Proposed amendments to the Water (Special Measures) Bill
1st October 2024

We propose amendments to the Water (Special Measures) Bill as follows:

1. Put failing water companies into special administration
2. Stop public bailout of the water industry (the bill allows for public bailout).
3. Reform the duties of Ofwat to be for clean water, conservation and reasonable bills. This brings English water regulation up to the standards of, and improves upon, the Water (Scotland) Act 1980 section 1 (The Bill puts growth before the environment.).
4. Put employees and bill payers on the Boards of water companies. This reflects the normal practice in most wealthier OECD countries for large companies.

We have had the assistance of Prof Ewan McGaughey, Professor of Law at Kings College, London, in drafting the following attached clauses and explanatory notes.

1. Context

1.1 Thirty-four years of experience of how privatised water companies interact with regulators, both economic and environmental provide extensive evidence that despite many attempts to make both work, neither have. The most graphic example is provided by Thames Water which has failed spectacularly from the public's, bill players' and country's perspective in arriving at the edge of bankruptcy holding around £15billion of debt, whilst continuing to unaccountably avoid Special Administration (a government decision to temporarily take over the company to get it back on its feet). This is a situation being mirrored by the whole sector, with all water companied heavily in debt and failing their performance requirements. The success of this strategy, from the shareholders' perspective is that the profits gained remain untouched while the billpayer will be forced to provide the extensive investment required to fix the infrastructure black hole unless the government acts to determine differently.

1.2 As a result of the Windrush Against Sewage investigation into illegal discharges of untreated sewage in 2022, the Environment Agency is now conducting its largest ever criminal investigation into potential widespread breaches of environmental permit conditions at wastewater treatment works by all water and sewerage companies; and Ofwat is also undertaking a criminal investigation into all water companies for illegal discharges.

1.3 In January 2021 Defra admitted; ***'.. water infrastructure has not kept pace with development growth over decades.'*** Yet the enormity of the damage done over decades is only just being recognised as the economic time bomb created by the failure of the foundations of sustainable housing growth, slowly explodes. The neglected and, since 2017, illegally operating sewerage infrastructure now blocking thousands of houses at Oxford, for example, cannot simply be ignored by housing ministers who will risk serious public health as well as environmental and legal consequences.

1.4 As we enter the next 5-year funding review and face huge bill hikes proposed by Ofwat for customers; the government, regulators and water companies continue to claim that

over £200Billion investment came from shareholders and £88Billion will come from them again, when the evidence shows that to be an entirely false. This claim is being used to prop up a failed and possibly unworkable system, unless government is to allow billpayers to be highly exploited and unnecessarily overcharged - again.[i]

1.5 The Water (Special Measures) Bill is not provided to protect the public and does not address this broken system

2. The Water (Special Measures) Bill is failing customers and the environment

2.1 Regulating highly financially motivated companies that have dreadful recidivist histories has proven to be very difficult – Thames Water for example has over 180 criminal convictions even with the lamentably inadequate regulatory response, dictated by Defra. This permits the Environment Agency to investigate and prosecute only a small fraction of the criminal offences that have been built into business as usual, not just for Thames Water but across the sector.[ii] The Water Bill's focus on growth is at the expense of the environment and furthers this motivation.

2.2 Strong and effective regulation is undoubtedly the answer to providing good environmental protection and service delivery but in the light of what is now so well known, surely the answer to much of that is to simply stop the incentives that encourage water companies' illegal behaviour. The proposed bill, despite suggesting that it will control bonuses and dividends, brings nothing that is likely to succeed in that aim.

2.3 Boosting funding of regulation to the point where it may be able to tackle highly professional polluters may have an impact but would simply add another unnecessary financial burden to the only funding source in this arrangement – the billpayer.

2.4 The Water (Special Measures) Bill does not deal with this issue and simply tinkers with a broken system to help it limp along slightly better than it does at present. It does not identify nor address the reasons why current law is not enforced adequately and has made illegal pollution a profitable choice for water companies.

