

BOARD'S OVERVIEW**EXECUTIVE OVERVIEW**

The reporting year has seen the further development of the Company's vision and strategic direction for the business as the preparations for the 2009 Periodic Review (PR09) continue along side delivering the outputs agreed at the 2004 Periodic Review (PR04). It continues to be our aim to be seen as a highly respected and caring water supplier – offering the highest standard of service, at the lowest possible cost

In its pursuit of its vision, the Company is able to report another good year in terms of outputs to maintain its long term high level performance of service standards to its customers. The average household bill has continued to be one of the lowest in the industry (25% below the industry average) in spite of the continued price increases following the 2004 Periodic Review.

Whilst lower than allowed for in the first two years of the 2004 Final Determination, operating costs during the year have risen in several areas. Leakage costs and the level of bad debts continue to be above the levels allowed for in the Determination. Going forward in future years there will be further increases in costs in the areas of power and the implementation of the Traffic Management Act which are beyond the Company's control. It is notable that it is becoming increasingly difficult to absorb these costs when efficiency levels are already high.

The high calibre and performance of the Company's employees is essential to its achievement of business objectives and regulatory outputs. The recruitment of high quality employees into senior and specialist roles is becoming increasingly difficult due to a shortage of engineering and water specific skills, competitive external employment packages and lack of candidate interest. These recruitment challenges have highlighted the need to retain key staff, to formalise succession plans and be more innovative in recruitment strategies.

Following the slow start to the delivery of the capital investment experienced in the first year of the AMP4 period, the Company has achieved its highest ever level of capital expenditure in 2006-7. The achievement has significantly restored the previous year's shortfall and the Company is now largely in line with the cumulative PR04 Determination position. Achievement of the key outputs and levels of expenditure as defined in the PR04 Determination remains at the core of the Company's commitment to the Regulator and our customers.

The Company remains firmly committed to ensuring our customers receive the best value for money of any water company in England and Wales. We also intend to remain at the leading edge of the industry, holding strong values of excellence, credibility, price and delivery. To this end, a further enhanced level of governance has been implemented for the 2007 June Return process. These requirements have added an additional step into the process which has imposed even further time constraints into an already tight schedule for the completion of the Return which has caused the Board and particularly the Non Executive Directors some concerns.

The 2007 June Return is the first to be audited by the Company's new Reporter, Kyle Robins, and his team from Atkins. However Kyle Robins will be leaving Atkins in July, requiring the Company to appoint a new Reporter, a process which may not be completed until the Autumn. This situation is of some concern to the Company as the appointment will be made relatively late in the preparations for the submission of the Draft Business Plan in 2008. There will be a need for a much accelerated induction programme for the new Reporter to be made aware of the Company's key issues for PR09.

During the report year, the Company undertook a review of its systems, procedures and controls for compliance with the GSS Regulations, in accordance with the requirements of MD220. As part of the review the Company identified a number of minor weaknesses with its processes and controls, the majority of which have already been actioned and remedied. The Company's review and action plans were audited by its Auditors with no further issues identified.

The report year has seen the Company's preparations for PR09 start in earnest with the establishment of a senior management level Steering Group for the process which now meets on a monthly basis. The first drafts of the Strategic Direction Statements (SDSs) have been completed and are in the process of being finalised for consultation with key stakeholders and our customers over the summer months. At the heart of the SDSs is the Company's over arching strategy which falls into three areas; carbon, customers and costs. Each one of the SDSs, as well as overall business objectives, will fall under the heading of one or more of these key strategies. The SDSs will cover the following areas:-

- Service to customers, including the quality of water
- Asset management
- Sustainability
- Cost efficiency and financing

- Innovation
- Climate change
- Ethic and corporate social responsibility
- Future charging structures

GOVERNANCE FOR THE PROVISION OF REGULATORY INFORMATION

The Company takes its obligations for the provision of regulatory information very seriously and has in place processes to ensure the information it provides is reliable, accurate and complete.

