be particularly punitive in the case of Dwr Cymru. The government also made it clear, in a general sense, that it believed that regulation had failed to strike an adequate balance between consumer and company interests. Yet it did nothing to challenge the cost-reflective policies pursued by companies since privatisation and which, with the enthusiastic support of the regulator, have produced the widening gaps which consumers, according to the accident of geography, face from one part of the country and another. The policies pursued by New Labour show no sign of equalising this poverty lottery by public action.

Prepayment Meters

New Labour's record on prepayment metering and other similar devices is amongst the strongest elements in this policy field. The decision to make such devices unlawful had to be pursued against the opposition of the industry, the regulator and the CSCs. The Welsh Customer Services Committee, for example, had reaffirmed its support for the

use of Budget Payment Units at its meeting of 13 March 1997 (CSC Wales 1997) In his 1997 Annual Report Mr Byatt remained grudgingly opposed to the disappearance of prepayment, recording the High Court case which found Ofwat to have been acting illegally in this way: 'Despite safeguards and evidence that customers found BPUs to be a convenient method of payment, six local authorities objected to their use and sought Judicial Review in the High Court of the Director's decision not to prevent water companies offering this payment option' (Ofwat 1999).

With the passage of the Water Act, which received the Royal Assent on 30th June 1999, not only were prepayment meters brought to an end, but disconnection of domestic water supplies for non-payment of bills was also made illegal in Wales and England, bringing them back into line with the situation which had always appertained in Scotland and Northern Ireland. Needless to say, the move had again been opposed by the trinity of companies, regulator and customer committees, with Ian Byatt plainly lining up with those who believed that 'without the threat of disconnection' reluctant payers would not meet their bills' (Ofwat 1998). This was a prediction of particular concern to Dwr Cymru which, in addition to its pioneering work in the prepayment field had also just recorded the second largest rise in the number of domestic disconnections over the same period amongst all the privatised companies and a pattern of rising figures over a three year period (Ofwat 1999).

Commenting on the passage of the Act into law, the Minister responsible for the water industry in England, Michael Meacher commented in terms which lie at the heart of the argument which this paper presents: 'Maintaining an uninterrupted supply of water is a benchmark of civilisation, on which life and good health depend....It is totally

unacceptable that anyone should be deprived of a water supply in their home simply because of an inability to pay' (DETR 1998a).

The changes in relation to disconnection thus emerge as a significant change in the operating environment of such an essential service as supply of water. Before leaving the issue altogether, however, it is worth recalling the warning of Martin Fitch that the concentration upon disconnection itself distorts essential debates in this area, focusing upon the 'way we process the poor', rather than upon ways in which poverty itself might be addressed (Fitch 1998). If the only effect of the Water Act changes is to be a new twist in the race to develop technological devices which force water bills to the top of poor people's spending priorities, or to turn the companies attentions to more oppressive ways of pursuing bills short of disconnection - county court proceedings, bailiffs and so on - then the gains of the Act may yet prove illusory.

Trickle-flow

When it became clear that pre-payment methods were to be unavailable to the industry, some companies, and Dwr Cymru in particular, set off instead in the direction of what came to be known as 'trickle-flow' meters. The system, as the name implies, involves the installation of valves which allows a much-reduced flow of water to those customers who had failed to pay their bills. Six months after the High Court judgement in relation to prepayment meters, Dwr Cymru had installed some 1,000 trickle flow meters in Wales, as part of a plan to move rapidly to 3,000 (Wales Local Government Anti-Poverty Forum 1999).

When such devices had been considered by North West Water, Liverpool City Council's Environmental Health Service took the view that 'trickle-flow' potentially

represented a more serious hazard than a straight disconnection. The Service was particularly concerned about the likely dangers to certain types of heating systems, particularly older systems which were not regularly maintained (this includes 'multi-point' systems; as well as central heating). Such problems are commonplace in houses in multiple occupation - exactly the type of property where prepayment meters were most likely to be installed....British Gas took the same view as Environmental Health, leading to North West Water discounting 'trickle-flow' as a viable option.

When technicians in Liverpool City Council's Architect's Department carried out a series of experiments on the practical implementation of trickle flow, using technical information supplied by North West Water they found that the flow rates proposed meant that it would not be possible to run a shower, a washing machine, or a combination boiler central heating system (effectively disconnecting the consumer's main heating source). A toilet cistern would take 20 minutes to fill and the amount of water supplied would just about be sufficient to boil a kettle or wash one's hands and face.

