

Report by Jeremy Long, Reporter on Board's Overview

Approach

We have:

- reviewed, and looked for shortfalls, in the process established by SST to ensure that the Board Overview is well founded and consistently supported by the textual and numerical information in the June return and the reports by the DWI relating to the quality enhancements programme
- given our opinion on the effectiveness of the SST June return process and whether it has been followed
- commented on the consistency of the Board Overview commentaries with the numerical information drawn from the annual return tables and their associated commentaries, and from the Quality Regulators' reports
- briefly summarised the key trends in SST performance, for chapters 1, 2, 3 and 4 of the Board Overview, and confirm or otherwise the accuracy of the Board Overview statements and supporting numerical data (including costs but excluding financial performance measures)

We have received full co-operation from SST staff throughout the reporting process, timely access to staff with draft and final version of tables and commentaries being made available as they were being produced. We find the SST level of cooperation very helpful.

Executive Overview and Summary of Achievements

We find the Executive Overview and Summary of Achievements to be consistent with the remainder of the Board Overview and others parts of the June Return submission.

General

We have not seen any change in morale of staff and the way SST operates following the demerger and then the acquisition by Arcapita Bank B.S.C. SST continues to be keen to achieve and maintain high efficiency and to give best value to their customers. Service performance overall remains high.

We have found throughout our reporting term that the Board is directly concerned with the detailed management of SST and particularly with the JR and PR processes. We find the statement made by SST in relation to 'Board Governance for the provision of regulatory information' to be accurate.

Levels of service

Generally good. We discuss in more detail under Key Outputs and Service Delivery (Table A) below.

Leakage

SST total leakage was 73.44 MI/d achieving the target of 75 MI/d for 2005-06, though without severe weather during the year. Should severe seasonal weather be experienced in coming years the leakage target may become very difficult to meet. Beating leakage will take time. SST are steadily building up their district meter areas (DMAs) and from the evidence we have seen reaching the goal of 100% coverage by 2008 is likely to be effective in lowering leakage, provided that SST can react effectively during extreme weather events. This combined with steady progress on reducing bursts should enable stable serviceability to be achieved during AMP4.

Water quality

Excellent. We discuss in more detail under Key Outputs and Service Delivery (Table A) below.

Water resources and customer expectations

SST currently has an adequate margin over target headroom both for average annual and peak conditions. This should last through AMP4 provided that the leakage programme is effective.

Energy prices

SST has an electricity supply contract negotiated and signed in December 2004, which will provide for a further 16 months. See SST commentary. The likelihood is that expenditure will be substantially above the 2004 Final Determination allowance.

Pensions contributions

No commentary.

Above ground asset management

SST has a team dedicated to building the data needed to enable use of the Common Framework at PR09, and improve the management of the assets. This is positive and constructive.

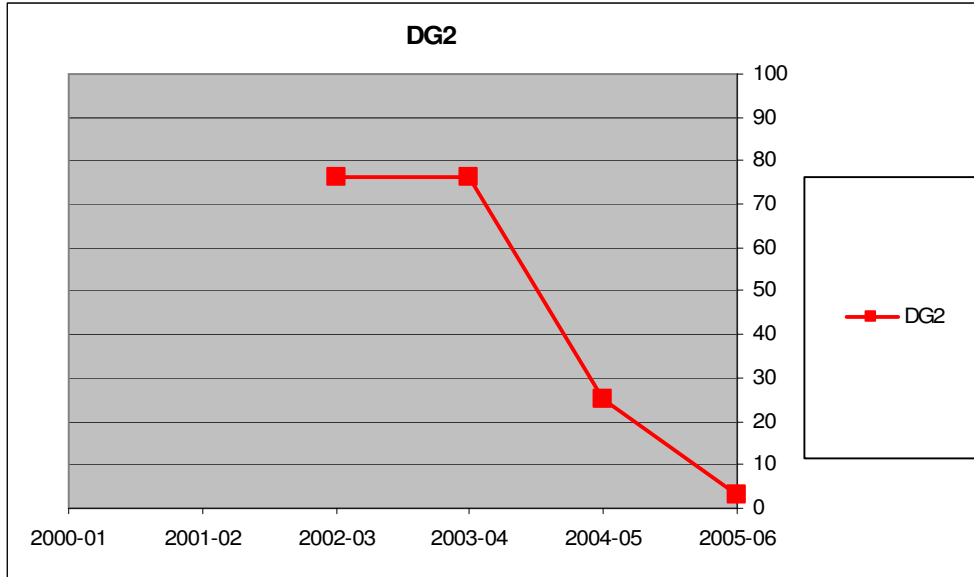
Key Outputs and Service Delivery (Table A)

