



# OFWAT

## FORWARD PROGRAMME 2000-01

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## **FOREWORD**

The year ahead presents a range of objectives which should help us deliver the best deal for customers by ensuring that the companies carry out their functions within their new price limits.

The purpose of this document is to inform companies, customers, government departments and other interested organisations on our work programme for 2000-01. This document has been revised in the light of consultation on a draft forward plan. It sets out:

- the main outputs to be delivered during the financial year 2000-01;
- a summary of the routine work of the office; and
- the resources required to deliver the forward programme.

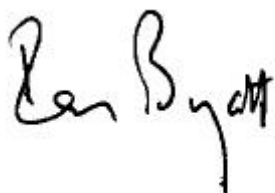
Key events during the year will include:

- a major shift in emphasis in facilitating competition following the Competition Act 1998;
- the implementation of new price limits and delivery of the required outputs by the industry;
- contributing to the proposed Water Bill;
- the impact of the Water Industry Act 1999, notably in respect of the approval of charges schemes.

In addition to our planned work, we will respond effectively to new priorities as they arise, such as mergers, acquisitions and new policy development.

The Customer Service Committees (CSCs) and Ofwat National Customer Council (ONCC) will publish separately their own forward plan 2000-01 in April.

In May I will publish my Annual Report for 1999-2000.



**I C R BYATT**

*Director General of Water Services*

## 1 EXTENDING COMPETITION

The forward programme takes into account the effect of the Competition Act 1998 (the Act), and proposes further action for competition, including:

- facilitating common carriage;
- developing the scope for inset appointments;
- other measures to create the conditions for competition and choice of supplier.

Our aim is to give our work on competition a high priority by including its development in all aspects of regulation.

The Act has two key prohibitions. It prohibits agreements that restrict, distort or prevent competition and prohibits abuse of a dominant market position. This legislation will be applied concurrently by the Director General of Fair Trading and the sector regulators, including the Director General of Water Services (the Director). Guidelines on implementing the Act were issued early in 2000.

We will put in place a process for dealing with anti-competitive agreements and/or abuses of a dominant position under the Act. The process will be consistent with that of the Office of Fair Trading as outlined in our guidance on the application of the Act.

The Act opens up the scope for common carriage and strengthens the legal powers available to the Director to prevent abuse of a dominant position and other anti-competitive behaviour. The Director will work to create an open and level playing field, allowing markets to work without favour to anyone, so that competition can flourish where it benefits customers. We will work with the companies to introduce a coherent and stable framework for common carriage including interaction of this framework with other aspects of regulatory policy such as water resources. Our work will include co-operation with the DWI over quality related issues. We will continue to ensure that customers' interests are protected.

We will continue to develop the scope for inset appointments and administer them efficiently. The new streamlined process is set out in *Inset appointments — guidance for applicants* (February 1999). We will ensure that completed applications are granted within four months for greenfield sites, and within seven months where a bulk supply or sewerage connection agreement is required.

The Director has consistently advocated the reduction of the large user threshold for inset appointments to 100 megalitres per year. We will review the scope for further reductions in the threshold, in the light of the Competition Act.

We will work with the Department of the Environment, Transport and the Regions (DETR) to take forward competition following its review of competition in the water industry. In Ofwat's view increasing the tradeability of abstraction licences would help to secure a more efficient allocation of water resources. It would also facilitate competition by improving access to raw water for new entrants into the Water Industry. We will contribute to the development of government policy on water abstraction concerning the tradeability of licences to abstract.

## **2 FUTURE WATER AND SEWERAGE CHARGES 2000-05**

The Director set price limits for 2000-05 on 25 November 1999. They will apply between 1 April 2000 and 31 March 2005. Companies will publish their five year monitoring plans by 31 March 2000. We will review the plans to ensure that they reflect the outputs funded in the 1999 price review (PR99). These plans will describe how customer service standards and environmental obligations will be met under the new price limits.

Mid Kent Water plc and Sutton & East Surrey Water plc have asked the Director to refer their price determinations to the Competition Commission. The Commission has six months from the date of the reference in which to report. An extension of six months can be allowed if the Commission finds this necessary. We will explain the background to the Director's determinations and respond to queries raised by the Commission.

