Corporate Watch

Leaking away: The financial costs of water privatisation

As water bills rise again, an investigation by Corporate Watch into the finances of the 19 water and sewerage companies in England and Wales has found:

- Almost one third of the money spent on water bills goes to banks and investors as interest and dividends.

- People are paying £2 billion more a year – or around £80 per household - than they would be if the water and sewerage supply was publicly financed.

- Six companies are avoiding millions in tax by routing profits through tax havens, using a regulatory loophole the government has chosen to keep open.

- The CEOs of the 19 water companies were paid almost £10m in salaries and other bonuses in 2012.

When the water regulator Ofwat announced last week that water bills would rise by 3.5% to an average of £388 a year, it promised to "make sure customers get value for money."

But while helplines report that record numbers of people are being forced into debt by their bills, and 3.4 billion litres - almost a quarter of the supply – leak out of water pipes every day, water companies continue to be a huge source of income for banks and financial investors.

Since the water and sewerage service was privatised in England and Wales in 1989, the companies have been bought and sold by a variety of conglomerates, investment funds, banks and pension funds from around the world (see the table below). Only four companies out of 19 – Severn Trent, United Utilities, South West[1] and Dee Valley Water – are still publicly listed on the London stock exchange. Increasingly, their owners have looked to raise the money to run the supplies by taking loans from banks, or issuing bonds (essentially IOUs) to be bought by investors and speculators.[2]

Going through the most recent accounts of all 19 water companies in England and Wales, as well as those of their associated subsidiaries and parent companies, Corporate Watch has found that, between them, they have amassed a staggering £49 billion in total borrowings.

They paid more than £3 billion in interest payments on these borrowings in 2012, in addition to £884 million in dividends to their owners.

The water industry’s total revenue in 2012 was £10 billion, meaning almost one third of the money spent by people on water bills in England and Wales went to paying the interest on the companies’ debts or as dividends.

When asked about this, the companies all said they had to borrow to fund the much-needed improvements in the system. Southern Water, which takes care of water and

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[1] (Through its owner the Pennon Group)

[2] Corporate Watch asked all the companies who holds their bonds. None of them would say, often because they do not know as the bonds are traded after they have been originally issued.

sewerage in Kent, Sussex, Hampshire and the Isle of Wight, said the 'right' combination of debt and equity helps reduce customer bills:

“customers pay for the ongoing financing cost, rather than full construction cost at the time of building a new asset or improving existing assets – similar to the way in which an individual would choose to take out a mortgage to facilitate purchase of their house. Shareholders provide the equity to support the financing, and provide the financial buffer to protect customer bills from cost shocks during a five year regulatory period.”

In the current economic context, borrowing may well be the only way to finance investment. And it is true that some are more indebted than others. The private equity-owned companies such as Thames Water or Anglian Water have more debt in relation to equity than the companies that are publicly listed on the stock market, for example United Utilities or Severn Trent (Thames and Southern are more 'leveraged', in financial jargon). Severn Trent told Corporate Watch that companies should be encouraged to raise finance “in a way that incentivises shareholders to invest their own money, where appropriate, and not always to rely solely on increasing already record levels of industry debt.”

But no matter the relative strengths of their balance sheets, just like the companies winning contracts under the Private Finance Initiative, all the water companies are paying far more to borrow this money than the government would if the supply were public. The UK government can borrow much more cheaply than companies because it is regarded a more secure investment.

In other words, if the water and sewerage system was in public ownership, borrowing and financing costs would be much lower. The Public Services International Research Unit at Greenwich University has previously estimated savings of £900 million a year based on industry figures from 2004-5.