2.5 This strongly suggests new legislation will meet the same fate. The measures being given to the regulators are not addressing the root of the problem which is the lack of clarity about enforcement of the law, nor is it focusing regulatory effort on protecting the environment and the consumer.

2.6 The Bill as it stands allows for a public bailout overtly or by stealth and a complete betrayal of the duty to protect customers of monopoly companies providing something that no-one can give up – water. Current law allows the government to ensure that debt liability stays with the shareholders but appears to have chosen the public as the victim and the party that will have to pay up the compensation to fix the damage done to the country's water and sewerage infrastructure.

2.7 The representation of the interests of the public has been sadly lacking as water industry lobbying and other engagements led to the capture of regulators which remains a serious issue. Giving billpayers' and interest parties an effective voice may begin to push back on the worst of the imbalance.

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Amendments to the Water (Special Measures) Bill

By Prof Ewan McGaughey.[iii]

After clause 8

Insert the following new Clause –

Water regulator obligations

8A Duties of water regulators for clean water

(1) The Water Industry Act 1991 section 2 shall be amended as follows:

(a) omit subsection (2A)(c) (the duty to secure reasonable returns on capital for water undertakers),

(b) in subsection (2B) replace 'promoting effective competition between persons engaged in, or in commercial activities connected with, the provision of water and sewerage services' with: 'ensuring:

(a) clean and wholesome drinking water,

(b) bathing waters of excellent quality,

(c) lakes, rivers and beaches of high ecological status,

(d) the conservation of water resources, and

(e) reasonable water bills'.

(2) The Water Industry Act 1991 section 3 shall be amended by inserting in subsection (2) before '(a)':

(aa) a requirement to achieve excellent quality of all bathing waters, lakes, rivers and beaches of high ecological status, and elimination of sewage, waste and other pollution so far as reasonably practicable from all waterways.

8B Prohibition of conflicts of interest in regulation

(1) An employee, director or advisor of the Water Services Regulation Authority, or the Secretary of State, shall be prohibited from taking any employment, directorship, commercial opportunity, or other significant transactional relationship with any regulated water company, or connected party, and shall be prohibited from accepting gifts of any amount that could produce the possibility of a conflict of interest.

(2) A connected party shall include any shareholder, significant creditor, or other entity with a significant transactional relationship with a regulated water company.

In place of clauses 10 to 12

Insert the following new Clauses –

10 Special administration for breach of environmental obligations

(1) Pursuant to the Water Industry Act 1991 section 24(2)(a), the Secretary of State shall petition the High Court for special administration of the companies listed in Schedule 1 for serious breach of the principal duties to:

(a) maintain efficient and economical water supply,
(b) improve mains for the flow of clean water,
(c) provide sewerage systems that are effectually drained,
(d) comply with the terms of its licence, and
(e) comply with basic environmental standards and stop pollution.

(2) The Secretary of State shall compile and present to the High Court the grounds for continuing appointment being inappropriate, including the records of:

(a) water pipe leaks,
(b) sewage spilled into waterways, bathing waters, and private properties,
(c) falling below international standards of effective water management.

11 Prohibition on bail-out of water company shareholders and creditors

(1) The Secretary of State and His Majesty's Treasury shall be prohibited from directly or indirectly discharging, assuming, or guaranteeing any debts of legal entities in any water company group listed in Schedule 1.

(2) The special administrator of a water company shall reduce the debts owed by the regulated entity to its creditors by 100 per cent.

(3) The prohibition in subsection (1) and the reduction of debts in subsection 2 shall not include pension, wage and other obligations owed to employees, excluding any past or current member of a board of directors, within the water company group.