The companies' non confidential elements of the Business Plans submitted by the companies during the 1999 price review (Submission K) and the Quality Costing update (Submission J) will be placed in the Ofwat library in April 2000. This will exclude those companies which have been referred to the Competition Commission.

### **Interim determinations**

We will adjust price limits if, for specific reasons set out in the licence, a company experiences a material increase in costs, or loss of revenue, and seeks an interim determination. We will assess the appropriate net additional costs or revenue loss, to test against the specified materiality threshold and adjust future price limits only if the aggregate of all the approved changes exceeds the threshold. These net additional costs/loss of revenues may arise from Notified Items and/or new water quality and environmental obligations. Three new Notified Items were included as part of the November 1999 price limit determination. These relate to the effects on debt recovery of banning disconnections, uptake of optional metering and administrative costs of protecting vulnerable groups.

### **Review of Periodic Review 1999**

Section 2.11 of *Future water and sewerage charges 2000-05* summarised the process that underpinned PR99. The review of the price review will include a structured survey of the lessons learnt by internal and external stakeholders. It will be completed by May 2000. Ofwat will publish an MD letter containing the main learning points by the end of July. These learning points will inform the planning for the next price review in 2004 (PR2004).

## **3 THE WATER BILL**

In February 2000 the Government announced its intention to withdraw the part of the Utilities Bill relating to the regulation of the water industry in England and Wales. It was subsequently announced by the DETR, that the proposed Water Bill would contain those elements omitted from the Utilities Bill related to water regulation. Currently there is no date fixed for the publication of the Bill.

The aim is to work with the DETR and other interested groups to ensure the Water Bill delivers a good deal for customers.

During the year work will proceed to develop the panel of senior industrialists into a panel of independent advisors who will work with internal managers to assist the Director General. A memorandum of understanding between Ofwat and the ONCC will also be formulated.

We will raise with DETR a series of issues for inclusion in the Water Bill aimed at enhancing regulation.

## **4 REGULATING COMPANY PERFORMANCE**

We will monitor companies' outputs and report on their investment each year. We will use the annual returns and Regulatory Accounts and specified reports from the quality regulators to inform this work.

Fair and firm regulation is a vital component of our forward programme. It is in this way that we protect customers. Following the price review, a major part of our role is to monitor company performance and, where there are deficiencies, to take action. Our work in this area will prepare the way towards PR2004.

### **Quality outputs**

We will work closely with the Environment Agency (EA) and the Drinking Water Inspectorate (DWI). They take the lead in checking that companies deliver the quality and environmental outputs specified in the final determination of price limits.

Failure to deliver the required minimum outputs will lead to regulatory action. Failures in legal requirements may result in prosecution or enforcement proceedings by the EA and DWI. Regulatory concerns could lead to requirements for formal undertakings from the companies.

We will record any shortfalls in delivering outputs and quantify these in financial terms. We will trigger an interim determination of price limits if the estimated financial effect of an output shortfall exceeds the prescribed materiality threshold. Any shortfalls will be taken into account if a company seeks an interim determination. If not, we will take account of any financial gain at the price review in 2004. We will consider any company claims for extra remuneration to take account of additional obligations using the protocol set down in Appendix E of Future Water and Sewerage Charges 2000-05.

### **Service levels**

We will work to ensure that companies provide good service to customers. We shall achieve this by:

- monitoring and reporting on the companies' performance in customer service;

- where standards are poor, asking companies to put things right. If necessary we will carry out special investigations. We will give this information to companies' remuneration committees to inform their decision making on boardroom pay;
- continuing to work with companies and customer representatives to establish ways of assessing qualitative aspects of service and more generally, where practical to ensure that levels of service indicators continue to reflect customers' interests;
- collecting information on customer satisfaction and carrying out market research to maintain up-to-date information on customers' views. This will be done within the framework of developing a longer term market research strategy which takes account of the work done by companies.

Ofwat will consult before introducing new measures or altering existing measures of service.

We will carry out a review of the methodology for assessing companies' overall performance and consult on options for linking the results to future price limits;

## **Disputes**

The Director will determine certain disputes between customers and companies. Decisions are lodged in the Ofwat Library with the aim of informing companies, so that dispute resolution avoids the need to refer to the Director. We hope that companies will learn by this process.