Despite this evidence, and the views of the regulator that trickle-flow meters were covered by the same set of arguments which the High Court had developed in outlawing prepayment meters, Dwr Cymru insisted on going ahead with their installation. It was not until the Government made it clear that such devices would also be legislated against in the Water Bill that the company altered its policy. Government intentions in this regard were set out in the *Response to Consultation* document provided by the DETR, declaring that it does not 'believe that they provide sufficient assurances against the concerns over public health which are at the heart of the Government's water charging policy.'

As Fitch (1998) would have predicted, however, the actions of the companies were not at an end. In Wales, Hyder, the parent company of Dwr Cymru had, in 1996, acquired ownership of the privatised electricity supply company, SWALEC. A number of concerns had already been expressed about the powerful position which multi-utility companies would occupy in the lives of their customers, including anxiety that information about debt to one arm of the parent company might be shared with another. Now, Dwr Cymru proposed a means of organising payment of their water charges through the far more extensive network of electricity prepayment meters inherited through Swalec. Within the industry, the approach became known as the 2-in-1 system and involved automatically depriving people of their electricity if they failed to keep up payments for water as well. Negotiations about the new system began between SWALEC and the electricity regulator, Offer, early in 1998. Offer became concerned that the use of electricity ppms for this purpose could result - in the event that customers did not re-charge their meters - in their supply of electricity being disconnected because of water debt. By mid-June the Director General had concluded that it was not reasonable for electricity supply to be cut off by self-disconnection in the circumstances in question. SWALEC was told by the regulator that it should therefore take all reasonable steps to discontinue the scheme as soon as possible. This was reiterated in August 1998, but with little apparent effect. By the time the matter came to the attention of the Secretary of State at the Department of Trade and Industry, in October 1998, as many as 3,000 customers were said to be paying for water in this way. In the following month, SWALEC informed Offer that, in its view, the concerns which had been expressed were misplaced. It proposed issuing proceedings for a judicial declaration to resolve the question. In the meantime, it gave assurances that, pending the outcome of

declaration proceedings, no new customers would be taken onto the scheme. It was left to the courts, once again, to declare the system illegal (Fitch 2001).

In terms of the central issue of public and private responsibilities which runs through this volume, the history of pre-payment, trickle-flow and 2-in-1 meters casts an instructive light upon the reliance of Government upon the powers of the regulator in dealing with private companies. In the first two cases, the regulator quite directly took the side of the companies against those individuals and organisations who had questioned the legality and morality of providing water in this way. In all three cases, the companies' response to regulatory requirements raises questions about the effectiveness of regulators' powers. Dwr Cymru seems to have ignored for several months the water regulators' instructions to take out or disarm BPU's. The company equally acted in open defiance of the advice which the regulator provided in relation to trickle-flow. SWALEC delayed acting on the regulator's advice to stop the 2-in-1 scheme. The balance of power in the new settlement between private and public in the provision of utility services seems unambiguously weighted in favour of the former.

New Labour and Water

The Water Act of the New Labour government provided a number of real gains in terms of access to water for the most vulnerable households, but continued to display a sense of ambiguity in relation to some fundamental issues. In opposition, Labour had declared that, 'We will outlaw water disconnections for residential properties and ban compulsory water metering' (Labour Party 1994). Now, in contradiction of that stance, the Act provided a new impetus to the installation of volumetric meters for water, adding to the sense of 'creeping meterisation' which has come to be characteristic of the

industry since privatisation (see Thackray 1997 for a more general account of the debates surrounding different methods of paying for water). The effect of volumetric charging is broadly regressive, shifting costs from those who can afford them the most to those who can afford them the least. Previous research had already established the way in which the purchase water by volume acted to the detriment of vulnerable households, especially in the case of large families or those whose particular health needs led to heavy demands for water. A discussion paper published by the Rowntree Foundation in June 1997, concluded that 'metered tariffs discriminate against low-income households who need above average amounts of domestic water, including those with young children or older people with incontinence problems or other disabilities requiring intensive water-use' (Thackary 1997). A study for the *Save the Children Fund* (Cunninghame et al., 1994), for example, found that those with meters paid 4% of their income on water charges, compared to a UK average figure of 1%.

