

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water industry in England and Wales provides customers with a good quality and efficient service at a fair price.

Ofwat's strategy – taking a forward look

Ofwat – Protecting consumers, promoting value and safeguarding the future



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About this document

This document sets out our priorities for guiding how we will develop economic regulation of the water and sewerage sectors in England and Wales over the long term, and how we will deliver our aim of protecting consumers, promoting value and safeguarding the future.

For each part of our aim we set out:

- our long-term strategic priorities;
- how we will reflect those priorities in the way that we regulate;
- what we want to achieve through our work and in partnership with others; and
- the programme of work we will deliver in the next three years to help achieve this.

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Overview

The water and sewerage sectors have come a long way since privatisation 18 years ago – with about £70 billion invested in infrastructure by 2010, better standards of service, and increased environmental and drinking water compliance. However, if the industry is to continue to deliver high quality, good value services to consumers it will have to go even further to meet new challenges. These include mitigating and adapting to climate change, meeting rising consumer expectations, catering for an increasing population, and complying with more stringent environmental standards under the Water Framework Directive.

In order to meet such longer-term challenges all stakeholders have had to think, and plan, using a long-term approach. For example, the Government has recently published ‘Future water’, its vision for water and sewerage services in England for the coming years. We also required each company to prepare a 25-year strategic direction statement as part of the 2009 price review. Our Board has been considering its approach to both the water and sewerage sectors in the long term, and we have set out in this document what we will be doing in the next three-year period.

A key part of our work in the next three years is the price review in 2009. We have recently published ‘Setting price limits for 2010-15: Framework and approach’, setting out how we will set price limits. Although there are some changes to our approach from previous price reviews, we are building on our existing transparent, stable and consistent methods by setting the foundations for developing the water and sewerage sectors for the long term. This includes providing incentives for companies to deal effectively with future challenges, providing a framework for long-term planning and sustainability, and enabling the progressive development of competition.

Competition has the potential to empower consumers, as well as drive efficiency and innovation over the long term. We are committed to introducing competition into the water and sewerage sectors where this will be beneficial to consumers. As markets are opened, we will look for opportunities to withdraw regulation where competitive pressures provide sufficient protection for consumers. But until this happens, or where competition cannot provide this protection, we will continue to challenge robustly monopoly service providers to deliver the services their consumers expect.

In this document, we have set out the priorities that will guide our work over the long term in making sure that the water and sewerage sectors meet new challenges. But delivering the right solutions for consumers and the environment both now and in the future will require more than this. It will also need strong partnerships between the Government, companies, other regulators, consumer bodies and other key stakeholders. That is why we look forward to working with all our stakeholders, both now and in the years ahead, in meeting our aim of protecting consumers, promoting value and safeguarding the future.

