



news release

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OFWAT CONSULTS ON NEXT PRICE REVIEW

Ofwat today launched a three-month consultation exercise on how it will approach setting price limits.

Publishing the consultation paper 'Setting price limits for 2005-10: Framework and approach' is the first step in the price review. The new price limits for water and sewerage services in England and Wales for the next five years will be announced in November 2004 and take effect in April 2005.

Philip Fletcher, Director General of Water Services, said:

"Ofwat's aim is to ensure that water companies can maintain a high level of service to their customers and deliver essential further improvements. We do not work in isolation - in conducting the review we will be working closely with WaterVoice, as the customers' representatives, with the companies themselves, with Government and the quality regulators, and with all those who have a stake in the outcome - from city investors to environmental champions.

"Building on the lessons learned from previous reviews, we intend to make the process more open and transparent. This will ensure as broad an understanding as possible of the complex issues which we shall need to take into account in setting the final price limits.

"The extent of the capital investment programme will continue to be the main driver of bills. We need to establish the scale of investment that the companies will be required to make:

- to deliver legally enforceable European obligations;
- to maintain the water and sewerage infrastructure; and
- to make improvements where necessary.

"We shall take account of customer priorities, as expressed through Watervoice and through the joint research we are undertaking with other stakeholders. WaterVoice has particularly stressed to us the importance of dealing with the problem of homes at risk of sewer flooding. Later, customers will have the opportunity to have their say on the companies' business plans for the next five years. We will want to ensure that spending over and above essential levels is value for money and has the support of customers. We will also challenge the companies to continue to seek greater efficiency.

"Throughout, we shall be considering not just the five years up to 2010, but the long term issues confronting the industry.

"At the same time, the companies must be put in a position to finance their day-to-day running expenditure and their capital programmes - which may be considerable. Ofwat can help to keep such costs down by removing unnecessary regulatory uncertainty. To help with this, I am announcing today that, following consultation, I have decided to modify companies' licences to increase the length of the notice period for change from ten years to 25 years. All the water companies have agreed.

"The price limits will be set at whatever level is needed to enable the companies to finance and carry out their functions.

"The scale of the expenditure programme required, the need to ensure that companies can raise money from the markets and the

scope for efficiency will all have an important bearing. And I shall ensure that customers of these monopoly companies face no higher burden than is necessary. It is too early to start forecasting outcomes. But it would be unwise now, in the light of the likely pressures on most companies, for customers to expect real terms reductions in bills to result from the new price limits."

The consultation paper indicates where Ofwat has already taken decisions. For example, we plan to continue to use the incentive-based price cap model, RPI -X, to set prices.

The paper also sets out those issues where we propose changes to the process adopted in previous reviews and invites comments. We propose establishing capital programmes for the first year of the new period, 2005-06, ahead of final price limits. This is to enable companies to let contracts and avoid an inefficient dip in their investment programme.

The paper also asks for comments on whether the following review period, from 2010, should be for a period longer than five years.

Notes to Editors

1. Philip Fletcher, the Director General of Water Services is the economic regulator of the water and sewerage services in England and Wales. His primary duty is to ensure that the functions of the companies are carried out and that they are able to finance them. The Director has a duty to customers and a duty to facilitate competition. Customers' interests are represented by WaterVoice.
2. Ofwat will set price limits for companies for 2005-06 to 2009-10 in November 2004. The consultation paper, 'Setting price limits for 2005-10: Framework and approach', and a separate summary, will be available from Ofwat's library (0121 625 1373) and on Ofwat's website, www.ofwat.gov.uk/pr04/pr04_framework_151002.pdf
3. The consultation period ends on 14 January 2003. Ofwat will publish a summary of the responses and its conclusions in March 2003.

4. In the description of the incentive-based model RPI-X, RPI is the Retail Price Index and X represents the efficiency savings the company is expected to make.
5. Price limits for the period 2000-01 to 2004-05 allow for sewer flooding problems to be solved at 4,500 properties most at risk at a cost of nearly £140million. In March 2002 Ofwat consulted on its approach to sewer flooding. And in September Ofwat published a summary of the responses to that consultation and allowed companies to invest more in the current review period (up to March 2005) to make more rapid progress in dealing with the most serious cases. (Ofwat's letter to managing directors on flooding from sewers (MD180) is available from Ofwat's library and on Ofwat's website).
6. The joint market research is being undertaken by Ofwat, the Department for the Environment, Food and Rural Affairs, the Welsh Assembly Government, the Environment Agency, the Drinking Water Inspectorate, English Nature, the Countryside Council for Wales, WaterVoice and water companies through Water UK.
7. Ofwat will shortly publish draft information requirements that will need to be included in companies' business plans to support the 2004 price review.
8. Ofwat's letter to managing directors of water companies, MD 182, issued today confirms that companies' licences will be changed to increase the length of the notice period from 10 years to 25 years. It will be available from Ofwat's library.