

ENVIRONMENT PLANNING AND TRANSPORT COMMITTEE/

ECONOMIC DEVELOPMENT COMMITTEE

Date: Wednesday 15 November 2000

Venue: The Chamber, National Assembly Building

Title: **Glas Cymru's Plans for Welsh Water**

Introduction

On 3 November 2000, Glas Cymru Cyfyngedig and Western Power Distribution Limited announced that they had reached agreement, subject to contract, on terms for Glas Cymru to acquire Welsh Water from WPD. Glas Cymru expects to become the new owner of Welsh Water at the beginning of next year.

Glas Cymru is a new and independent company, incorporated and based in Wales, which was formed in March 2000 for the sole purpose of acquiring and owning Welsh Water. The acquisition of Welsh Water by Glas Cymru will ensure that the ownership and control of Welsh Water is restored to Wales. The Board of Glas Cymru believes that this will be in the best interests of Welsh Water, its customers and the environment of Wales.

In summary, Glas Cymru's plans will:

- offer the prospect of lower bills for Welsh Water customers. The Board of Glas Cymru believes its offer will allow Welsh Water to reduce customer water bills before the next regulatory review in March 2005;
- secure continued investment in the water industry and environment in Wales;
- create a stable, long term ownership structure for Welsh Water, ensuring that customers' interests are fully protected;
- ensure that ownership and control of Welsh Water will remain in Wales; and
- focus the management of Welsh Water exclusively on, and hold them directly accountable for, the efficient provision of high quality services to Welsh Water

customers at the lowest possible cost.

Glas Cymru's plans are mainly concerned with the overall direction of Welsh Water, and in particular the way in which Welsh Water is financed and governed in the long term. Glas Cymru's acquisition of Welsh Water will not affect the day to day services which Welsh Water provides, and customers will not be adversely affected by the change of ownership. A key ingredient of Glas Cymru's plans is that the highly qualified and experienced management team that currently runs Welsh Water will stay with the business.

Glas Cymru will be consulting widely over the coming weeks to ensure that Welsh Water's customers - and all who rely on or have an interest in Welsh Water - are content with its plans.

Key Benefits for Welsh Water and its Customers

The Board of Glas Cymru believes its plans will yield significant benefits for Welsh Water, its customers and the environment. Under Glas Cymru's ownership:

- **Water bills will be lower.** The Board of Glas Cymru believes that as a result of its plans there is scope to announce a reduction in water bills prior to the next regulatory price review, over and above the reductions recently announced by Ofwat. The cost of financing Welsh Water's assets absorbs nearly a third of its revenues. And with Welsh Water's continuing investment programme this proportion will increase. Glas Cymru will finance Welsh Water's assets with long maturity, low risk solid investment grade bonds and this will reduce the cost of financing Welsh Water's assets.
- **Welsh Water's profits will be re-invested.** Glas Cymru is a company like any other save for one important difference - it does not have equity shareholders. This means Glas Cymru does not pay equity dividends and profits after paying interest on bonds and other financing costs can be re-invested for the benefit of Welsh Water, its customers and the environment.
- **Customers will continue to enjoy the same legal and regulatory protections as now.** Like all other water companies, Welsh Water operates under a strict legal and regulatory framework which ensures that safe drinking water supplies cannot be compromised. This will not change. Welsh Water will continue to be regulated in the same way as all other water companies and the protections offered to customers by the current legal and regulatory system will continue as before.
- **Safety and quality of service will remain the top priority.** Welsh Water will retain responsibility for providing safe drinking water and protecting the environment, and it will also retain the people and resources necessary to ensure this primary responsibility continues to be met. The integrity of the water supply system will not be compromised.

By restoring Welsh Water to a sound financial basis Glas Cymru can ensure that Welsh Water's £1.2 billion investment programme to improve service reliability and water and environmental quality – recently agreed with the National Assembly, Ofwat, the Environment Agency and the Drinking Water Inspectorate - is carried out as planned.

- **Customers will not assume any new risks.** Under Glas Cymru's plans, customers will not own Welsh Water, nor is there any question of customers being asked to meet Glas Cymru's or Welsh Water's liabilities. Glas Cymru is not a "mutual". Glas Cymru will have substantial financial reserves which will protect Welsh Water and its customers against risk of adverse trading conditions.
- **Management will be focused and accountable.** Glas Cymru's sole purpose will be the financing of water assets in Welsh Water's area of appointment and letting commercial contracts for the operation of those assets and delivery of service to customers. Glas Cymru's constitution prohibits the company from diversifying into any other activity. The Board of Glas Cymru will ensure Welsh Water has a high quality management team and staff strongly incentivised to ensure the delivery of high quality services to Welsh Water customers at the lowest possible cost. The Board of Glas Cymru will themselves be open and accountable to Welsh Water's customers their representatives, including the National Assembly.
- **Ownership and control of Welsh Water will be restored to Wales.** Welsh Water provides an essential public service, and it is important that Welsh Water's ownership is in "safe hands". Glas Cymru's ownership will ensure that Welsh Water remains a distinctly Welsh enterprise located in and run from Wales. As now, Welsh Water will place equal importance on its customers in England who will equally benefit from Glas Cymru's plans. Customers will benefit from the fact that the customer and environmental policies of Glas Cymru will have a local focus and will be highly responsive to local priorities.