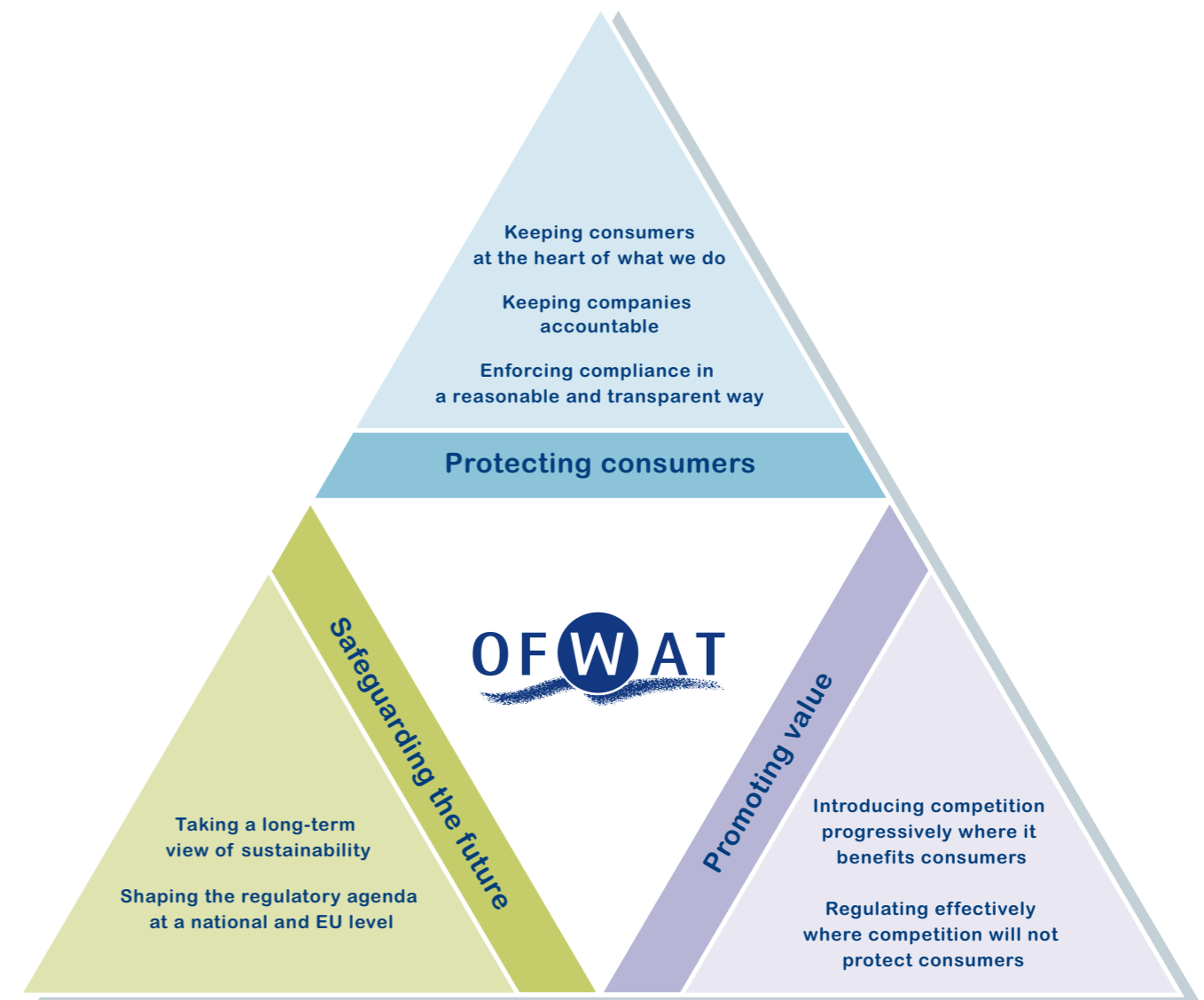


Philip Fletcher – Chairman



Regina Finn – Chief Executive

Our strategy – a summary



1. Protecting consumers



Our priority:
Keeping consumers at the heart
of what we do

How we will regulate:

- We will make sure that our work reflects consumer priorities.
- We will set challenging service standards that aim to deliver what consumers would choose in a competitive market.
- We will set price limits to protect the customers of monopoly providers of water and sewerage services.
- We will require companies to deal with complaints effectively and enforce this through licence conditions where appropriate.
- We will identify and address systemic service failures.
- We will engage effectively with the consumer representative bodies in place.

What we want to achieve to protect consumers:

- An industry that takes responsibility for the needs and concerns of all consumers.
- Consumers who know that they will be treated fairly and properly in the event of service failures or disputes.

In the next three years we will:

- carry out joint stakeholder research based on companies' draft business plans for the 2009 price review to make sure that consumers' views, priorities and willingness to pay are understood and reflected in companies' final plans and our decisions (2008-09);

- introduce and pilot new consumer experience measures to drive improvements in the experience consumers have in dealing with their supplier (2008-09);
- carry out research into customer priorities to inform our review of consumer service incentives (2008-09);
- consult on consumer service incentives, including a revised overall performance assessment mechanism that better serves the needs of consumers (2008-09);
- publish the findings from our consultation on our future strategy for customer charges for water and sewerage services (2008-09);
- work with the Consumer Council for Water (CCWater), as the current consumer representative body, and make recommendations to the Government's review of future consumer representation for water consumers (2008-09);
- review and revise our consumer focused literature (2008-09);
- contribute to the Government's independent review of water charging (2008-09);
- review companies' complaints handling procedures and practices (2008-09); and
- produce a new Ofwat website that better meets the needs of consumers and other stakeholders (2008-09).



Our priority: Keeping companies accountable

How we will regulate:

- We will take enforcement action, where appropriate, if a company's data is inadequate or its performance is poor.
- We will develop approaches that rely on less regular data from companies but we will conduct detailed checks of the underlying source data for completeness and accuracy as and when we consider appropriate.
- We will minimise the regulatory burden wherever possible.

What we want to achieve to protect consumers:

- Simple, effective and efficient regulation that achieves best value outcomes over the long term for consumers.
- Regulation that exemplifies best practice and is underpinned by the better regulation principles of transparency, accountability, proportionality, consistency and targeting.

