

UNISON

*Response to
OFWAT
Setting price controls for 2015-20
-framework and approach
Consultation*

March 2013



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OFWAT

Setting price controls for 2015-20 – framework and approach. A consultation

UNISON response

Introduction

UNISON is the UK's leading public services union, representing 1.3 million people across local government, the health service, housing, the utilities, transport and the voluntary sector.

In the water industry our members include engineers, scientists, technicians, industrial workers and staff working in offices and call centres.

They deliver a safe and wholesome drinking water supply, maintain the sewerage system, provide a wide range of customer services and deal with a wide range of emergencies.

In addition to being a key stakeholder on industrial and occupational issues, our members also actively engage in public debates about all our public services and utilities from a citizenship perspective.

We recognise that the consultation on 'Setting price controls for 2015-20 – framework and approach' is of critical importance to our members and the communities we serve. We also believe that any new pricing control regime needs to be robust and challenging.

We are not however convinced that in previous reviews the industry has been properly scrutinised and certainly worrying trends have emerged which cause members and the wider community a great deal of concern. Fundamentally UNISON does not believe that the provision of water and sewerage services is the right vehicle to make large profits at the expense of hard pressed consumers.

In responding to the consultation we have answered the main consultation questions in the themed groups as opposed to individual responses to each question. This gives a more general position but one which reflects our more immediate concerns.

Consultation

Delivering what matters – an outcomes-focused approach

UNISON does support the need for clear customer focus in prioritising resources and outputs. We would, of course, point out that domestic consumers are serviced by private sector monopolies whose key priority and obligation is to make a profit for its shareholders and an ability to attract additional debt to finance further capital expenditure.

We do not agree with the industry being able to have greater flexibility to set its own incentives. The industry needs tighter regulation not a less specific framework. Companies have proved themselves adept at finding ways around relaxed regulatory regimes to maximise income.

The consultation document makes various references to the views and needs of the consumer. We are not convinced that in general this is the most effective way forward. Much of the information consumers receive about the industry comes from the water companies themselves. We would support more effective and rigorous scrutiny of the business priorities and performance of the industry. The Consumer Council for Water provides an effective customer focused voice and we would support a greater role for them in assessing incentive regimes.

Defining retail (and wholesale) services

UNISON does not support the concept of retail separation. We believe that such moves are bad for the consumers and bad for those who work in the industry. The only beneficiaries would be owners of the businesses. Retail separation will create a false proposition that competition exists within the industry and will itself drive customer improvements. We see almost no evidence provided to support this notion and in other areas of utility provision like energy and transport, liberalisation could be viewed as a failure.

We would be very concerned about the impact such changes would have on the total customer experience, accountability and the competence levels of staff dealing with customer issues. These would include supply issues and customers with highly sensitive debt problems - an area of potential growth in the current economic climate.

Retail separation will undoubtedly drive down the wages of people employed in this part of the business, many of whom are women and already some of the lowest paid staff in the industry. This would be a scandalous proposition and yet the consumer will lose out through a lower quality of customer service.

Setting wholesale controls

Again we confirm that we do not support separate pricing arrangements and believe this will merely encourage obfuscation. We do not believe this measure will improve matters.

We are especially disappointed that RPI plus arrangements have been suggested at a time when household incomes are under such pressure and yet profits in the industry continue to increase.

The pricing regimes suggested in the consultation make it ever harder to directly compare the financial performance of the companies and this makes the businesses less transparent and less willing to respond to consumer pressure. The suggested flexibilities within the proposed regimes only favour the industry and not the consumer.

We would strongly argue for greater incentivisation towards refurbishment of assets as opposed to capital replacement. We believe this is more environmentally sound and delivers better value to the consumer.

UNISON is totally opposed to efforts to avoid paying corporate taxes. It is a scandal that some water companies have been able to organise themselves to pay as little corporate taxation as is practically possible. This is a private sector monopoly and water bills are akin to a general taxation on each household. They must be held accountable for their practices.