## **Maintaining Serviceability to Customers**

Carrying out sufficient capital maintenance of the water and sewerage asset networks to maintain serviceability to customers (both now and in the future) is an important part of each company's statutory duties. Reaching judgements and assumptions on the appropriate levels of capital maintenance for the next five years was an important element of the recent price review. Ofwat's approach is to start with a view being taken on the trends in serviceability in each company, using the indicators collected as part of the reporting cycle. This method will be used to gauge each company's progress in monitoring serviceability to customers year by year through the next period.

In order to better inform regulatory judgements both on compliance with this duty and future capital maintenance needs, Ofwat will commence a series of projects to develop enhanced measures of serviceability as well as the key components of a full economic appraisal of capital maintenance needs.

During the year we will set up a joint project with the Drinking Water Inspectorate to better assess the linkage between water quality measures, serviceability to customers, capital maintenance activity and associated investment levels. We will consult with the industry and interested parties on the scope and progress of this work.

We also intend to examine the feasibility of other joint projects in this area related to the sewerage service.

## **Comparative competition**

We will continue to make comparisons between companies so as to be able to apply competitive pressures to them. We will continue to make assessments of companies' performance and identify the best and worst performers.

Following detailed analysis of companies' returns, we will publish during the year our conclusions in a series of reports:

- *Report on financial performance and expenditure of water companies in England and Wales 1999-2000* in July 2000<sup>1</sup>;
- *Report on levels of service for the water industry in England and Wales 1999-2000* in July 2000<sup>1</sup>;

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<sup>1</sup> In MD156 we sought the co-operation of companies in submitting their Annual Returns a month early in order to publish these reports in July.

- *Report on water and sewerage service unit costs and relative efficiency 1999-2000* in December 2000;
- *Report on leakage and efficient use of water 1999-2000* in September 2000.

### **Development of Comparators Outside the Regulated Water Companies**

The assessment of companies' performance will be better informed if like for like comparisons can be drawn with performance elsewhere in the UK economy, in Europe and wider afield. Such comparisons could involve other regulated utilities, service industries as well as the performance of water enterprises outside England and Wales. We would want to test water company performance against like for like "best-in class" performance in other enterprises.

We will assess through a short feasibility study the nature and value of performance indicators from selected water enterprises/authorities outside England and Wales, other utilities and comparable service industries. These may include for example levels of service, tariffs, unit costs, accounting and output measures. The study will review the reliability of the data and the scope for developments to assist us in applying further competitive pressures to the regulated companies. We will consult on the findings on this work and seek views on the way forward in developing comparative competition to include performance assessments outside the England and Wales water sector.

## **Regulatory Accounts**

The financial performance of the water companies is reported in their Regulatory Accounts. The form and content of the accounts will be reviewed. This review will cover the following issues:

- The links between the outcomes of PR99 (including projected capital values) and the reporting of the actual performance of the companies in the accounts.
- Whether the accounts are sufficiently transparent to show the costs of providing services. This will help our work in implementing the Competition Act.
- Whether the accounts are consistent with those of other utilities. This will be considered in conjunction with the other regulators.

The guidelines and reporting requirements for Regulatory Accounts will be reviewed to assess the impact of new accounting policy standards, eg FRS12 concerning provisions and FRS15 concerning accounting for tangible fixed assets. There will be no change in the process for Regulatory Accounts.

We will review the approach to the broad equivalence between capital maintenance expenditure and current cost depreciation.

## **Multi-utility regulation and transfer pricing**

We will continue to work closely with the other economic regulators. Our work will be directed at ensuring that company costs are allocated appropriately and that licence conditions governing relationships with parent and Associate companies are complied with - as set out in the joint paper *Regulatory issues associated with multi-utilities* (May 1998).

Transactions between water companies and Associates will be monitored and, where necessary, investigated by consultants. Action will be taken to ensure compliance with licence requirements for ring fencing. The outcome of the monitoring will be published in the *Financial performance and expenditure report*.