Levels of Service

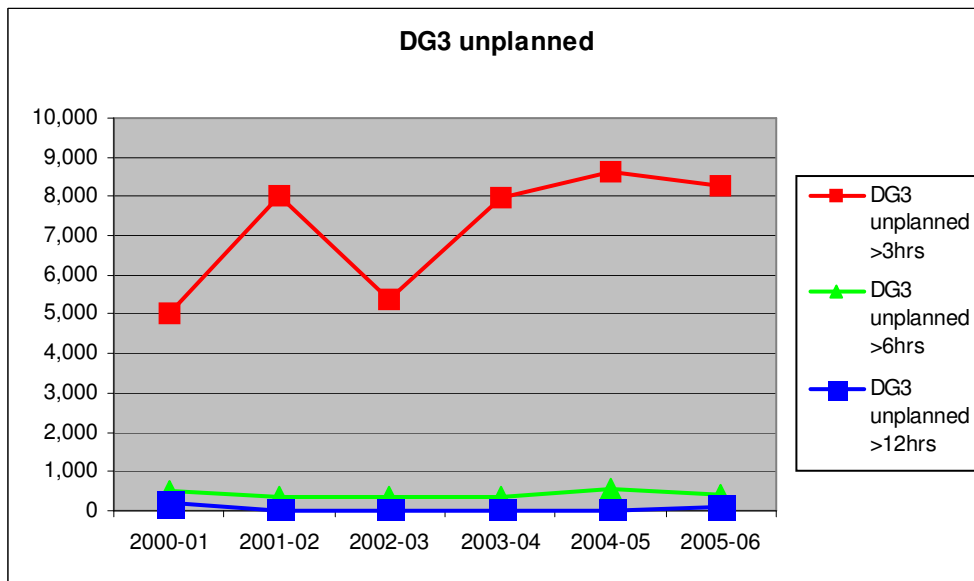
DG2 performance continues to be good. The only concern we have is that only properties identified by complaint, or by knowledge of surrogate pressures in the mains, will be recognised as below reference level. This may well be correct given the detailed knowledge of SST, but there could be low pressure properties on unidentified common services where no complaints have been made.

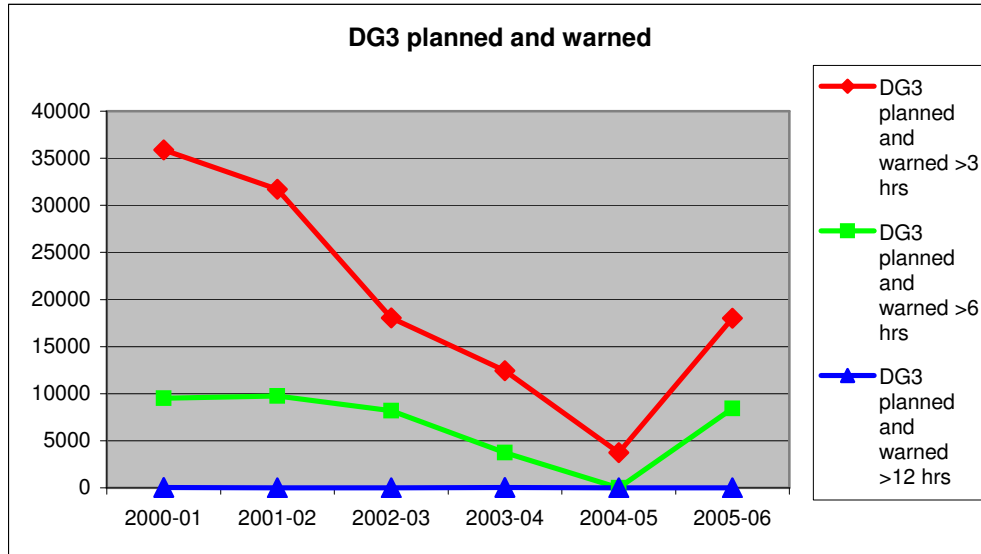
By March 2008 SST plans to have full DMA coverage of the network with a pressure logger sited at the critical point in each of the 550 DMAs. To date, 130 critical point loggers are operable but not linked into the DG2 recording procedures.