These benefits depend on the new way in which Welsh Water will be financed and governed under Glas Cymru's ownership.

Glas Cymru's ability to raise low cost capital

The key to Glas Cymru's plans is being able to finance Welsh Water's assets with long maturity, strong investment grade bonds on attractive terms. This means putting in place plans and structures which together clearly demonstrate to bond investors that Welsh Water is very low risk and that there are virtually no circumstances under which Welsh Water could get into a position where it could not pay interest or principal due on the bonds. This is what Glas Cymru's plans are intended to achieve.

Ways in which Glas Cymru will reduce the risk of investing in Welsh Water include:

- **No equity shareholders.** Glas Cymru's constitution requires that profits, after paying interest on bonds and any related financing costs, are re-invested for the benefit of Welsh Water, its customers and the environment. Glas Cymru's ownership of Welsh Water will therefore remove the fundamental tensions and risks that arise from the fact of equity shareholder ownership of a monopoly providing an essential public service.
- **No diversification risk.** Glas Cymru's constitution strictly limits its purpose to that of only financing water assets in Welsh Water's area of appointment and letting commercial contracts for the operation of those assets so as to ensure the proper carrying out of its functions and responsibilities in accordance with Welsh Water's licence. The worry that Glas Cymru might diversify into other risky activities is completely removed.
- **Strong reserves.** Glas Cymru will start with reserves of over £150 million and the board of Glas Cymru expects that these will build up to some £350 million – representing about 15% of Welsh Water's "Regulatory Asset Value - before savings are passed on to customers. This level of reserves will cover the financial cost of possible "shocks", such as, for example, a major drought.
- **Competitive Procurement Plan.** Welsh Water already out-sources its annual £230 million capital investment programme. Glas Cymru will extend this approach by also out-sourcing the day to day operation of assets and provision of customer services to specialist Service Providers. This means that the proportion of Welsh Water's annual cash expenditure carried out by specialist private sector contractors will increase from 60% currently to around 80%. These Service Providers will give Welsh Water the benefits of competition, best practice and best value, and Welsh Water will not be exposed to risk of day to day variations in running costs. By having properly discovered market prices for over 80% of its actual costs, the risk that at future price determinations Ofwat may under-estimate the true cost of providing water and sewerage services is also reduced. The remaining 20% of costs are largely fixed and cover items such as rates, licence fees, environmental fees and other company-wide costs which are not related to day to day operations.
- **Licence changes.** Glas Cymru will agree with Ofwat to a package of licence changes to Welsh Water's regulatory licence which will reinforce the independence and "ring-fencing" of Welsh Water and emphasise the creditor protections provided by the current regulatory and legal framework given the essential public service nature of water supply and sewerage.

Procurement Plan

Glas Cymru will implement a Procurement Plan whereby Welsh Water will out-source the day to day operation of its assets and delivery of service (as well as billing and customer contact management) to specialist Service Providers under competitive commercial contracts. Welsh Water itself will at all times retain the key skills and resources to retain overall control of its operations in accordance with its legal responsibilities. The Procurement Plan will be published annually and will be subject to audit and approval by Ofwat. It will set out:

- how the technical competence and service record of potential Service Providers will be assessed during the tendering process;
- how tendering procedures will ensure a competitive outcome;
- how Glas Cymru will ensure that Service Providers follow specified policies and working practices (eg the ISO9002 water quality system already operated by Welsh Water);
- how Welsh Water will monitor the performance of Service Providers (including regulators' requirements for access to information); and
- Welsh Water's step in rights in the event of poor service performance and stand-by procedures for alternative service provision.

A Service Provider's reputation and record on performance will be an important ingredient in its success in winning future contracts with Welsh Water and with other water enterprises in the UK and elsewhere. This will give a powerful and direct financial incentive to provide a high quality service and to avoid shortfalls in standards.

Corporate Governance

Glas Cymru is a company limited by guarantee, incorporated under the Companies Act, and owned and controlled by members instead of equity investors. Glas Cymru will initially have up to 50 members (maximum of 200 in due course) who, like equity shareholders, will own and control the company, and otherwise carry out the responsibilities of shareholders. However the Members will not receive dividends or have any other financial interest in Glas Cymru.