12 Governance structure of water companies

(1) The board of directors of a company providing drinking water or sewerage services to the public, and any parent or holding company, shall have:

(a) at least one-third of its members elected by the employees of the company or group,
(b) at least one-sixth of its members chosen by local authorities in the water catchment area, in consultation with independent environmental and consumer groups.

(2) Every employee and bill-payer has the right to be entered on the register of members of their company.

(3) Employees as a group shall be entitled to a minimum of one-third of the total votes in the general meeting of the company. Bill-payers as a group shall be entitled to a minimum of one-sixth of the total votes in the general meeting of the company. Relative to one another, each employee and bill-payer shall have one vote.

(4) The Secretary of State may by order increase the proportion of directors in subsection (1) that are elected by employees to one-half, and chosen by local authorities to one-quarter, and shall raise the proportion of votes in the meeting in subsection (3) accordingly.

In place of clause 13(5)

Insert the following new sub-clause –

(5) The following provisions come into force two months after the day on which this Act is passed—
(a) section 4 (impeding investigations: sentencing and liability);
(b) section 8A (duties of water regulators for clean water);
(c) section 8B (prohibition of conflicts of interest in regulation);
(d) section 10 (special administration for breach of environmental obligations);
(e) section 11 (prohibition on bail-out of water company shareholders and creditors);
(f) section 12 (governance structure of water companies).

After clause 13

Insert the following new Schedule –

Schedule 1

1. Thames Water
2. Such other water company as the Secretary of State may decide has not fulfilled its duties.

8A Duties of water regulators for clean water

Clause 8A changes the duties of Ofwat to be compatible with the public interest. Since privatisation, the statutory goals of Ofwat have included securing a return on capital for investors, even if this damages the interests of customers. It also requires serving customers mainly by inventing competition, even though water companies hold regional monopolies and logically no competition is possible or has ever been created. Clause 8A eliminates this corporate welfare and legal fantasy and reforms the duties of Ofwat to be for clean water, conservation, and reasonable bills. This brings English water regulation up to the standards of, and improves upon, the Water (Scotland) Act 1980 section 1.

8B Prohibition of conflicts of interest in regulation

Clause 8B requires that senior staff who work at the regulator cannot have a potential conflict of interest by being lured into a job at a regulated company, and also requires that the Secretary of State has no conflicts of interest, for instance by accepting gifts from those interested in water companies. Where this could happen, regulators will have an incentive to do more 'light touch regulation' in order to please their future employers, and ministers may be encouraged to use their regulatory powers in the interests of regulated companies instead of the public. Examples include the former chief executive of Ofwat becoming a director of Thames Water, and according to the Observer there were '27 former Ofwat directors, managers and consultants working in the industry they helped to regulate' (1 July 2023). In addition, the Secretary of State took tickets and hospitality valued at £1,786 from a major shareholder of a regulated water company (25 September 2024). Clause 8B ensures that regulated companies cannot corrupt their own referees with the temptation of money or gifts.

10 Special administration for breach of environmental obligations

Clause 10 would require that, to make an example, Thames Water and other companies designated by the Secretary of State under Schedule 1 are put into special administration. 'Special administration' enables the Secretary of State to take control of, and restructure, a failed water company. This differs from ordinary administrations for insolvent companies, where the secured creditors take control, and may restructure a business. Similar procedures were used for Railtrack (which led to the transfer to a new public company, Network Rail Ltd),

and for Bulb (which led to transfer to the private company, Octopus). Special administration does not determine whether a future water company must be publicly or privately owned. However, in order to raise funds efficiently borrowing costs of the public sector are significantly lower than the costs available in the private sector.

Clause 10 says special administration is for breach of water companies' statutory 'primary duties' to ensure clean water, and infrastructure investment, under section 24 of the Water Insolvency Act 1991. The Secretary of State currently has the power to take this step, but under the Conservative administration, it failed to use its discretion to do so. Therefore, the Act is an instruction from Parliament to the Government to act.

