



**KEYNOTE ADDRESS UTEL CONFERENCE
AT
BIRMINGHAM NEC**

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Introduction

Welcome to Birmingham, heart of England. By repute, home of manufacturing. In fact, successful break into services: NEC, Airport, and no great city complete without at least one national regulator, in this case Ofwat.

Rob Siddall spoke to some of you earlier today from a large business water customer's perspective. Guy Chant, Jeanne Golay will talk from the perspective of the water companies themselves. I come at the issues from the perspective of all customers, current and future, business and household alike. And business includes the very substantial representatives of the public sector here today.

Customer requirements

Our customer survey work, and our regular forum with business customers, suggests unsurprisingly that you will want secure supplies, usually of potable water, at all times of day and night and with equal confidence of the secure disposal of waste water.

In 2001, Ofwat and WaterVoice carried out a survey of over 2000 household customers. Nine out of ten told us they were satisfied with the service provided by their water and sewerage companies. Two thirds also believed the service was good value for money. The few customers who were dissatisfied (4%) were concerned mainly about the taste, appearance or pressure of their water or about leakage. Most customers who experienced problems were satisfied with the way their complaint was handled although only 25% actually went as far as complaining.

Our survey did not cover business customers – and of course they have different perceptions – but it does suggest that the water and sewerage companies are generally meeting customers' needs (although they could do more to tell customers about the services they offer).

No other country in the world has organised its water and waste water business like England and Wales: your supplier of water and waste water is usually a single large company, a regional monopoly whose boundaries were related to the objective of integrated river basin management. Each such monopoly is subject to three specialised regulators, the Drinking Water Inspectorate and Environment Agency to safeguard the quality of clean and waste water and Ofwat to ensure that you the customers receive a fair deal. Some of you of course will also, for water supply, be the customers of the 13 water only companies.

Achievements of regulation

Over the last 12.5 years the privatised water sector has a great deal to its credit. For example ...

Achievements	
<u>Drinking Water</u>	1 in 100 failed test in 1990 1 in 500 failed test in 2000
<u>Rivers</u>	83% (chemical) 86% (biological) classified good or fair in 1990 94% (chemical and biological) classified good or fair in 2000
<u>Sewage Treatment Works</u>	Compliance 90% 1990 98.6% 2000
cont...	

Achievements	
<u>Bathing beaches</u>	up to 98% compliance EC directive in 2001
<u>Bills</u>	20.1% up in real terms since 1989 (includes 12.5% cut in 1999) 2002/03 average up 0.3% (in real terms)

This would not have been possible, I maintain, without rigorous economic regulation. Do not take my word for it. Sir John Bourn said on the publication of the NAO report, Pipes and Wires, last month "The way that the regulators have used their price reviews to drive down the costs of the major utility networks while the quality of the service delivered has improved, represents a great success story."

But regulation exists to mimic the operation of a fully competitive market. It is always going to be second best. As Sir John Bourn went on to say "But regulation inevitably has its drawbacks and I am glad that the regulators are considering how to head off the risks we have identified to incentives and future investment". True competition between evenly matched companies can achieve benefits for customers going beyond the administrative reach of a regulator. So it is right that Government and others should have engaged in a rigorous debate on how far competition can and should go in the provision of water and sewerage services to you.

Competition: progress so far

It is fair to say that progress has been limited. Especially when you compare water to, say, energy or telecoms.

Reasons for this:

- No market in production (ie resources and treatment)
- Water expensive to transport relative to final price
- No national grid and mismatched supply and demand
- Average potable water bill only £110 (cf electricity £260 and gas £320) plus slightly more for the waste water service
- Retail prices within classes of customer affected by cross subsidy (some of which contributes to Government's social objectives)
- Only 20% of household customers pay by consumption (ie metering). 12% of business customers unmetered.

Still scope for many customers to save money by being more efficient in consumption. Companies are starting to become wise to this. It is worth speaking to your supplier.