The 1999 Water Act recognises some of the difficulties which would be faced by such families, in properties where volumetric metering has become compulsory. It proposed offering low income customers in these circumstances the option of charge by average use. The Act also included specific protections for vulnerable groups who find themselves compulsorily supplied with a volumetric meter. Under clause 5 of the Act the Secretary of State was empowered to make regulations to define the groups to be offered protection and the precise nature of the support they should receive. At the same time, however, the Government remained anxious not to place any burden upon the private companies through the protection it sought for vulnerable individuals. In its *Response to Consultation* paper, for example, it made it clear that, 'the Government does not intend to place unnecessary burdens on water companies in offering protection

to customers with special needs.’ (DETR 1998b, para. 42). The tension between public welfare and private provision of essential services was, once again, apparent and remained so in both the Utilities Act of 2000 (which contained a provision empowering the Secretary of State to require companies to adjust tariffs in favour of low-income consumers, accompanied by assurances that it was most unlikely ever to be evoked (Fitch 2001)), and the ‘water benefit’, introduced in April 2001.

What verdict might be offered on the emerging New Labour policy approach to water issues? Fitch (2001) perhaps sums it up best as caught in the ‘ambiguity of a softening of budget discipline (ending disconnection) together with a determination to press ahead with marketisation.....Water companies remain profit driven and will be anxious to deploy alternative sanctions for debt recovery.’

A Third Way?

This paper has concentrated upon a disputatious period in the delivery of water services in Wales. The events considered, however, did not exhaust the capacity for controversy contained within the industry. Labour’s tightening of the regulatory regime produced an impact upon water companies throughout England and Wales, but appeared to make a particular impression upon the Welsh Water company, Dwr Cymru, and its parent company, Hyder, who entered into a period of falling profits, declining stockmarket confidence and growing corporate uncertainty. The company appeared to have achieved the impossible, in turning the monopoly supply of a basic necessity into a risky business.

The seeds of Hyder’s difficulties were sown in its ambition to become a multi-utility. It later became clear that it had paid the top of the market price for the Welsh

electricity supplier, Swalec, just at the time when the impact of the incoming Labour government of 1997 was making itself felt in the actions of the regulators. At £870 million, the 1996 Swalec acquisition had the effect of trebling the group's gearing. The company was then particularly affected by the Gordon Brown windfall tax on the utilities in which it had to pay £282 million – or half as much as BT, a company worth at least 80 times the value of Hyder. Even at this stage the political connotations of these difficulties were apparent. The *Guardian's* industrial analyst, David Gow, concluded an end-of-year review by noting that, 'Hyder's problems are heightened by the fact that it is Wales' biggest home-grown PLC and politicians in the new National Assembly are already anxiously scrutinising the horizon for signs of approaching invaders' (*Guardian* 6 December 1999).

The first public indications that Hyder was in difficulty came in the autumn of 1999 when the company warned of a further 600 job losses in its water division, because of the regulator's drive to force down prices. By October, newspapers were reporting concerns that the company might be forced to 'breach covenants with its bankers' (*Observer* 20 October 1999), because of the 'savage' regulatory reviews in both water and electricity industries. The effect of water price controls alone was estimated to have the effect of reducing the company's annual profits by some £70 million.

At the end of March 2000, it became clear that Hyder – which had seen its share price dip from a peak of £10.32 to a low of £1.79 – were in talks with a potential bidder. On 18 April an agreed bid of £402 million was made by the Japanese investment bank, Nomura. This provided a share bid of £2.60 and was created, according to newspaper accounts, with a sigh of relief from 'everyone in government and City circles'

(*Guardian* 19 April 2000). If so, it was to prove one of the shortest lived, and least well founded senses of relief. By the start of May it was clear that an alternative, hostile and higher bid was to be made by the American firm, Western Power Distribution, owner of the neighbouring electricity company of the Southwest of England. From a local political perspective WPD was a problematic bidder. Any higher bid would have to be based upon economies of scale, affecting the Cardiff head office which had been maintained by Hyder, as well as higher levels of job losses.

It was against this background that, on 18 May 2000, Ian Byatt, Director General of Ofwat, Guy Hands, managing director of the Principal Finance Group, Nomura International p.l.c. and Graham Hawker, chief executive of Hyder (amongst others) gave evidence to the first ever joint meeting of the National Assembly's Economic Development and Environment, Transport and Planning Committees.