Setting retail controls for household customers

We clearly believe the consumer should be protected from excessive profiteering and tax avoidance that is prevalent in the industry. A simple measure of efficiency and cost would in theory be positive as would a standard measure which stripped out variables such as environmental costs and servicing large rural areas. It is clear that whatever measures are adopted the industry is well versed in finding ways to circumnavigate any negative impact.

The use of SIM could be attributed to a general industry wide improvement in customer satisfaction. UNISON would argue that it also partly reflects the abilities of those in the industry to keep consumers in the dark. Consumers are not always well informed and so using SIM to measure industry performance is not wholly reliable. It is by its nature subjective because the information flow is controlled by the company who, of-course, have a vested interest. It can also divert companies to chase SIM performance as against more sustainable and productive outputs.

Water efficiency measures and the tackling of all leaks (not just customer-side) in a prompt manner should both be given additional resourcing and priority within the pricing regime.

Setting retail controls for non-household customers

UNISON remains deeply sceptical about the development of competition within the non-household sector. We are unsure what long term benefit this will provide to consumers and society in general. To fragment the industry in this way could actually drive up standard domestic bills and create instability without any real productive gain. Further liberalisation of the market is unlikely to produce any significant competitive pressure and the business case is wholly unconvincing.

Making better use of water resources

Water trading to improve resilience in the industry is one approach to ensure that in areas which suffer short term supply issues, or longer term structural problems, consumers are not disadvantaged. However UNISON would argue that aside from designing a trading regime, companies should address their business models to ensure they have the right level of infrastructure and internal resilience. UNISON would support a more co-operative and regulated position which does not leave customers at a price disadvantage simply by geographical location. If companies dealt more effectively with leakage a significant supply issue could be addressed.

Attempts to replicate trading, as they exist in energy and transport (with little customer gain), is not an effective pathway and seems a distraction. To move water around is in itself a costly and energy intensive business and better water management would be a far more effective proposition.

Managing abstraction is essential as an environmental safeguard. We support the use of measures which are proposed within the consultation. It is essential that the Environment Agency and the new body in Wales; Natural Resource Wales, are given a key role to ensure both rigorous management and control takes place by an independent third party not connected to the industry.

Overall incentives, risk and financeability

We believe the industry will welcome the proposals contained within the report. Since the announcement of the consultation, the share price of those UK listed water companies rose in

expectation of a favourable market environment going forward. The losers from this favourable environment are consumers and those who actually work in the industry. The industry is already a protected monopoly and hence risk is limited by virtue of this fact. It should not be for the regulator to further minimise risk in such a favourable environment. In reality many companies in the industry are doing a great deal to create a more unstable environment by the amount of leveraged debt being absorbed and unsustainable dividends being paid out.

Delivering Price controls in 2014 and building for price reviews in 2019 and beyond

In developing price controls and considering the future of reviews beyond 2019, UNISON would welcome the strengthening of the consumer voice within the industry. We believe that voice is well represented by the Consumer Council for Water, and this body should have increased powers to further scrutinise the industry on behalf of the consumer and intervene to protect the consumer interest.

UNISON would also argue for a workers voice within the industry as a key stakeholder. Too often regulatory reviews have ushered in general attacks on workers' pay and conditions including pensions. The efficiencies required have simply been delivered by these attacks as a substitute for better ways of working. This cannot be allowed to continue as it is damaging to our members and also the industry going forward. The age profile of the skilled workforce is particularly alarming and needs to be urgently addressed.

Future pricing cannot be removed from the ability of households to meet increased costs. Water as a commodity is not affected by global prices in the same ways as in energy and as such, as a percentage of household income, the price should be falling in real terms.

We are particularly concerned at the impact of future prices on the most vulnerable in our society. They are already having to shoulder significant welfare reforms which will impact on household incomes and levels of household debt.