## **Balancing supply and demand, leakage and the efficient use of water**

We will monitor the water resource positions of the water companies, as part of the Director's statutory duties under the Water Industry Act 1991. We will provide advice to the Secretary of State regarding companies' applications to allow compulsory metering in water stress areas.

We will set leakage targets annually, six months before the start of the year in which they will apply, and then publish the performance of companies in meeting their targets in our yearly report on *Leakage and efficient use of water*.

We will carry out a joint study with the EA and DETR to help inform our judgements of appropriate economic levels of leakage for each water company and, from these, the annual leakage targets set by Ofwat.

Ofwat will review companies' plans and activities for promoting the efficient use of water by their customers, against the Director's requirements as set out in his 1999 report on *Leakage and efficient use of water*. We will work with the EA and others to promote best practice in the economic and efficient use of water, and to understand better the economics of water efficiency.

We will publish further guidance relating to Long Run Marginal Cost (LRMC) and review the work submitted by companies later this year. This is to ensure that companies are able to demonstrate consistency between their investment decisions on supply and demand (eg leakage control, demand management, water efficiency and resource development) and their charging policies. We will use this work as part of assessing company performance on leakage, appropriate pricing policies in the area of competition and company tariff proposals.

We will contribute to the development of policy on economic instruments for water abstraction and on trading in abstraction licences following review by the DETR.

### **Verification by independent Reporters**

We will issue guidance to the Reporters for the June Return. This will ensure consistent reporting across the companies. The ultimate aims are to receive comparable regulatory information from the companies, and to ensure that the Reporters' efforts are focused on the information that has the most impact on regulatory decision-making. Reporters are engineering consultants, used by Ofwat to audit company returns. Audit plans are submitted by Reporters and assessed for completeness of coverage. We will carry out an annual review of Reporter performance.

We will work with the companies to ensure continuity in the effectiveness and value for money of the Reporters' work for the Director.

Most of the Reporters' contracts with their companies end in 2000-01. We will review the effectiveness of the present arrangements and consider whether alternative or additional arrangements should be made for advising the Director on the quality of the information supplied to him by companies.

### **Review of the annual returns and Regulatory Accounts 2000-01**

We will review our information requirements to ensure that the process of collection and analysis is efficient and effective in supporting the Director. We also aim to avoid any unnecessary data burden on the companies. We will consult on the format of the June Return 2001, during the summer of 2000.

### **Work with other regulators**

We will maintain regular contact and effective working with the other utility regulators and with the water quality and environmental regulators in England and Wales. The Regulators have undertaken to report regularly on what has been achieved and what further joint work is planned.

The utility regulators issued a joint statement in November 1999 which set out details of a number of areas of joint working. As well as regular meetings of the regulators themselves, a number of working groups have been established. Ofwat leads on the following issues:

- best practice principles for multi-utilities regulation;
- best practice on service delivery standards;
- price control and cost of capital.

Ofwat is also represented on the other joint working groups.

Our work with the water quality and environmental regulators is highlighted elsewhere in this forward programme.

## **5 APPROVING WATER AND SEWERAGE CHARGES**

We will publish the Annual Report “Tariff structure and Charges 2000-01” in early May. This will set out the tariffs for 2000-01 and explains the basis of the decisions Ofwat has taken in approving companies Charges Schemes.

We will review the current criteria used to approve charges schemes for 2000-01, as set out in September 1999, in the light of guidance from the Secretary of State as well as any guidance received from the National Assembly for Wales.

We will also review any outstanding tariff policy issues which could not be resolved for 2000-01 because of the tight timescale. This will include a review of the differential between measured and unmeasured tariffs, and issues raised by the Secretary of State’s guidance to the Director on charging matters. We will consult widely on any issues relevant to the approval of charges schemes for 2001-02.

We are reviewing the process for approving the 2000-01 charges schemes, in order to improve the process for 2001-02:

The coming year will see the implementation of important elements of the Water Industry Act; in particular, the introduction of statutory protection for vulnerable groups in England and of consumers’ entitlement to the installation of meters free of charge. We will monitor these carefully to identify any initial problems on which action may need to be taken.

## **6 VULNERABLE CUSTOMERS**

We will monitor the implementation of the Water Industry (Vulnerable Groups) Regulations 1999, and ensure that companies’ approved charges schemes provide satisfactory arrangements for the timing and methodology for payment of bills.