Finances and ownership of water companies in England and Wales, 2012 (£ million)

Water and sewerage companies	Owners	Equity	Debt	Revenue	Operating Profit	Interest and financing costs	Tax paid	Dividends paid
Anglian Water	Canadian Pension Plan Investment Board Colonial First State Global Asset Management (Australia) Industry Funds Management (Australia) 3i (UK)	298	6900	1138	363	422	1	151
Northumbrian Water	Cheung Kong Infrastructure Holdings (Hong Kong)	1200	4000	342	154	111	0	0
Severn Trent Water	Listed on London Stock Exchange	981	4300	1458	470	314	72	159
South West Water	Pennon Group Plc (UK) – listed on the London stock exchange	494	1900	475	205	70	29	78
Southern Water	IIF International SW UK Investments Ltd UBS Global Asset Management (UK) Ltd (Switzerland)	589	4500	716	239	326	0	0
Thames Water	Macquarie Infrastructure Fund (Australia) China Investment Corporation Abu Dhabi Investment Authority	1500	9000	1700	577	635	-70	165
United Utilities Water	Listed on London Stock Exchange	1760	5900	1565	592	316	40	209
Dŵr Cymru Cyfyngedig / Welsh Water	Glas Cymru (not for profit)	1480	2900	695	191	189	-3	0
Wessex Water	YTL (Malaysia)	62	1700	447	228	77	33	91
Yorkshire Water	Citi Infrastructure Investors (US) GIC Special Investments (Singapore) Infracapital Partners LP (UK) HSBC Bank Plc (UK)	968	4700	975	335	406	0.1	0

Water only companies	Owners	Equity	Debt	Revenue	Operating Profit	Interest and financing costs	Tax paid	Dividends paid
Affinity Water*	Infracapital Partners, Prudential Group (UK) Morgan Stanley Infrastructure Partners (US) Beryl Datura Investment (UK) Veolia Water (France)	362	595	288	75	24	8	0
Bristol Water	Capstone Infrastructure Corporation (Canada) Sociedad General de Aguas de Barcelona S.A. (Spain) Itochu Corporation of Japan (20%)	91	265	108	25	13	2	4
Bournemouth & West Hampshire Water	Sembcorp Utilities (Singapore)	44	83	45	16	6	2	6
Dee Valley Water	Listed on London Stock Exchange	25	49	22	12	4	1	3
Portsmouth Water	South Downs Capital (UK)	25	90	37	5	8	0.04	1
South East Water (including Mid Kent)	Caisse de depot et placement du Quebec Utilities Trust of Australia	261	992	199	66	75	9	20
South Staffordshire Water (now includes Cambridge Water)**	Alinda Capital Partners (US)	11	488	88	16	33	0.2	0
Sutton & East Surrey Water	Sumitomo Corporation (Japan)	57	219	57	17	16	1	0
TOTAL		**10208**	**48581**	**10355**	**3586**	**3045**	**125.34**	**887**

All figures relate to the largest group the water company is part of, except where that group has substantial interests in other business, for example the Pennon Group for South West Water.

* formerly Veolia Water and recently bought by Rift Acquisitions. The company would not confirm how its finances had changed since the takeover.

** South Staffordshire acquired Cambridge Water in October 2011. The consolidated accounts for Hydriades IV have not been released yet so have taken figures from the 2011 accounts

Source: Companies' annual accounts compiled by Corporate Watch.

Corporate Watch has now found that, given the government does not have to pay dividends to shareholders and is currently paying around 3.5% a year on the 30-year bonds it is issuing (compared to the overall 6.2% rate the companies are paying) it would only pay £1.9 billion in interest payments for the same amount of money currently held by the companies (including their total debt and equity).

Almost £2 billion a year could therefore be saved if the financing for the water supply was raised publicly. This could either be reinvested in the system to address problems like leakage, or help reduce customers' bills. If it was all taken off bills, the average saving per household would be around £80 a year.

Capital costs paid by companies in 2012 (interest + dividends):	**£3.9 billion**
Capital costs if financed with 30-year government bonds at current 3.5% rate [(debt + equity) x3.5%]:	**£2 billion**
Total savings if publicly financed:	**£1.9 billion**
Total average savings per household in England and Wales (total savings/24 million households)	**£79**

Money from bills is also going on the salaries, bonuses and other benefits going to the water companies' CEOs. They amounted to £10 million in in 2012 (see table below) after rising for many years previously. All the companies say this is necessary to attract the right people. United Utilities, whose CEO Steve Mogford was the highest paid, earning £1.4 million in 2012, told Corporate Watch:

"The company's remuneration arrangements are designed so that the overall level of remuneration is sufficient to attract, retain and motivate executives of the quality required to run the company successfully. The company does not pay more than is necessary for this purpose."