Current legislative instruments

- a) Inset appointments: available in suitable circumstances to customers over 100 megalitres a year (250 megalitres in Wales) eg major greenfield development, NHS Trust Hospital, industrial plant, airport, 9 so far. Most rely on onsite supply or bulk supply. Most recent Severn Trent for Bowyers in Wiltshire. Also waiting on Anglian to finalise arrangements for Greenfield housing development site at Mill Hill North London, Thames area. 6 other current expressions of interest. Cumbersome setting up process. Aim to streamline, though the "cumbersomeness" derives more from the need to secure a bulk transfer from the incumbent, rather than the inset process itself.
- b) Common carriage: principle of common carriage through distribution network. Ofwat aims to encourage fast adoption of best practice across industry. Companies published access codes in autumn 2000 (update in July 2002). So far no deals have been struck (so far as Ofwat is aware – no requirement to involve us). But common carriage must protect public health and maintain integrity of the water networks (uneconomic to replicate). Guidance published in March this year on what companies should include in updated access codes. Guidance aims to encourage all companies to adopt best practice. Indicates how we might expect to deal with complaints. Meanwhile, all but two companies have published access prices but these two will do so soon. Important step forward in helping competitors to judge viability of proposals.
- c) Self-lay: was persistent cause of complaint: should businesses other than water companies be allowed to lay new water pipes, which then become the water companies' responsibility? Self-lay gives developers more choice; spurs improved efficiency and innovation; particularly relevant to multi utility infrastructure provision. Most water companies have already started giving developers the option to do this work. In March published conclusions on consultation and guidance to companies on policies and procedure to underlie self-lay policies. Main points:

- water companies should allow developers to organise and undertake most of the works involved in installing new water mains and service pipes;
 - water companies to have clear comprehensive self-lay policies which are freely available and tested against our principles;
 - establishing self-lay advisory group to encourage companies and self-lay organisations to work together. Aim is to represent all interested parties to facilitate progress in the market. Priorities include how best to establish national levels of service and a national scheme for approving SLOs.
 - hope to see more competitive prices emerging whether the work is contracted out by the water company or the developer's contractor.
- d) Competition Act 98 complaints: came into effect March 2000. Still developing. Ofwat has concurrent powers with OFT for water and sewerage industries to investigate anti-competitive behaviour. Published first in a series of annual reports last month. Received 69 and closed 48 complaints by 31 March 2002. Investigate under either CA98 or WIA91 as appropriate. Issues include:
- infrastructure – unreasonable charges, terms and conditions (eg self-lay);
 - tankered waste excessive charges;
 - network access unreasonable charges etc;
 - special agreement predatory pricing complaints.

We take a pro-active approach to CA98 by guiding companies on problem areas e.g. issuing guidance on self-lay and network access. Where issues arise, we seek constructive resolution, especially negotiation.

Outcome of 48 closed cases

- 22 no grounds for investigation
- 16 companies agreed to change behaviour
- 5 outside Act
- 4 resolved by negotiation
- 1 complaint pursued to alternative solution.

Annual report gives descriptions of cases intended as helpful pointers on handling. Recognise need to go on improving procedures, avoiding delays.

Competition: the future

Progress so far limited. CA98 not framed with special circumstances of water in mind (eg licensing for common carriage). WIA91 not framed around competition but the long term need for monopoly regulation.

Government thinking on these issues for well over two years (April 2000 paper, deciding in March 2001 to retain vertically integrated companies, but allow common carriage and retail competition). Rethink announced in March 2002: only allow common carriage for large customers. No household retail competition. Suggested threshold 50 megalitres per year – under 2000 such customers in England and Wales. Toe in the water.

Why so modest? Await promised consultation paper (now forecast for June). But factors include:

- points noted above on differences from energy sector;
- competition infrastructure costs (eg restructuring industry to separate potentially competitive (production/retail) functions from monopoly (distribution) and to create effective markets);
- cost of data transfer systems to facilitate retail competition in household sector;
- uncertainty about scale of potential benefits from competition (companies have delivered an estimated 4% per annum efficiency gain since 1989, roughly under current regime);
- two separate markets (water/waste water) - absolute requirements on health and safety etc;
- social concerns (eg no disconnection for debt, no prepayment meters for domestic customers);
- consequences of unwinding cross subsidy in domestic sector.