Special administration is also possible if a water company goes insolvent, by not being able to pay its debts as they fall due. Although companies in the Thames Water group are soaked in debt, creditors have an incentive to resist an insolvency procedure because special administration involves public control. Creditors do not want this. Unlike ordinary administration procedures, the 'special administration' procedure for regulated companies also enables the secured debts over the company to be reduced entirely. The test is that the High Court must be persuaded that the special administration order is needed for the statutory functions of the company for clean water and infrastructure to be fulfilled. The High Court would be expected to grant a special administration order swiftly, and defer to the reasons given for it. Ultimately this means that (unlike nationalisation) none of the debt owed by Thames Water to creditors must be added to government debt.

This and the following two amendments would replace the existing drafts of clauses 10 to 12. As currently drafted, clauses 10 to 11 enable the costs of special administration to be shifted onto bill payers, not banks and shareholders. Clause 12 gives water companies more rights to be heard in winding up petitions. These clauses give polluting parties more rights, are unnecessary, and by putting costs on bill-payers are radically opposed to Labour's election manifesto, not to be waived through under the Salisbury convention. The proposed amendments, by contrast, are consistent with Labour's promise to 'put failing water companies under special measures to clean up our water.'

11 Prohibition on bail-out of water company shareholders and creditors

Clause 11 requires the Secretary of State and HM Treasury to not bail-out the shareholders or creditors of any water company. To give Thames Water as an example, in May 2024, Thames Water Utilities Ltd had around £3.1 billion debt, and had given various cross-

guarantees, while the TW group owed over £16 billion in debts.

A chart from JP Morgan published by the Financial Times (2 April 2024) suggested that financial institutions expect 'Zero recovery' for creditors if special administration was triggered, reflecting the accurate legal position that debts may be reduced to nil if this would interfere with a water company's functions. The former UK government's 'Project Timber' was contemplating taking on the entire Thames Water group's debts, subject to merely a 5 per cent to 40 per cent haircut, as reported in the Guardian (18 April 2024). It was, however, reported in the Telegraph (8 September 2024) that Elliott Management, a New York hedge fund (or 'vulture fund') had bought £1 billion in debt at an undisclosed reduction from other creditors.

Clause 11 requires that between 50 and 100 per cent of debts are cancelled, taking into account the seriousness of environmental breaches and the excessive returns on capital so far, to reflect the costs that creditors have already imposed on the public, and the poor risks they took.

12 Governance structure of water companies

Before privatisation, and in Scotland or Northern Ireland today, the boards of publicly held water companies are typically appointed by Whitehall or government ministers without representation for staff or bill-payers. By contrast, modern forms of public governance require workers and bill-payers to be represented in addition to representatives of the investor (that is, the state or local council, in publicly owned enterprise). This prevents an overload on central government administration, draws on the expertise of the people who understand their enterprise the best, and provides an effective check on governance by service-users who, given a water company's status as a natural monopoly, cannot otherwise 'vote with their feet'. Examples of a mix of staff and bill-payer representatives are found in Berlin and Paris, which both transferred water companies into public ownership after privatised utilities had not functioned adequately.

Clause 12 requires minimum standards of at least one-third of water company boards to be elected by staff, and this threshold may be raised to one-half by the Secretary of State by order. (This is a similar rule to elected pension trustees in the Pensions Act 2004 sections 241 to 243.) This reflects the normal practice in most wealthier OECD countries for large companies. It also requires at least one-sixth of boards are chosen by local authorities, in consultation with independent environmental and consumer groups, and this threshold may

be raised to one-quarter. The remaining half of board seats (or quarter if the powers to raise thresholds are used) may be filled by the investors, whether the central government, local government or other entity. This provision would apply to all water companies, whether privately or publicly owned.

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[i] Prof David Hall – investment in water https://gala.gre.ac.uk/id/eprint/47165/

[ii] Prof Peter Hammond https://www.nature.com/articles/s41545-021-00108-3

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