OFWAT has done little to recognise the severity of this problem in the UK. Average household debt is rising and currently stands at £53,972 per household. Every day in the UK; 277 individuals are being declared insolvent or bankrupt and another 1374 consumer county court judgements are awarded with an average debt value of £2,615. Last year alone 8,308 new requests were made daily to the Citizens Advice Bureau for help regarding debt matters. These figures are all deteriorating and have happened before the more significant welfare reforms impact on consumers.

These reforms include; capping benefit increases and total household awards, housing benefit changes including the 'bedroom tax'. Changes to council tax benefit meaning all households face a percentage of the total bill and a move towards universal credit which it is intended will be a single monthly payment.

We would again urgently call for a regulated social tariff across the whole of the UK to protect the most vulnerable households. This could in effect be self-financing, as companies will undoubtedly face higher consumer debts among vulnerable groups and increased debt write-off will be necessary.

Conclusion

UNISON has many concerns over the current state of the water industry. It continues to deliver handsome profits and dividends and as a result both private equity and overseas investors have significantly increased their ownership of the sector.

We believe this indicates that the industry has become an easy vehicle to make handsome returns at the expense of hard pressed consumers. The profit margins that exist in the water industry outstrip those within the retail side of energy companies like British Gas and yet they deliver much lower corporate tax returns. They also receive less negative publicity due to the total bills being of a lower value as the raw material is not susceptible to global raw material prices.

We are very disappointed that the overall settlement allowing an RPI plus formula is proposed. This does not take into account the ability of the consumer to pay something OFWAT should have given greater priority too.

UNISON continues to be concerned that OFWAT has been too pre-occupied with finding ways to introduce more competition into the water industry when there is little evidence that the domestic sector shows any support for this. Contrary to OFWAT's belief that more competition would be good for water services, we note that the experience in the UK and throughout the EU with sectors such as energy and rail, as well as internationally for water, that the evidence suggests otherwise.

Fragmentation of the industry could undermine the principle of integrated river basin management, pioneered in England and Wales, which has since been emulated in a number of countries. The problems caused by the fragmentation of responsibility through outsourcing have been clearly seen in the railways industry both in the UK and also the USA, and were evident in a case of multiple deaths from water contamination in Canada eight years ago. Moreover, in the energy sector, the private companies have consistently pursued a policy of vertical reintegration.

Experience with sectors liberalised under EU directives, such as electricity and gas, do not support the assumption that competition will follow, nor that there are benefits to consumers.

The experience in electricity markets in the UK, EU and USA show that the transaction costs of switching electricity suppliers are higher than any possible benefits from prices. Tacit collusion between companies is widespread and in the USA, prices are clearly higher in states that liberalised than in states that did not.

There are weaknesses in the current regulated system and we do not believe these have been adequately addressed by the 2015-20 pricing review. The private companies' records on investment and efficiency are not as good as asserted by OFWAT, which itself has a poor record of dealing with 'gaming' by the companies, or dealing with leakage. However, there is no evidence at all that competition would solve these problems. Nor does the experience of other sectors support the assertion that competition would generate innovation: in electricity, expenditure on research and development has clearly fallen, both in the UK and throughout the EU, since liberalisation. The complex social, health and environmental issues surrounding water are better addressed through stronger regulation driven by government initiatives. Other countries are seeing increased public participation as a way of developing democratic pressure for innovation.

Greater reliance on competition risks being a dangerous distraction from the business of delivering benefits to communities in a complex sector where the interface between social, environmental and technical dimensions have implications going beyond the tenets of traditional economic theory. Strengthening the current regulatory and institutional arrangements remains the most credible approach to containing the preponderant capital costs characterising the water industry.

Finally, as pointed out earlier, there has never been any 'competition for the market' – the water supply and sewerage companies were given monopoly licences in 1989 without any competition. There is an opportunity to re-tender those licences for the first time and to conduct a comprehensive review of water services and their regulation by OFWAT. As we have made clear in our response, UNISON does believe the water industry in its current form is not sustainable and the regulation of the industry and government policy is largely to blame for this. Without significant change the water industry will continue to make excessive profits and avoid real reform which would benefit the consumer.