My view: 50 MI/y looks modest. Hope Government has open mind to promise consultation on threshold. Know that business customers want more competition. But right that Government, not regulator, should decide broad social issues involved, subject to Parliament's final say on legislation. Welcome fact that they are not asking the impossible: full blooded competition and preservation of domestic sector cross subsidies.

Await consultation. But do not assume likelihood of early "wedge in door". For great majority of customers, focus is good deal within regulation for many more years to come.

Future issues

Welcome your help. Business customer forum.

- a) Coming PR04: Methodology paper in October. Suggest issues for consideration.
- b) Tariffs: about to publish 2002-03 report. General principle – Ofwat sets limit on the average increase in charges that a company can impose in any year.
 - duty to enable (efficient) company to finance its functions;
 - price limit applies to basket of regulated charges (ie both measured and unmeasured water and sewerage services as well as trade effluent charges.) Within price limit companies can increase or decrease average charges for individual basket items by different amounts (eg unmeasured sewerage services as against measured sewerage services). But no cross subsidy between classes. Broadly customers' bills should reflect the cost of the services they receive (with limited exceptions for vulnerable household customers).

Noticeable that companies becoming more sensitive to needs of business customers in terms of elements of flexibility – largest users outside tariff basket original 250 MI/y minimum now down to 100 MI/y in England – companies cannot automatically recoup from other customers revenue lost as a result of reducing charges to large users.

Large user tariffs: Ofwat's role - prevent undue discrimination and undue preference; prevent potential abuses of dominant market position and other anti competitive behaviour; ensure that tariffs are structured (eg standing charge and measured charge) to send appropriate price signals – development of interruptible/seasonal tariffs.

Approach to trade effluents: (Mogden formula – broad test is that measured sewerage charge and notional trade effluent charge to domestic strength should produce similar indicative bills)

c) Water Bill

Competition will not be the only thing covered in the Government's promised Water Bill. Margaret Beckett announced earlier this month a number of changes in her response to consultation on the draft Bill. One which is particularly welcome to me is – ironically – a signal that spells the end of my job in its present form. From privatisation onwards, Ofwat's powers have been concentrated in its Director General. This can give rise to fears that the regulator might act from a personal whim rather than considered policies. The media's love of personalising issues can add to the problem. So the proposition that Ofwat should be constituted as a Board, similar to the Gas and Electricity Markets Authority seems to me very sensible, and a big improvement on the original proposals for a Water Advisory Panel outside Ofwat to second guess its decisions.

Mrs Beckett confirmed the Government's decision to set up a separate Consumer Council for Water. Again, I welcome this as clarifying the respective roles of the regulator and the customer voice.

I have already been looking to take both objectives forward so far as we can under existing legislation. I have appointed an Ofwat Board, with four Non Executive Directors, each of them very senior figures in the fields of business and regulation, to help give further breadth and depth to our decision taking. I have also, with Maurice Terry, launched WaterVoice, as the new embodiment of the Ofwat National Customer Council, to emphasise that the Council, and the Chairmen of the individual WaterVoice Committees, speak separately from me on behalf of all customers, business and householder alike.

Conclusion

I am running out of time. I shall be happy to take questions. There is much more of interest happening in this sector. I ought at least to mention the possible take-over by Vivendi of Southern Water. This requires a mandatory reference of the issues to the Competition Commission and I look forward to that discussion as a good opportunity to ensure that customer interests are properly safeguarded.

One last point. The water companies, its suppliers, contractors and consultants have done well over the last 13 years. Comparisons with efficient water provision in other countries, not least looking to Scotland, suggest that the privatised model still has considerable life in it. But this is not to be complacent. Business, society and the water environment are changing, and not always in predictable directions.

Whatever the issues that emerge, we need a robust framework to protect customers. The way in which the regulatory ringfence around Wessex Water withstood the collapse of its ultimate parent Enron is just one recent case in point. I expect you, the representatives of business, to ensure that we in Ofwat remain alive to your interests and look to you to tell us of the particular issues that concern you.