The completion of the June Return (JR) is coordinated by the Company's Regulation Manager, who reports to the Regulation and Asset Management Director, a Director of South Staffordshire Water plc. The Regulation Manager is the dedicated point of contact between Ofwat and the authors of the various JR tables / commentaries and ensures the dissemination of reporting requirements for the Return including any points of clarification issued by Ofwat.

Each and every table in the JR has an allocated author who is responsible for the collation of information for its completion and the writing of the accompanying commentary. The allocated authors are the individuals who will be audited by the Reporter and/or the Auditor as part of the overall JR completion process. It is these authors who will also be challenged by the Executive Director specifically allocated to their table as part of the internal audit process introduced for the first time for the 2006 JR.

Once all of the tables and commentaries have been finalised, the information is entered into the JR Information Capture System (ICS) by only three nominated individuals, the Regulation Manager, the Director of Finance and the Capital Programme Manager. The output from the ICS is rechecked and counter signed by the author who produced the data for the ICS originally.

The principles of the above process have been in place for previous JRs with the additional role of the Executive Directors being introduced for the first time in 2006 and reported to Ofwat following the submission of the 2006 JR.

In January 2007, a paper was presented to the South Staffordshire Water plc Board outlining the actions required to further enhance governance of the regulatory reporting processes of the 2007 June Return, and the timescales for achievement.

One of the key areas covered by the paper was the requirement for the whole Board including the non-executive Directors to be more involved in the June Return and PR09 processes. It is to be noted that two of the three non-executive Directors of the Board, Panton Corbett and Mike Hughes are also the sole members of the Company's Audit

Committee.

Details of the additional requirements identified by the Company through recent reviews and the recently published June Return 2007 Reporting Requirements were provided to the Board. This specifically focused on the role for companies' Boards, including non-executive Directors in the sign off of the Return itself, as well as the Board Overview. In addition their awareness of the purpose, content and existing processes for the sign off of the June Return was reinforced.

The key steps of the enhanced governance process agreed with the Board and undertaken throughout the JR07 preparations process are listed below:-

- Further education of all members of the Board in the purpose of the June Return and details of the tables and processes which are undertaken in its compilation.
- Nomination of Jack Carnell as the Managing Director and Panton Corbett, one of the non-executive directors to sign the Board Overview having satisfied themselves that the Board endorses it and the overall June Return.
- Continuation of the governance processes introduced for the 2006 June Return whereby each line and table of the Return was allocated to a named author who is responsible for its preparation and completion and also an Executive Director of the Board who will challenge those key assumptions and audit the data which supports them.
- The Executive Directors' sign off the June Return tables and commentaries they have been allocated to. They will also sign off any subsequent queries from Ofwat, post submission, related to their relevant tables.
- The sign off process is as follows:-
 - Meetings arranged between JR author/s and the relevant Executive Director to sign off table and commentary, after completion by the author and before audit by the Reporter / Auditor
 - The meetings cover the following for each table and commentary:-
 - matters the author wishes the Director to be aware of or areas of concern
 - key assumptions in methodology and production of tables

- confirmation that all material assumptions and judgements are detailed in the commentary
 - new reporting requirements or changes in methodology
 - new inputs / outputs
 - new reports to produce existing entries
 - material changes to statistics and/or confidence grades
 - confirmation of the appropriateness of the confidence grade assigned
 - random selection of line entries per table and follow of audit trail to produce the entry itself
- Once satisfied with reasonableness and robustness of table and commentary the Director signs a statement to that effect.
- The challenge of all of the June Return authors by the Executive Directors, as detailed above, is recorded using the proformas and systems which were established for the 2006 June Return.
 - Copies of the June Return tables and commentaries including the Board Overview sent to all Board Directors 2 days before the 'special' Board meeting arranged, specifically for its sign off.
 - A 'special' Board meeting held on 7th June 2007 to sign off the Return itself and the Board Overview.
 - The 'special' Board meeting covered the following:-
 - Reports from the Executive Directors on their audits with all of the June Return authors
 - Reports, in person, from the Auditors and the Reporters on their role within the June Return process
 - Challenge from Board members of those Auditor and Reporter reports
 - Challenge from Board members on the Executive Director's audits and completed proformas
 - Detailed examination of the Board Overview
 - Board endorsement of the Board Overview and approval for Jack Carnell and Panton Corbett to sign the Overview on the Board's behalf

- On the basis of the successful implementation of the above enhanced governance process each Director confirmed, backed up by the signature of the required statements, their satisfaction in signing off the June Return.