The purpose of the meeting was to advise the First Minister, Rhodri Morgan, on issues that he should include in his representations to the Office of Fair Trading.

At the time of the meeting it was clear both that Nomura's initial bid for Hyder had been recommended by the Hyder Board and accepted by the company's management, and that a further and hostile bid from Western Power Distribution was imminently expected. Nomura's account, to the Committee, pointed to a period over which Hyder had been in difficulty which extended before the time in which such issues had been public knowledge. Guy Hands told the committee that, 'Hyder had spend approximately seven months looking for alternatives and had considered in great detail the various alternatives for going forward. It came to a considered decision to recommend our offer.'

The joint Assembly committees sought reassurance in relation to two of the key criticisms which had already been aired in relation to Nomura – that it was a bank which would have no long term interest in the supply of utility services in Wales and that its real interest lay in the non-regulated, rather than the utility, dimensions of Hyder. The First Minister put the first point bluntly, in asking Mr Hands, ‘Are you bankers or are you owners?’ The leader of the Liberal Democrats at the Assembly, Mike German, tackled the second, in asking if Nomura’s real interest were not simply to ‘fatten up’ the water and electricity arms of Hyder, so that they could be ‘sold off’.

Both points were vigorously defended. ‘We are definitely owners’, Mr Hands replied, and ones who were ‘used to investing in long-term businesses with stable income levels’. The company provided assurances that the head offices would be retained in Wales and that employment plans would be held at the levels intended by Hyder.

The political salience of water in Wales was emphasised repeatedly by members of more than one Party. Phil Williams, the veteran Plaid Cymru member, put it this way: ‘water has had a special significance in Wales, especially in recent political history: the drowning of valleys against opposition and what was seen as the irony of Welsh consumers sometimes paying more for water than those outside.’ A specific assurance was sought that the company would seek to avoid similar sorts of development in the future. A cross party set of issues and principles were agreed – safeguarding jobs and the environment, retaining a Welsh headquarters and continued investment – which, the First Minister undertook to ‘express very strongly’ in his representations on behalf of the Assembly.

Within days of the Assembly committees' meeting, formal offer was made by WPD which valued the company at £464 million and offered individual shareholders 300 pence per share, as opposed to the £2.60 put forward by Nomura. The break up of the Cardiff headquarters of Hyder, and of the business itself, were rapidly flagged up as reasons for opposing the bid. The scene was thus set for a struggle at both political and industry level. Politically, while the National Assembly had no direct locus in the take-over process and, indeed, had displayed some anxiety about appearing partisan between potential bidders, it soon became clear that the Labour administration shared the general anxiety about WPD. In a letter to Stephen Byers, then Trade and Industry secretary, he said that he shared the concerns of the Assembly committees that the WPD bid would have an adverse impact on jobs in Wales, on the future management of the water and electricity businesses and on the non-regulated dimension of Hyder's activities. Referring to a division of power between the European Union and the United Kingdom administration, he urged Mr Byers to act so as to 'enable the bid to be considered within the UK and under the relevant UK legislation'. Mr Morgan was to be disappointed. The Westminster government declined the opportunity to 'repatriate' the WPD bid from Brussels. This was to follow, early in August, with a refusal to refer the bid to the competition commission, as argued by the Assembly on the grounds that for WPD to retain the assets of Welsh Water, but to hand over operational management to the Northern-based United Utilities (as the company proposed) amounted to an effective merger.

As the regulatory decision-making wound slowly along, the tussle between the rival bidders intensified. By the end of July, Nomura was making it know that it was prepared to raise its bid of £2.60 per share to a level above the £3.00 offered by WPD. It

did so, with an offer which now valued the company at £495 million and a share price of £3.20. WPD countered immediately with a fresh offer of £526 million, and £3.40 per share. Within a week, Nomura had responded with a further enlarged bid, amounting now to £557 million. The share price of £3.60 represented a 90% premium on the £1.89 at which the company had traded on the day before the bidding war broke out.