- We will review Ofwat’s existing guidelines on debt and the data requirements necessary to monitor company performance.
- In conjunction with the ONCC we will convene a conference on the provision of services for customers with special needs.

## **7 WORKING WITH CUSTOMERS' REPRESENTATIVES**

### **The Director and the CSCs**

The Director will continue to work closely with the CSCs and ONCC in achieving benefits for customers. He will consult with the CSCs and ONCC on policy that affects customers and looks forward to regular contact and meetings.

The Director will continue to support their work by providing resources, accommodation and central services such as public relations, legal advice, IT and financial services.

During 2000-01 the Director requires a number of important outputs from the CSCs and ONCC.

#### **Periodic Review**

- To contribute to the review of the Periodic Review.

#### **Competition**

- To represent customers' views on competition issues and pass to the Director complaints that may represent an infringement of the Competition Act 1998.

#### **Standards of service**

- To report on the quality of service provided to customers based on sample audits of individual cases and other assessments of company practice. These reports are to be provided in a form that enables comparisons to be made across companies. The service areas to be covered include:
  - complaint handling;
  - customers in debt;
  - services for customers with special needs.
- To advise on incorporating measures of quality to complement existing quantitative measures.
- To advise on how companies handle customers in debt now that they are prevented from disconnecting customers for non-payment of charges.
- To bring to the Director's attention issues of customer service which may require the exercise of his powers or which raise broader policy issues. In respect of issues concerning multi-utilities he expects close liaison with the relevant customer representative bodies for the other utilities.
- To advise on companies' codes of practice in advance of approval by the Director.
- To report changes to our database of best practice.

## **Tariffs**

- To advise on tariff rebalancing and, more generally, the development of companies' charging policies.
- To advise on the criteria the Director will apply for approving charges schemes for 2001-02.
- To advise on any issues raised by the Secretary of State's statutory guidance.

## **Generally**

- To provide advice or information on issues which may arise during 2000–01.

## **8 EXTERNAL RELATIONS**

Ofwat is an open and transparent regulator. We will aim to keep customers and all interested parties informed about Ofwat's work and the performance of the companies. Good decisions can only be made with access to good information. We support Open Government and operate under our Code of Practice on Access to Government Information and in the spirit of the forthcoming Freedom of Information Act. We are committed to Modernising Government. Customers and outputs are the focus of our work.

- For most customers the media is their main source of information. We will provide a fast and efficient press office service.
- We will publish, or make available, a range of information for all our audiences. We will produce all Ofwat publications and leaflets cost effectively and error free. Most of the information is available free of charge and is available on our website.
- We will provide an efficient library and public information service. We will make publications and other material available to all interested parties on demand and make publicly available the water companies' returns (June Return and PR99 information submissions), responses to Ofwat consultation papers and other material. Information submissions from the companies will be placed in the Ofwat library in April 2000 (except for those which are appealing to the Competition Commission).
- We will also develop the delivery of news through electronic means. The Ofwat website will be developed as an effective communication tool for the twenty-first century and we will aim to place all Ofwat press notices and publications on the site on the day of publication. The website will include the Ofwat organisation chart.

## **9 RESOURCES**

The main aims for the year ahead are as follows:

### **Staff**

- Maintain Investors in People accreditation by adherence to the principles of training and developing our staff towards meeting our objectives.
- Implement the objectives set out in Modernising Government. This will include further developing our staff and some of our management procedures.
- Communicate effectively with staff and ensure full involvement in objective setting and appraisal.
- Involve and consult with staff over any changes arising from the Water Bill.
- Support the DETR in the recruitment and induction of the new Director General of Water Services.

### **Finance**

- Manage efficiently Ofwat's budget of £12.5 million, which is recovered from the industry through the licence fee.
- Hand back to the industry efficiency savings from 1998-99 by reducing the 2000-01 licence fee.
- Continue to monitor expenditure plans and reduce costs where appropriate.
- Adhere to government accounting and audit procedures.

### **Management**

- Adopt proven project management methods to deliver relevant outputs.
- Ensure management development reflects the actions arising from 'Modernising government'.