In the next three years we will:

- require only one draft business plan from most companies, as part of the 2009 price review (PR09), and discuss with those companies that wish to submit an alternative plan the best way to do this (2008-09);
- publish final information requirements and information capture systems for companies' PR09 draft business plans and final business plans respectively (2008-09);
- increase the onus on each company to provide reliable, accurate and complete data by publishing each company's annual returns soon after submission to us in June each year (2008-09, 2009-10 and 2010-11);
- publish a framework to simplify the regulatory regime within the context of the potential development of competition (2008-09);
- include impact assessments (IA) when we consult on major proposals, taking account of recommendations from the National Audit Office report on IAs (2008-09, 2009-10 and 2010-11); and
- carry out a review of the June return reporting requirements and process (2008-09, 2009-10).



Our priority:
Enforcing compliance in a
reasonable and transparent way

How we will regulate:

- We will enforce standards and compliance using a transparent enforcement policy.
- We will use our judgement about whether, and how far, to take specific cases.

What we want to achieve to protect consumers:

- Each company to meet its obligations and know that appropriate enforcement action will be taken if it fails.

In the next three years we will:

- consult on and publish our enforcement policy, incorporating a review of our policy on financial penalties (2008-09); and
- carry out a post-implementation review of our enforcement policy (2010-11).

2. Promoting value



Our priority:
Introducing competition progressively
where it benefits consumers

How we will regulate:

- We will open contestable water and sewerage activities and markets to competition where we reasonably believe it will benefit consumers.
- We will proceed step-by-step, enabling competition to prove itself and using the evidence to convince stakeholders and justify further market opening.

What we want to achieve to promote value:

- An efficient and innovative industry.
- Effective market competition, which delivers the best outcomes for consumers.
- Each company taking account of its economic, social and environmental impacts, and acting to address the key sustainable development challenges in the way that it operates.

In the next three years we will:

- make recommendations to Government for a framework to enable effective competition. We will work with the Government's wider independent review of competition and innovation in the water industry by publishing, for consultation, the conclusions of our review of market competition in the water and sewerage sectors (2008-09);
- improve the transparency of costs for all stakeholders by developing guidelines for, consulting on and implementing formal accounting separation for all appointed companies through changes to their Conditions of Appointment and regulatory reporting requirements. This will require all companies to provide us with relevant accounting information for each separately identified part of their business in delivering water and sewerage services (2008-09, 2009-10 and 2010-11);
- publish a revised, clear process for applying for, and granting, inset appointments (2008-09);
- seek reductions in the threshold for competition under the water supply licensing (WSL) regime, put in place the systems that would be needed to deal with switchers in the extended market, and develop access pricing and other access terms and conditions (2008-09, 2009-10); and
- begin to implement changes to the competition framework which follow from the Government's independent review (2009-10, 2010-11).



Our priority:
Regulating effectively where
competition will not protect consumers

How we will regulate:

- We will continue to regulate prices and service in contestable markets until competition is strong enough to protect consumers.
- We will ensure that companies deliver value and good quality in non-contestable services.
- We will regulate prices and terms for access to the natural monopoly parts of the water and sewerage system.

What we want to achieve to promote value:

- An efficient and innovative industry delivering best value for consumers and sharing the benefits of improving efficiency fairly.
- Regulation that effectively fills the gaps where competition cannot, or does not yet, protect consumers.
- Each company to deliver good service and value to its consumers in the same way as would be needed to attract and retain their business in a competitive market.
- Water and sewerage services that are efficiently delivered, meet consumers' needs, comply with statutory obligations, and maintain high standards for the local environment and drinking water quality.

In the next three years we will:

- publish our draft decisions on price limits for 2010-15 for consultation (2009-10);
- set price limits in November 2009 that protect consumers, promote value and safeguard the future (2009-10) based on:
 - clear understanding of the right outcomes for consumers, reflecting their preferences and taking full account of costs and benefits;
 - a robust understanding of the costs of delivery;
 - appropriate assumptions to ensure that well-run companies can finance their functions; and
 - a framework of incentives that promotes efficiency and delivery;
- publish a policy statement explaining our approach to making sure that our regulatory regime promotes and incentivises innovation (2008-09);
- publish a review of the use of benchmarking in setting price limits and describing potential improvements (2010-11);
- produce an updated financial model to take account of our methodology for the 2009 price review (2008-09);
- review options for price setting in 2014, subject to an enhanced understanding of costs from our accounting separation work (2010-11); and
- carry out a broad review of the package of incentives in our approach to price setting for the 2014 price review (2010-11).