On the day after the latest Nomura bid – 11th August – the London Stockmarket takeover panel invoked a procedure in which the process was to be brought to an end through sealed bids. These were to be deposited with the panel by 4.30 p.m. on Friday 12th August. This was the first time in which the procedure was to be used, and was intended to introduce an element of finality and seamliness into a course of action which appeared to be dangerously out of control and open-ended. The attempt rapidly fell apart when Nomura appealed against the procedure and WPD's new bid of £3.65 a share failed to arrive before the deadline but was still allowed to proceed by the panel. Faced with an appeal, the panel decided to meet on Monday 15th August. Despite a day-long meeting, it failed to issue a clarification of the position until the following day when it ruled in favour of WPD. The National Assembly's Environment Minister, Sue Essex, issued a statement on behalf of the administration, regretting the panel's decision on the grounds that 'this effectively means the break-up of the Hyder group and an end to one of Wales' most prestigious and well known companies'. After a few more days of considering its position, Nomura announced that it would issue no further challenge and the whole saga was at an end.

Problems for WPD were not completely over, however. In October 2000, the Courts ruled that its plan to contract services to United Utilities breached British and UK regulations and would have to be accomplished through open tendering. The

emergence of Glas Cymru in November 2000 must have come as some relief, not only to politicians, but to the victorious bidder as well. Glas Cymru advertised itself as a Welsh based, not for profit company, limited by guarantee, in which members would take on the corporate governance role of shareholders. It intended, from the outset, to set a self-imposed impediment, contained in its covenants, preventing the company from diversifying out of water. It claimed that, by raising the money needed to finance the industry's statutory investment programme through debt, rather than equity, it would be able both to reduce costs and the bills charged to customers.

A second joint meeting of the National Assembly's Economic Development and Environment, Transport and Planning Committees was held on 15 November 2000. Speaking on behalf of the company, Geraint Talfan Davies opened by reminding members that 'We all know that the water issue resonates in Wales in a way that it does not do anywhere else in the UK.' It was, said another contributor, both 'a highly emotive subject and a valuable economic resource.' The company's plans were 'based on the premise of exposing the fact that the water industry is a low risk business. It provides an essential public service. It is a monopoly.....The company will have a local focus on priorities in Wales and, because it does not have equity shareholders, it is our belief that it will be more open and accountable than is currently the case with some of the equity-owned companies. We have no reason for secrecy and I think that that is a major benefit for this company.'

Despite the fact that Glas Cymru's bid was headed by former Treasury permanent secretary, Lord Burns, the initiative was opposed by what the *Guardian* (10 January 2001) described as an 'unlikely alliance' of central government departments. The Treasury had already successfully opposed plans to turn Scotland's municipally

owned water companies into mutuals. It now combined with the Department of Trade and Industry and the Department of the Environment, Transport and the Regions to resist the Glas Cymru proposals, largely on the basis the absence of shareholders would militate against incentives and efficiency. Regulators, too, proved sceptical. The *Financial Times* on 23 January 2001 reported that the electricity industry regulator, Callum McCarthy, had opposed the use of debt rather than equity on the grounds that such a structure lacked the incentives necessary to improve efficiency.

On the other side of the political equation, the deal secured the active support of many National Assembly for Wales politicians and the background encouragement of the First Minister, Rhodri Morgan, who emphasised the importance of the proposal being given a fair hearing. A meeting with the Ofwat regulator, Philip Fletcher, produced an understanding, set out in the regulator's position paper on the proposed acquisition of Dwr Cymru by Glas Cymru (Ofwat 2001a), that their consultation had shown 'broad support in Wales for Glas, notably from the National Assembly for Wales.' Against this background, Glas Cymru acquired acquired Welsh Water on 11 May 2001 in a deal which involved paying WPD £1 for Dwr Cymru, while assuming £1.85 billion in net debt from the parent company, Hyder. A bridging loan was acquired to buy-back the Hyder debt, before a bond issue raised the capital necessary to refinance the deal. While sharing some of the conventional disquiet at the capacity of the company to raise sufficient low interest bond market funding, and at the absence of efficiency incentives within the proposed company structure, Ofwat nevertheless gave the go-ahead to the acquisition, subject to a number of caveats, particularly those in relation to incentivisation. In a final letter of 11 July, the Director General gave his approval in these terms: 'In the absence of shareholder pressure, it is intended that the

approach you have taken to rebates and the structure of executive director's remuneration should provide incentives to achieve continuing greater efficiency' (Ofwat 2001b).