SUMMARY OF ACHIEVEMENTS

The Company is able to report a number of key notable achievements over 2006-7. These include: -

- Another good year of performance in the levels of service given to customers. The Company was again placed in third position across the industry for 2005-6, based on Ofwat's Overall Performance Assessment (OPA) with a score of 286 points out of 288. This has confirmed a top three place for each of the last seven years. The Company estimates that this level of performance will be largely maintained for 2006-7 with a slightly reduced score of 285.
- Achievement of the 2006/07 leakage target of 75 MI/d. The relatively mild weather during the year supported achievement of the target, with the number of burst mains also reported lower. These key indicators are now identifying stable performance and will therefore support achievement of future regulatory targets. It is pertinent to note, however, that changes in weather patterns beyond the norm, including hot dry summers, can still result in an adverse reaction from the distribution pipe network, with increased burst and leakage rates, as experienced at certain times in the year, continuing to reinforce the view that the network is still fragile and vulnerable to external environmental impacts.
- An overall water quality Mean Zonal Compliance of 99.973%, maintaining the Company's high level of performance over recent years.
- Ofwat ranking the Company as the fifth most efficient in terms of operating costs for 2005-6. The Company continues to be ranked Band A for both operating cost and capital investment performance; one of only three companies to receive this banding for both categories of expenditure. The Company's long term strategy is to remain Band A for both operating and capital efficiency. However it is recognised that there will be periods where the performance of other companies cannot be foreseen, as a result of which movements outside of Band A may occur in the short term.

WATER RESOURCES AND CUSTOMER EXPECTATIONS

The Company obtains its water resources from three main sources: Blithfield Reservoir (20%), the River Severn (35%) and 26 groundwater sites (45%) across the Company's area of supply.

Groundwater is abstracted from the Triassic Sandstone aquifer and because of the nature of the strata does not tend to react rapidly to periods of low rainfall. Rainfall for the year as a whole was average with 7 months having average or above average rainfall and the remaining five months having below average rainfall. The groundwater position remained healthy throughout the year.

The River Severn is a regulated river, managed by the Environment Agency, with flows in the river being augmented by inputs from both groundwater and reservoirs at its head. Regulation releases of 82 days occurred over the period June to October which is above average reflecting the dry summer period and the above average soil moisture deficit.

The Company uses the level in Blithfield as an indicator of resource availability. Blithfield started the year 100% full and was drawn down to 62% by end of September recovering to 100% by the end of December. The levels in Blithfield at no point gave cause for concern.

The Company resource position remains healthy with no concerns over the supply situation for the forthcoming summer and the need for a hosepipe ban is regarded as highly unlikely.

TO THE FUTURE

It is the Company's view that the June Return Board Overview should also focus on high level issues going forward. Detailed below are issues relevant to the AMP4 period and issues which are pertinent for PR09.

Energy prices

The movements in electricity prices over the last two years have been well documented with unprecedented levels of volatility. The 2 ½ year contract the Company signed in December 2004 when prices were £28-29 MW/hr successfully avoided the peaks of £58 MW/hr observed in the market through 2005 and 2006.

In January 2007 a dip was identified in market prices and a new two year contract starting on the 1st October 2007 was signed, when prices fell to around £36 MW/hr. Unfortunately the prices of the January 2007 contract could not be extended up to or beyond the end of the current AMP period due to increased risk premiums from suppliers.