3. Safeguarding the future



Our priority:
Taking a long-term view
of sustainability

How we will regulate:

- We will be open to companies' proposals for meeting social and environmental challenges.
- We will assess how companies' proposals promote value and sustainability over the long term, taking account of social and environmental costs.
- We will work with other stakeholders in developing environmental and social policies that take account of economic signals and deliver long-term benefits to consumers.

What we want to achieve to safeguard the future:

- Safe and reliable water and sewerage services for all consumers now and in the future.
- Investor confidence maintained such that companies can access the finance necessary to deliver their capital programmes.
- An industry delivering best value for consumers and the environment, and efficiently delivering sustainable water and sewerage services into the future.
- Each consumer to pay the fair value of the services they use.
- Each company to have a business approach and assets that are robust enough to meet the twin challenges of adapting to and mitigating the effects of climate change.
- Evidence-based decisions on the best value way to deliver water and sewerage services now and in the future, including economic approaches to asset stewardship, quality and service improvements, water resources, leakage management, water efficiency, surface water drainage and metering.

In the next three years we will:

- require each company to test the costs and benefits, including social, environmental and carbon costs and benefits, of all proposals in its business plans for the 2009 price review (2008-09);
- revise water efficiency targets for 2010-15, drawing on companies' experience of operating voluntary targets in 2008-09 and 2009-10 (2008-09, 2009-10);
- consult on an alternative methodology for setting leakage targets (2008-09);
- publish guidance for sewerage companies that will help them implement appropriate cost beneficial drainage systems and submit business plans for the 2009 price review (2008-09);
- develop a consistent and coherent framework for companies to assess flood risk and identify cost beneficial measures to improve resilience of critical assets (2008-09);
- pilot company reporting on carbon and greenhouse gas emissions to help develop a framework for regular reporting (2008-09);
- publish guidance on our approach to renewable energy (2008-09);
- publish a statement setting out our climate change policy to inform and guide our stakeholders on climate change issues (2008-09);
- publish a review of how companies compile sewer flooding 'at risk' registers to make sure that they have a consistent and robust understanding of sewer flooding risk (2008-09);
- consult on and publish our social and environmental policies (2009-10, 2010-11); and
- report on our contribution to the delivery of the policies set out in the Government's social and environmental guidance in our annual report each year (2008-09, 2009-10 and 2010-11).



Our priority:

Shaping the regulatory agenda at a national and EU level

How we will regulate:

- We will work within our statutory remit and work to change that remit where we believe it is necessary to meet our aim.
- We will influence at a high level policy development and legislation in England and Wales and Europe.
- We will work with our stakeholders to share our thinking behind this new strategy and explore areas where we might work together.
- We will invest to enhance and continually renew our regulatory capability.

What we want to achieve to safeguard the future:

- The best possible outcomes for water and sewerage consumers in England and Wales in terms of value for money and long-term benefits in developing policy and legislation at a national and EU level.

In the next three years we will:

- explore our links with individuals and organisations from the UK that are operating and influencing at an EU level (2008-09);
- explore our links with key EU-level institutions and individuals (2008-09);
- work with our stakeholders on relevant policy issues to deliver this strategy by, for example, contributing to the Government's independent reviews of competition and innovation, water charging, and future consumer representation respectively (2008-09, 2009-10 and 2010-11); and
- learn from other sectors, particularly those which have been opened to competition (2008-09, 2009-10 and 2010-11).

4. Financing the delivery of our strategy

Ofwat is based in Birmingham and has about 200 staff. We are the economic regulator of the water and sewerage sectors in England and Wales. These sectors have a combined turnover of about £9 billion each year and a regulatory capital value of about £42 billion.

Our revenue comes from the companies we regulate. Each company pays a licence fee, which is set as a percentage of its turnover each year, and this is recovered from customers through their bills. The size of the licence fee is limited by condition N of each company's licence. In recent years, it has been about 0.15% of the regulated businesses' turnover and we have kept our licence fees down by using our unused funds from previous years.

This strategy sets out how we will develop economic regulation of the water and sewerage sectors in England and Wales in the long term. Our Board has developed this new strategy following a review of the issues facing the sectors both now and in the future, as well as considering how we should develop regulation to protect consumers, promote value and safeguard the future. In carrying out this review, we also took account of our consultation on our draft forward programme for 2008-09 to 2010-11 and the responses we received, the production of strategic direction statements by the companies, the publication of the Government's water strategy, 'Future Water', and its draft social and environmental guidance to us.

In this document, we have set out our long-term priorities, what we want to achieve in the medium term and our programme of work for the next three-year period. To deliver this work, which in some areas is additional to what we presented in our draft forward programme, we will require a step change in our resources. This will have an impact on the licence fees we charge each company to recover our running costs. However, even with this increase, in 2008-09 our budget will only represent approximately 0.2% of industry turnover or about 75p for each customer in England and Wales.