Despite the qualms of traditional financial interests, the bond issue was 70% over-subscribed. £2 billion was raised on the British and continental bond markets, drawing 79 investors. £1 billion of this sum was triple-A rated, a market assessment which placed the company in the very lowest risk category, and thus able to borrow money at the lowest rates of interest. By contrast, Dwr Cymru in its final and most trouble stages had been rated as triple B minus, the lowest level of investment grade rating. The practical effect was to cut annual the cost of capital to just over 4%, rather than the normal 6%. This, by itself, saved the company £50 million annually, more than its entire salary bill.

As to incentives, the three executive members on the nine-strong board are able to double their £125,000 salaries through bonuses 'tied to customer service performance, water quality, reduced gearing, credit rating and other criteria' (*The Guardian* 11 May 2001).

Will Hutton (2001) suggested that the successful launch of the Glas Cymru model had provided a 'third way' in utility organisation, replacing both public ownership and privatisation models with a new 'public interest' form of ownership.

An essential part of Glas Cymru's successful seeking after a high investment grade was an outsourcing strategy for operations and maintenance functions on the one hand and customer services on the other. By transferring financial operating risks to outsourced providers, the risks to Glas Cymru were reduced and the prospects of being able to borrow money through low cost bonds was enhanced. The practical

consequences of this decision were to retain a core workforce at Glas Cymru itself of some 120 people, while 1,800 people were to be subject to the outsourcing contracts. The potential impact upon this larger number were soon apparent. By 11 June, the then-Economic Development Minister Michael German was in talks with Directors of Glas Cymru to find out more about some 185 job losses announced in the previous week by United Utilities, winners of the outsourcing contract for operations and maintenance. The company advised that the job losses were a consequence of the OFWAT targets to reduce operating costs by five per cent per year for the next five years and were not a result of the acquisition. However, it was also made clear that that long term employment within the business, including the outsourced activities, would depend on the efficient level of costs for the water business – in other words, that further job losses might yet follow.

At the point of writing, Glas Cymru's actual performance remains at a very early stage. Yet, in reporting its first half-yearly results in November 2001 the company recorded an underlying surplus for the period of £11.8 million, all of which, in the nature of a not-for-profit arrangement, was retained in the business. Pre-tax profit for the six months was 3% higher than forecast. Reductions in household bills were confirmed, while the target for establishing a contingency reserve against unexpected future difficulties was already expected to be exceeded (Glas Cymru 2001a). In December 2001, the company was awarded the most innovative deal of the year award by the *International Financial Review*. The award citation suggested that the deal 'was a ground breaker in all kinds of ways...The deal's structure looks set to provide a financing solution for a range of utilities and for water companies in particular' (Glas Cymru 2001b).

Conclusion

The issues considered in this paper do not lead to a neat set of interlocking or causal relationships. Some themes, however, do emerge. The connection between water and the public interest which came under concerted attack from the high reaches of Government during the late 1980s and 1990s has been replaced by an understanding both of the risk which individuals face when going without a sufficient supply of clean water and of the risk which are then posed to the community more generally. Such a recognition is explicitly identified by the New Labour administration as the rationale which underpins a number of its main Water Act reforms (see, for example, Mullin 1999).

It is the contention of this paper that that there are inevitable consequences which lie outside their own boundaries when private firms pursue the profits which are their basic *raison d'être*. O'Donnell and Sawyer (1998:8) suggest that the essential contrast between the public and private modes of operation can be summarised as, 'public ownership will have wider objectives than private ownership: ultimately the former is concerned with the promotion of the general social interest and the latter with profits.' The modified boundary of public/private ownership in the water industry in Wales generated an outcome in which it was clearly to the profit-enhancing advantage of the supplier to squeeze the cost-consequences of their policy decisions into the public sphere. While commercial, rather than social pressures, led to the demise of Dwr Cymru, it remains instructive that the public debate in Wales concerning its replacement revolved around core question of how far is it possible to deliver publicly-desirable goals such as social inclusion, community safety and well-being through a market-

system based upon profit-driven companies. To suggest that jury remains out on the prospects of a 'public interest' solution, such as that advanced by Glas Cymru, is not a form of academic equivocation, but rather, a genuine reflection of the fluctuations in the contemporary state of policy-making in this essential field.

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