When Corporate Watch showed Ofwat the figures comparing public and private borrowing the regulator did not dispute them but said: "Private investment in the sector since privatisation has led to significant improvements in the supply of water and sewerage services, there has been a significant reduction in the number of pollution incidents and customers receive world class drinking water."

Others dispute the private sector has been more efficient. A 2007 paper by the Public Services International Research Unit (see here) concluded "The historical evidence on the UK water industry, the actual experience under privatisation in England and Wales, and global experience all indicate that the industry would be at least as efficient under public ownership." The paper also says much of the investment in the system has been driven by targets set by legislation, which would have been the case whether the supply was public or private.

Channelling profits, leaking taxes

More money that could be re-invested or taken off bills is leaking out through tax avoidance.

All water companies enjoy various tax benefits. They are allowed to defer tax during periods of heavy spending on infrastructure for example, to encourage them to invest. They can also deduct the interest payments on their borrowings from their taxable profit.

However, Corporate Watch has found that six of the water companies - Northumbrian, Yorkshire, Anglian, Thames, South Staffordshire and Sutton and East Surrey Water - are artificially adding to their debts by taking high interest loans from their owners through the Channel Islands stock exchange. The interest payments further reduce their taxable profits in the UK and, thanks to a regulatory loophole, go to the owners tax-free.

In the most brazen case, Northumbrian Water is paying 11% interest on just over £1 billion of loans it has taken from the Cheung Kong group, a Hong Kong-based conglomerate run by Li Ka-Shing, the world's ninth-richest person.

The loans represented almost half of the £2.4 billion that Cheung Kong paid to buy Northumbrian in October 2011, with most of the rest invested as equity. If the company had invested it all as equity, any dividend payments would not have been deducted from the Northumbrian group's UK profits.

The companies are borrowing from subsidiaries of their owners based overseas. They can receive the interest payments tax-free because they have issued the loans through the Channel Islands stock exchange as 'quoted Eurobonds'. Usually, when a UK company pays interest to a non-UK company, it has to 'withhold' 20% of the payments and give it to the UK tax authorities. But if the loans are issued as quoted Eurobonds on a 'recognised' stock exchange, such as the Channel Islands' or the Cayman Islands', they benefit from an exemption that means no withholding tax is taken off.

Northumbrian Water's loans are described in the company's annual accounts as "shareholder loans" but Corporate Watch has found they are listed on the Channel Islands stock exchange, and thus benefit from the quoted Eurobond exemption.

Interest payments on the loans were only £50 million in the 2011/12 tax year because Cheung Kong only took over Northumbrian half way through it. Even so, combined with the interest payments on its other debt, the company did not pay any UK tax in 2012, even after it declared an operating profit of £154 million.

Over the next full tax year, more than £100 million will be deducted from Northumbrian's profits just from the shareholder loans, potentially avoiding around £24 million in UK corporation tax. This money is then leaving the UK through a complex web of subsidiaries ultimately leading to the Cheung Kong group.

At least one of these subsidiaries, Cheung Kong Infrastructure (Holdings) Ltd, is registered in Bermuda, a tax haven. Corporate Watch asked Northumbrian if the others were based in tax havens and why its owners had chosen to invest so much as Eurobonds. The company did not respond to the questions directly but said it "complies stringently with all corporate reporting and regulatory reporting requirements as set out by Ofwat, our primary regulator."

If the subsidiaries lending the money are based in tax havens, they will not pay any corporation tax on the interest when they receive it there either.