The key areas where additional resources are required in 2008-09 are as follows.

- **Delivering the 2009 price review**

2008-09 will see us complete the preparation for the key decisions we need to take in 2009 in order to set price limits for the period 2010-15. As at similar stages in previous price reviews, this will involve us doing significant additional work over and above that needed outside a review period.

- **Reviewing how we set price limits in 2014**

By setting price limits for the period 2010-15 in 2009 we commit ourselves to setting price limits again in 2014. By 2014, the sectors could look quite different if competition has begun to change the water and sewerage sectors or the nature of the businesses we are regulating. For that reason, we need to start reviewing this year how we should set price limits in 2014.

- **Promoting competition in consumers' interests**

To deliver an effective framework for competition, we are embarking on a programme of work that includes developing separated accounts, working with the Government's independent review of competition, and reviewing and developing access prices and terms. We will be creating a new Markets Division to embrace competition developments, case work and enforcement.

- **Enforcement**

Enforcement activity must be carried out effectively, fairly and efficiently. We have established a new team to carry out enforcement in cases where this is appropriate to protect consumers and indeed, we have undertaken significant new enforcement work already.

- **Litigation and case work**

As well as developing the framework for competition, we must resource and effectively manage increasing case work in a number of areas – for example, work generated by the Competition Act 1998 and changes introduced by the Water Act 2003. We will ensure that adequate resources, including ring fenced contingency provision, are in place to meet litigation challenges as they arise.

Our gross budget for 2008-09 is £17.9 million. Of this, about £0.52 million relates to our work on the Thames Tideway scheme, which will be paid by Thames Water Utilities Ltd, not the industry as a whole.

In our draft forward programme our original budget estimate of approximately £13.7 million for 2008-09 did not include the new strategic developments set out here, which our Board was in the process of developing. These account for the change in our budget. We will publish proposed budgets for 2009-10 and 2010-11 in our next draft forward programme in autumn 2008.

We will continue to monitor and control our expenditure carefully to deliver value for money. We will seek efficiencies in our operations and make sure we are fully prepared to implement our strategy over the coming years. However, in light of the new strategy, we will review licence condition N, which covers the mechanism for us to recover our expenditure from the companies in the water and sewerage sectors. Depending on the outcome of the review, we may seek a licence modification in autumn 2008.

Year	£ millions
2007-08 revised budget	13.6*
2008-09	17.9

*The 2007-08 budget was revised because of additional expenditure on competition, enforcement and the Thames Tideway scheme. The original budget for 2007-08 was £13 million.

5. Summary of responses to our draft forward programme consultation

We have included within this document our final forward programme of work for 2008-09 to 2010-11. We consulted on our draft programme of work between 6 December 2007 and 7 February 2008. We received 20 responses to our consultation. Full copies of the responses, as well as our consultation document, are available on our website at www.ofwat.gov.uk.

Overall

In general, respondents welcomed the new, more focused structure. Some respondents also welcomed our plan to publish a high-level view of our long-term approach to regulation. But we also received a number of requests to be more specific about timescales for delivering our work.

Protecting consumers, promoting value and safeguarding the future

We received a range of individual comments relating to protecting consumers. There were particular comments about some of our projects, including our review of the overall performance assessment, joint stakeholder research for the 2009 price review, voluntary water efficiency targets and our leakage review.

For promoting value, respondents focused primarily on the review of competition, commenting mainly on the scope for competition. There was also interest in our projects on accounting separation and a framework for simplification.

And for safeguarding the future we received some very broad comments on sustainability and climate change, as well as on the 2009 price review. However, a number of respondents referred to flooding and flood risk. Some felt that we should have a more substantial work programme for safeguarding the future.

Resources

Some respondents, particularly companies, welcomed the ambitious programme we have set ourselves but warned that we should not underestimate the work involved both for us and other stakeholders, nor let it divert attention during a key year for the 2009 price review.

Our response

We thank all of our stakeholders who responded to our draft forward programme consultation.

We have reviewed all of the comments we received and incorporated changes into this document where appropriate. For example:

- during 2008-09, we will publish detailed timetables on our website for key projects, such as accounting separation, in the same way as we have done for the 2009 price review; and
- this document sets out our work on safeguarding the future in more detail.

In addition to making changes in this document, we will consider all of the comments we received on specific projects in planning and carrying out this work. We will also communicate further details on specific projects in a timely and transparent way to all relevant stakeholders during the coming year.