

The Benefits of Investor-Owned Water Utilities

Introduction

There has been a longstanding debate over the role of investor ownership in the water utility sector, which some say – as an essential resource – should be in the hands of government entities. However, this argument is commonly grounded on misconceptions about how investor-owned utilities operate. In reality, investor-owned water and wastewater providers often have the financial and technical capabilities to address challenges and better serve communities than government counterparts.

Government-owned systems make up approximately 84 percent of our nation's water systems, but many municipalities are challenged by limited budgets, inability to raise capital and competing priorities. In fully owning, managing and operating a water system or in working with municipalities via public-private partnership (PPP) agreements,¹ investor-owned utilities can meet local needs and ensure communities receive high-quality, reliable water now and in the future.

Meeting Challenges

The growing water needs of Americans are creating challenging situations. Communities are faced with investing vast amounts of resources as they struggle to renew their aging water and wastewater systems, meet growing demand and comply with new water quality standards. Investor-owned water and wastewater service providers offer several advantages for addressing these issues that many municipalities cannot.

Access to capital

The cost of upgrading water and wastewater systems presents sizeable financial challenges for many cash-strapped state and local governments. Because water related services require miles of pipes and extensive treatment plants, the industry is twice as capital-intensive as providing electricity and three times as capital intensive as providing natural gas. Indeed, the Environmental Protection Agency (EPA) has estimated that the country is facing a near trillion dollar challenge over the next twenty years to address the aging water and wastewater infrastructure. Often, new EPA requirements carry costs in infrastructure improvement, treatment process or security that can be a burden for all service providers, but especially for municipalities that may have competing priorities. Smaller systems in particular often lack the financial and technological means to comply with EPA regulations, and accordingly receive the most EPA violations per population served.²

¹ Please see the American Water white paper "Challenges In The Water Industry: Public-Private-Partnerships as a Solution" for more information.

² Shih, Jhih-Shyang; Harrington, Winston; Pizer A., William; Gillingham Kenneth. Economies of Scale in Community Water Systems. American Water Works Association Journal. September 2006.

Government owned utilities have a limited taxpayer and revenue base which must service all the municipalities needs, not just water and wastewater services. As a result, many municipalities, particularly medium to smaller systems, find themselves with significant constraints in their ability to attract capital to maintain reliable service and comply with increasing quality requirements. On the other hand, large investor-owned water utilities, such as American Water, often have a greater ability to secure cost effective capital and thus make major necessary investments. For example, in the last year alone, American Water invested approximately one billion dollars in capital improvements to ensure that communities served by its utility subsidiaries continue to receive reliable, high-quality water services.

Cost efficiencies and economies of scale

Public systems serving a small population have little bargaining power when it comes to paying for equipment, tools, services and chemicals, and a host of other goods and services needed to provide high-quality, reliable service. Despite their tax base, they still must provide the same basic services such as billing, customer service, and water testing as a larger utility, meaning water service management and maintenance comes at a much higher price.³ As operations become increasingly complex and costly, many small systems may find it difficult to meet performance standards and sustain operations.

By operating on a larger scope and serving multiple communities, investor-owned water utilities like American Water can take advantage of economies of scale and bargain to keep down construction and operation costs. As the largest US investor-owned water and wastewater utility, American Water is able to procure materials such as pipe, hydrants and fleet vehicles for less than smaller systems, and also manage systems more effectively. As proof, through engaging in a PPP with American Water and leveraging their expertise in water management to make operational and financial improvements, the city of Buffalo, NY saved \$21 million in six years.

Experience and expertise

Even with the willingness to spend the money, many communities lack the in-depth experience to design and/or implement infrastructure upgrades on their own or to operate and maintain systems that are becoming more complex due to increasing water quality requirements. With deep water industry experience, investor-owned water utilities can provide tailored, innovative solutions to meet a community's specific needs. For American Water, this means everything from local pipe maintenance, to leak detection, to large-scale desalination projects, to water reuse technology and many others. Along with managing and operating systems, American Water employs a team of world-renowned researchers to conduct scientific studies, develop groundbreaking programs and apply new technologies in the areas they operate. Through PPPs, municipalities can also gain access to such technical expertise and resources that would otherwise be unavailable.

How Investor-Owned Utilities Operate

Because water is an essential resource, investor-owned water service providers generally do not “own” the water contained in the sources from which they obtain the supplies necessary to provide service, such as rivers, lakes or underground aquifers. Typically, they have a right to use these sources of supply and these rights are often circumscribed by withdrawal or permitting requirements controlled by government entities as well as other laws and legal precedents. Investor-owned water utilities provide the service of securing necessary sources of supply, treating and distributing the water to the customers' taps and investing in and maintaining the

³ Shih, Jhih-Shyang; Harrington, Winston; Pizer A., William; Gillingham Kenneth. Economies of Scale in Community Water Systems. American Water Works Association Journal. September 2006.

complex and costly infrastructure to do so, while remaining in compliance with all national and local quality standards. Water rates reflect the cost of this service.