The Yorkshire Water group, which is owned by investment funds based in the US, UK and Singapore, and HSBC bank, accrued £66 million in interest payments on £844 million of quoted Eurobonds in 2012. This, together with the interest payments on its other debt, helped it pay just £100,000 in corporation tax on an operating profit of £335 million in 2012. Corporate Watch asked the company for a comment but did not receive a reply.

Thames Water, part-owned by the Australian Macquarie investment bank and sovereign wealth funds from China and Abu Dhabi, confirmed the interest payments on its £310 million of quoted Eurobonds from its owners are tax deductible.

Combined with its other debt, these helped the company wipe out an operating profit of £577 million, meaning it received a tax credit in 2012. Thames paid £165 million to its shareholders in 2012.

Anglian Water, which is owned by Canadian and Australian pension and infrastructure funds, confirmed the “loan notes” listed in its accounts are quoted Eurobonds and tax-deductible. A spokesperson for Anglian said this was “typical for private investors into UK infrastructure assets”.

Anglian paid £151 million to its owners in 2012 but just £1 million in tax in 2012 after an operating profit of £363 million.

Southern Water, which is owned by UBS bank and an investment fund, also owes £566 million to its owners in quoted Eurobonds. The company said at least some of the interest on them is not tax deductible.

Sutton and East Surrey said it would be “inappropriate” to answer any questions regarding its finances as it was in the process of being bought up by the Sumitomo Corporation of Japan. South Staffordshire Water confirmed the “loan notes” listed in its accounts were quoted Eurobonds.

Company	**Quoted Eurobonds as of 2012 (£m)**	**Interest rate**
Northumbrian Water	1033	11%
Yorkshire Water	844	6-7%+LIBOR
Southern Water	566	11%
Anglian Water	462	10%
Thames Water	310	11%
South Staffordshire Water	162	Not disclosed

Sutton and East Surrey	60	12%
Total	**£3.4 billion**	

HMRC almost closed the quoted Eurobond loophole in October last year, noting some companies were using it "for the purpose of circumventing the requirement to deduct tax at source rather than being directed at the raising of third party finance" but decided against it.

All the companies using the quoted Eurobond exemption have subsidiaries or related parties in tax havens. This makes scrutiny of their finances much more difficult, if not impossible, as countries such as Jersey or Guernsey require far less corporate disclosure than the UK. Kemble Water International Holdings, for example, the majority owner of the Thames Water group, is registered in Guernsey. Corporate Watch asked Thames Water if it would be possible to see its accounts but was told they were not publicly available.

Corporate Watch asked Ofwat if it was concerned that several companies are owned by or have transactions with tax havens, and if it would recommend regulating the water industry so companies cannot use tax havens. The regulator said it "does not have the power to prevent any change of ownership. However, following a change of ownership we consult on the ability of new owners to be the fit and proper owners of a regulated water company. We have made a number of amendments to the regulatory ringfence conditions in companies' licences to ensure we regulate companies within larger groups effectively and provide reassurance that the companies remain able to finance their regulated activities."

Water companies' CEOs' pay, 2012

Company	CEO	Total 2012 salary, bonus and other benefits (£)
Anglian Water	Peter Simpson	1024000
Northumbrian Water	Heidi Mottram	595000
Severn Trent Water	Tony Wray	1035000
South West Water	Christopher Loughlin	517,000
Southern Water	Matthew Wright	632000
Thames Water	Martin Baggs	845000
United Utilities Water	Steve Mogford	1421000
Dŵr Cymru Cyfyngedig / Welsh Water	Nigel Annett	547000
Wessex Water	Colin Skellett	664000
Yorkshire Water	Richard Flint	800000
Affinity Water	Richard Bienfait	287000
Bristol Water	Luis Garcia	197000
Bournemouth & West Hampshire Water	Roger Harrington	156000
Cambridge Water	Stephen Kay	202000
Dee Valley Water	Norman Holladay	119000
Portsmouth Water	Neville Smith	137000
South East Water (including Mid Kent)	Highest paid director	331000
South Staffordshire Water	Elizabeth Swarbrick	202000
Sutton & East Surrey Water	Anthony Ferrar	290000
Total		**10001000**