DG2 performance is shown on the following graph:



DG3 'unplanned' and 'planned and warned' performance is shown on the following graphs:





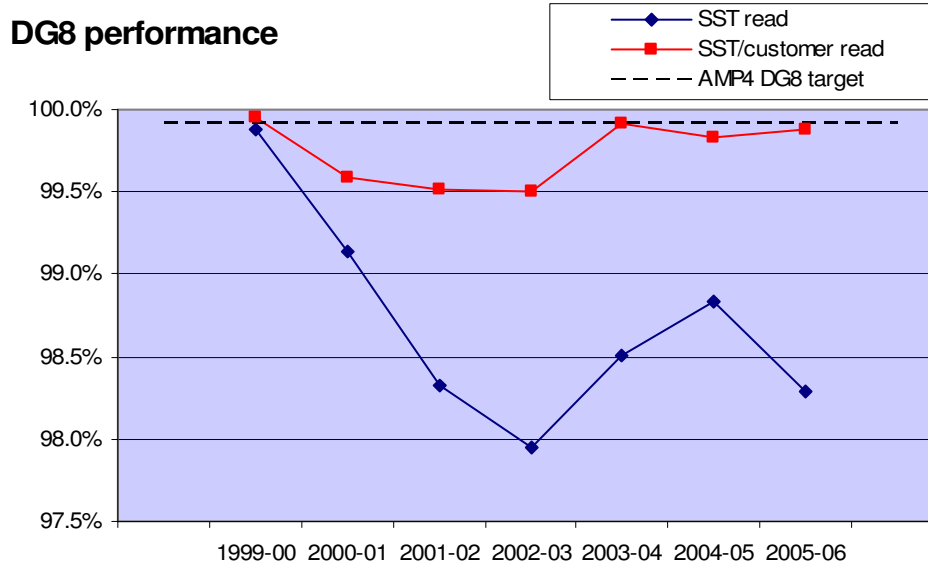
The rise in DG3 planned and warned from the low figure in 2004-05 will be due to the start of the increased AMP4 mains rehabilitation programme.

DG4 remains at zero and the SST policy is to avoid restrictions except in exceptional conditions. They have been able to avoid restrictions since the drought in 1976.

DG6 has 99.4% billing contacts dealt with in 5 days and the remainder in 5 to 10 days. This was 99.5% in JR05 but total number of contacts has risen by 18.4%. The factors that have contributed to the increase, which is significantly higher than in previous years, are higher charges, a 50% increase in meter option applications, debt control activities and the upward trend in on-line payments.

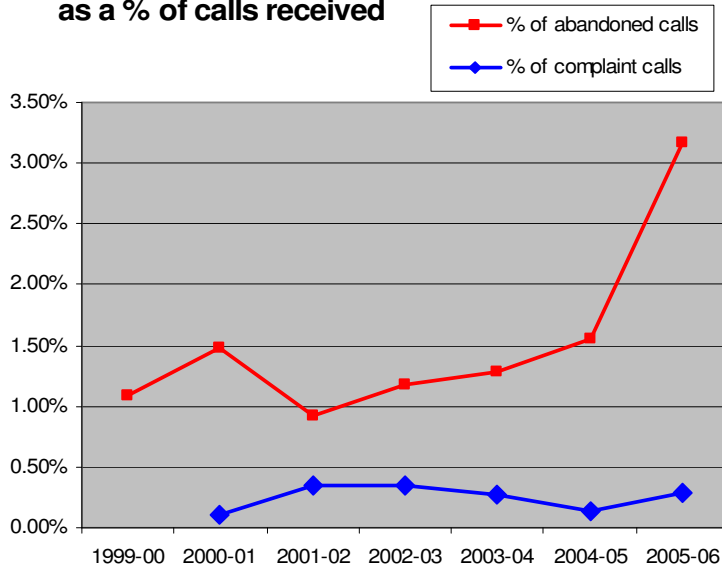
DG7 written complaints are again at 100% responses within 10 days in line with the AMP4 target of 100%.