The main driver of rate increases is capital investment, or the money water companies need to invest to provide reliable service, including repairing and upgrading the water supply infrastructure. With the current state of our nation's infrastructure, this means that rates will likely continue to rise as communities update their systems. Thus, the public will need to pay more for water services regardless of whether the system is investor-owned or public. Despite concerns over rate increases, American Water still provides high-quality, reliable water from the original source, through complicated treatment processes and many miles of expensive distribution facilities to the tap in a customer's home. They do this all at the cost of about a penny a gallon - a remarkable value compared to other household utilities.

One key difference to note: whereas public water utilities generally set their own rates, investor-owned utilities must go through a state public utility commission (PUC) approval process and take part in formal, public hearings. Rate increases are necessary to allow investor-owned water utilities the ability to recover investments and operating costs they incur to ensure long-term, sustainable service. However, investor-owned utilities must demonstrate to the PUC that the investment and costs are prudent. The ability of investor-owned water companies to earn a return on capital provides a clear financial incentive to run operations efficiently that does not exist for public counterparts. Rate oversight by the PUC helps assure that rates to customers are as low as possible consistent with high-quality, reliable service, while also allowing the utility to attract the essential capital necessary to invest in replacing ageing infrastructure. Political pressures, constraints on the ability to raise capital and many competing needs sometimes result in municipalities that do not set rates that are sufficient to cover the cost of service and provide for necessary infrastructure replacement.

Investor-Owned Utilities in Practice

With employees very much a part of the communities they serve, investor-owned water utilities are deeply committed to meeting local water and wastewater needs. While isolated cases of eminent domain (where a government takes control of water assets) or opposition to investor-owned water utilities tend to get much publicity, there are far more instances where communities see positive outcomes from investor ownership and/or partnerships. For example, when American Water faced condemnation efforts in Lexington, KY, residents overwhelmingly voted for Kentucky American Water to continue operation of its systems. Through investor-owned ownership and management, communities benefit from improvements in the following areas.

Reliable, high quality water

In meeting standards, communities have seen a real improvement in water quality as a result of investor-owned involvement. American Water has a long history of complying with and, in many cases, surpassing applicable environmental laws and regulations.⁴ In 2008, American Water systems were found to be almost 100 times more likely to be compliant with EPA standards than the average public or investor-owned water system.⁵

Accountability and transparency

⁴ In 2007, American Water achieved more than a 99.9 percent compliance rate for meeting state and federal drinking water standards.

⁵ USEPA Statistics on Regulated Business Maximum Contaminant Levels (MCL) and Monitoring and Reporting (M/R) Violations-2006-2008.

The price of water for investor-owned water systems reflects the full cost of water services for a given period, whereas public systems may not. While public systems may defer costs and recover them in the future, costs for capital improvement projects must ultimately be recovered through taxes or rates. Because of regulation by the PUC, investor-owned water utilities, tend to operate with more transparency and make clear exactly what customers are paying for on their bills. This way, the investor-owned company demonstrates full accountability for services and charges.

Economic growth

The local reliability of water infrastructure and availability are important factors in attracting business to an area. In providing reliable, high-quality water service with a capability to meet specialized water needs, investor-owned water companies can significantly contribute to the local economy and spur growth. As one example, American Water helped spur economic development in Foxborough, Massachusetts, by implementing an in-house wastewater treatment system for Gillette Stadium. By recycling wastewater for toilet flushing, the city is able to accommodate 69,000 football fans without creating additional demands on the community's existing systems, which could not have been achieved otherwise.

Social involvement

Aside from paying local business taxes, investor-owned water providers are very much a part of the communities they serve. Employees work closely with local leaders and customers, and they and their families are typically customers themselves, drinking the same water they help to treat and deliver. American Water also has a long track record of educating customers on wise water use and supporting local organizations. The company also educates customers on controlling their water use and offers other information on protecting water resources.

Reliable customer service

Investor-owned water utilities are committed to meeting customer needs and responding to customers quickly, which often means fixing a problem, such as a service disruption, before it worsens. In its commitment to putting customers first, American Water provides 365 day, 24 hour customer service access, which cannot be said for most publicly-owned water authorities. As a result, independent surveys show over 90% of American Water customers are very satisfied with the service they receive.

Conclusion

Working with investor-owned water providers is a viable solution to a number of serious water industry problems. Investor-owned water companies, like American Water, can help address these challenges by offering access to capital for investment, identifying more cost-effective ways to deliver service, and providing industry expertise and experience. In working together with municipalities, investor-owned utilities can offer clear benefits to communities. Investor-owned water companies remain fully committed to helping communities meet local water and wastewater needs.