The Board of Glas Cymru will be accountable to its members. Members will be individuals from across the region served by Welsh Water with backgrounds in a variety of sectors including industry, finance, small business, education, health, the environment, charities and local government. Members will be put forward by an independent panel following an open selection process based on "Nolan principles". All members must be prepared to act in accordance with

the constitution of the Glas Cymru, and in particular will have the duty to further the company's primary object of providing high quality water and wastewater services at least cost to the community. They must also be able to play an active role in providing a critical oversight of the Board's performance.

Glas Cymru will be obliged to act at all times as though it was listed on the London Stock Exchange and this will impose reporting and other obligations. Glas Cymru will be subject to the Companies Act framework and will act in accordance with the Principles of Good Governance and Code of Best Practice as required by the listing rules of the London Stock Exchange. In the event of serious under-performance by Directors, the Members will have the power to remove them and elect replacements.

Ofwat's requirements for new ownership structures in the water industry

In June of this year Ofwat consulted on possible new ownership structures in the water industry. This consultation set out the issues raised by these new structures, identified the potential advantages and indicated the key requirements that would have to be met for regulatory consent.

The Board of Glas is confident that it can meet the regulatory tests set out by Ofwat. In particular:

- the Board of Glas Cymru is independent of Hyder and WPD, and it has engaged its own independent financial and legal advisers in the course of the preparation of its offer to purchase Welsh Water;
- Glas Cymru is not a "mutual", and Glas Cymru's acquisition of Welsh Water will not mean any transfer of ownership or liabilities to Welsh Water's customers;
- Glas Cymru will operate with strong commercial incentives to deliver efficient and low cost water and sewerage services to Welsh Water's customers. Glas Cymru will implement a procurement plan which will ensure that Welsh Water achieves the full benefits of competitive prices and best practice;
- the transaction agreed by Glas Cymru and WPD depends on Welsh Water having strong financial prospects which allow it to raise new capital and maintain a strong investment grade rating; and
- the Board of Glas Cymru believes that it will be able to provide a highly efficient service to customers and that there will be scope to announce a reduction in water bills prior to the next regulatory price review and as such Glas Cymru's acquisition of Welsh Water will deliver tangible benefits for Welsh Water's customers.

Glas Cymru will agree with Ofwat to a number of changes to Welsh Water's regulatory licence which will reinforce the independence and "ring-fencing" of Welsh Water, and which will require Welsh Water to carry out its functions in an open and accountable manner, to procure services efficiently and competitively, and to maintain a solid investment grade rating so that Welsh Water can continue to raise new capital from investors to finance efficiently its ongoing investment programme.

Key issues for the National Assembly for Wales

The Board of Glas Cymru believe that the new structure fulfils many of the concerns of the National Assembly. The following issues are particularly significant:

- **A distinctly Welsh business:** the Memorandum and Articles require Welsh water to be owned and managed in Wales for the benefit of its customers.
- **Preserving the maximum number of jobs:** Glas will retain the "head office" jobs in Wales.
- **Commitment to investment and development of the regulated business:** this will be the sole purpose of Glas, and it will be restricted from diversifying into unregulated businesses.
- **Maintaining the environmental record and continued investment:** Glas Cymru ownership will secure finance for the environmental investment programme.
- **A commitment to sustainable development:** Glas Cymru will have a clear focus on environmental performance and policies.
- **Recognising water as an economic resource:** Glas Cymru ensures ownership of an essential national resources is retained for the long term.
- **Providing high quality water and sewerage service:** the company will have a clear focus on customer service.
- **Operating a fair pricing policy:** Glas Cymru plans customer rebates prior to the next regulatory price review.

Next Steps

Glas Cymru will be consulting widely on its plans for Welsh Water. Glas Cymru wants to be sure that Welsh Water's customers are content with these plans and are content with Glas Cymru's ownership of Welsh Water. Customer support is crucial. The Board of Glas Cymru believes firmly that its ownership of Welsh Water is in the best interests of Welsh Water's customers and the environment, and Glas Cymru's consultation programme will seek to explain this fully.

Ofwat will also consult on Glas Cymru's plans, and the Ofwat Customer Service Committee for the Welsh region will be organising public meetings. Details of these public meetings and other occasions where Glas Cymru will be presenting and discussing its plans will be posted Glas Cymru's website www.glascymru.com. Further background on the water industry, on Welsh Water, and on Glas Cymru's plans for Welsh Water can be also be obtained here.

Glas Cymru encourages and welcomes comments and opinions on its plans for Welsh Water. Glas Cymru can be contacted by email at info@glascymru.com or in writing at 1 Kingsway, Cardiff CF10 3PW.

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