DG8 has risen marginally from 99.83% to 99.88% and is close to the AMP4 target of 99.91% to be reached by 2007-08. The following graph illustrates the DG8 performance over the past seven years relative to the 99.91% AMP4 target.

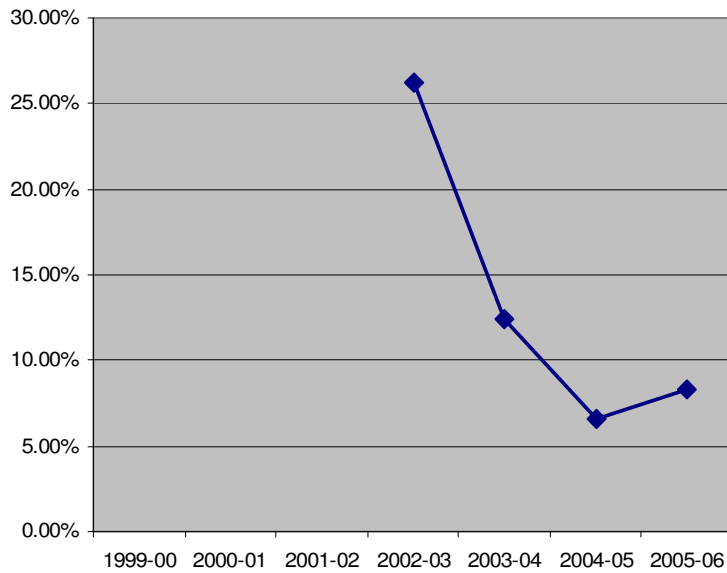


DG9 – SST had a poor start to the year due to staffing issues. This has had a significant effect on the year as a whole as highlighted in the graphs below. However, the month by month analysis of calls abandoned and all line busy included in SST’s Overview demonstrates that SST are well on the way to meeting the AMP4 targets.

**DG9 - Complaints and abandoned calls
as a % of calls received**



DG9 - All lines busy as a % of calls received



Water Quality

SST has continued to achieve a high level of water quality regulatory compliance and operational performance of 99.99%. There are no s19 undertakings, authorisations or confirmed programmes of work. The programme of installation of plumbosolvency treatment and control solutions is complete for all sites. The period of optimisation has been extended.

Serviceability – underground assets

The major contribution to the overall level of bursts, which have shown a stepped increase since 2000-01 is considered to be seasonal influences and irregular weather patterns. In 2001-02 there were severe winter peaks in leakage but no effective District Meter Areas (DMAs) which would have enabled rapid response as SST would be aware of the problem much sooner. In 2005-06 there were no high severe winter or summer peaks. In future with DMAs now built for 75% property coverage and increasing to 100% over AMP4, response to high burst events should be more rapid. SST has obtained weather data over recent years so that bursts can be monitored against weather to improve understanding of failure mechanisms.

Bursts are 233/1000km in JR06 against 225 in JR05. As 2005-06 did not have severe winter or summer events a clear trend is not evident.

SST has increased its underground asset management team to ensure delivery of its integrated strategy, and the actions taken appear to be well chosen and likely to be effective.

Serviceability – overground assets

Stable serviceability should continue. We have no evidence to suggest otherwise. We are pleased to see the formation of the new overground maintenance team to ensure that data needed for use of the Common Framework will be collected.

Table A input lines

In Line 12, the compliance figure of 99.99% is calculated from samples taken over the whole of the year in 23 zones and analysed against 40 water quality parameters.

For line 13, twenty two water quality zones had no failures for iron and one zone had one failure. The mean zone compliance was 99.89%.

For line 14, there are no water treatment works improvement programmes.

For line 15, SST has no water quality programme for water distribution mains renovation.

All other lines in Table A are transferred from the JR tables.

Expenditure and Financial Performance Measures (Table C)

No comments

Key Supporting Information (Table D)**Capital works activity**

SST has five early start schemes:

- Acid dosing for pH correction at HLTW
- Replacement of bulk chlorine at HLTW
- Mains renewals
- CP renewals
- HLTW to Sedgley 800mm duplicate main

The first two schemes are now consolidated in to one scheme. The bulk chlorine storage is being replaced at Hampton Loade Treatment Works (HLTW) with a hypochlorite system purely on health and safety grounds as COMAH inspections will no longer be required. Total expenditure is now forecast to be £1.900m.

All of the construction work on the 45" main from Hampton Loade Treatment Works to Sedgley was completed prior to December 2004 (during AMP3). Commissioning was completed and the scheme put in to operation in April 2005. The expenditure during 2005-06 (£0.198m) reflects closure of the project.

We discuss mains rehabilitation below.

Mains rehabilitation

The annual target for AMP4 is 70km of mains replacement. SST intends to reach this target during AMP4 and have put in place contractual arrangements which we expect to be sufficient provided that access to carry out roadworks is not more severely restricted.

Water balance (incl. leakage)

The SST water balance is within 1% and leakage has achieved the target. The new pcc monitor which is being built will provide much more robust estimates of unmeasured household consumption. Considerable efforts are also in hand to determine the accuracy of distribution input meters and improve the estimates of the minor components of distribution system operational use, and water taken legally and illegally.

Line 26

The total revenue outstanding for less than 48 months (£5.741m) as a percentage of annual forecast (Line 26) is reported as 12.91%. This is calculated by applying the three stage process detailed below and in line definition processing rules:

Part A Line 1 plus line 11 of Table 6a = 1.471 + 4.680 = £6.151m.

Part B Principal Statement line A1.10 plus line A1.13

= £42,265.435k + £8,383.191k = £44,479.972k

Part C Dividing Part A £6,151k by Part B £44,479.972k which equals: 12.15%

Efficiencies

SST has classified as A for both opex and capex efficiency. This level has been achieved by considerable efforts by the company and its staff.

We support SST's very real concern about the disparity between the level of funding and steeply rising operating costs, particularly in power but also in the other areas set out in the SST commentary.

Overview of Health and Safety Activities in 2005/06

The Reporter should give his opinion on the accuracy and completeness of the company's information on their health and safety initiatives and performance trends.

The SST Health and Safety and Emergency Planning Manager is responsible to the Board member championing H&S. He has a liaison role between the regulated water company and the non-regulated member companies of the new group.

There is a clear delegation of health and safety responsibility from the Board to management and employees. The H&S and EP Manager attends all meetings of the Health & Safety Committee, and advises on current and developing H&S requirements. He also provides training planning, presentations and workshops.

The Health & Safety Committee is chaired by the Director of Water Quality who reports to the Managing Director (H&S champion at Board level), and includes management and employee representatives as well as the H&S Manager. Key priorities continue to include risk assessments, lone working, ensuring contractor safety, H&S culture, working time issues, hand/arm/ vibration issues and asbestos management. A watching brief is kept on proposed and future legislation.

RIDDOR reporting statistics for 2005-06 include industrial diseases. The total reported is 3 SST incidents and 1 contractor incident. The priorities for H&S this year are accident reporting, avoiding danger from underground cables, stress and workplace transport.

The only COMAH site is Hampton Loade WTW and the COMAH status should cease following the conversion of disinfection from chlorine gas to a suitable replacement

system, probably on-site chlorine generation, which is planned for AMP4.

The H&S Manager maintains necessary procedures and pursues initiatives, all approved by the H&S committee. He also acts as the internal H&S auditor, as SST no longer operate an externally audited QA system. The committee minutes provide a record of the status of procedures approvals and training. It is likely to be of value that the H&S Manager also manages emergency planning and training, as many issues overlap.

In our opinion SST have in place a comprehensive system which is pro-actively managed and developed, with appropriate risk assessments. Every effort is being made to ensure accuracy and completeness.

Sustainable Procurement

The Reporter should give his opinion on the company's progress towards sustainable procurement.

Through the last 4 years we have noted a significant improvement in the procurement practices of SST. In general the processes used meet the aims of the British Water 'Guide to Sustainable Procurement'.

SST follows the EU Utilities Procurement Directives using the Achilles database to source suppliers and contractors and they have moved into partnering with their principal contractors. We have noted that they consider carefully whether potential contractors are likely to be able to deliver to time and budget efficiently when procuring contracts. In general SST are looking for long term relationships with contractors/suppliers which will keep costs as low as possible while maintaining good working relationships.

Date: 23 June 2006
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