The new contract changed suppliers from Eon to British Energy and will result in a full year increase in energy costs of circa £1M. Consequently, despite securing a competitive agreement, achievement of the energy budget allowed for in the 2004 Final Determination will not be possible for the first half of AMP4 and in fact there will be significant under funding for the latter half of AMP4.

The Company will continue to use electricity as efficiently as possible and seek new savings, for which it has a significant track record. As reported in previous returns, power costs are a higher percentage of the overall operating cost base for the Company, than for others, due to our individual highest level of pumping head requirements, which of course impacts on the Company's carbon footprint. Striving to decrease this footprint may, in the future, be in conflict with seeking the lowest energy bill.

With energy prices currently trading around £40 MW/hr (May 2007), the Company will continue to monitor fundamentals affecting energy prices and implement a strategy to sign a future contract when a significant dip in wholesale prices is observed.

Work to mitigate impacts of the TMA

Although the detail of the full Traffic Management Act is not known, and the extent to which restrictions will apply remain uncertain, the Company has continued to prepare for tighter restrictions and the potential for higher costs for distribution work undertaken in the highway. This relates to repair work, main-laying and mains rehabilitation. The normal working day of field operatives has been extended to allow 8am to 8pm coverage, thereby allowing more work to be completed each day and to reflect the fact that local authorities will restrict Company activities during rush hour periods in traffic sensitive localities.

Now that these difficult negotiations with the Company's workforce have been concluded, attention is being turned to prepare more efficient processes to deal with the specific challenges within the TMA for streetworks noticing and for reinstatement activity. The Company is concerned that the cost of future reinstatement activity will rise substantially, due to the fact that there will be a requirement to reinstate much larger areas of the highway than with present legislation. Therefore a review of the business process followed for reinstatement work can only mitigate rather than avoid large cost increases once the legislation becomes fully effective.

Assessment of maintenance requirements for overground assets

Following assessment of the Company's submission for maintenance requirements for overground assets, a significantly greater emphasis has been placed on this key area since the last PR. The dedicated team, championing overground maintenance issues has made good progress in developing formalised asset registers and works management system requirements across the broad asset group areas of non-infrastructure assets. Extensive reactive and routine maintenance data is also being collected. Techniques to understand asset criticality, economic risk based decision making, processes for the identification and justification of capital maintenance, and how assets are strategically linked to the Company Vision have been developed. The Company is also looking to develop Key Performance Indicators (KPIs) to aid its future assessment of serviceability of its assets.

All of this work shall ensure that the Company's approach to asset management planning is appropriately aligned to the UKWIR Common Framework methodology.

Tariffs

For the 2007-8 reporting year, the Company has set up a Tariffs Committee who will be looking at new elements of the tariffs structure and in particular those in the area of dealing with vulnerable customers and further control of sprinklers. The Company's billing provider will also be included in these discussions and the formulation of new proposals.

Preparations for the 2009 Periodic Review

The Company has continued and stepped up preparations for the next price review. For some areas of the business, such as asset management, this is now a continuous process rather than an activity specifically started for the review. Key areas of note are as follows:-

- Preparations for the Water Resources Plan are well-advanced to reflect the early submission date requested by the Environment Agency.
- In terms of asset management, it is at this stage too early to speculate on the future capital maintenance needs for over-ground (non-infrastructure) assets.
- For maintenance of the underground assets it is not envisaged that there will be a radical change in the level of activity required to keep asset serviceability stable.
- Concerns remain on the increased costs impact of the Traffic Management Act (TMA) specific to greater highway reinstatement activity.
- There are no material water quality issues envisaged for PR09, with the exception of potentially lead cp replacements to meet the 10ug/l standard for 2013.
- In terms of Supply Demand Balance, the high peak demands in the hot summer of 2006 have led to concerns about some specific areas of supply stress on the network. Options that include customer education, water efficiency promotion, sprinkler metering enforcement, and as a last resort capital investment to reinforce the distribution network are being reviewed to ensure customer supplies are not threatened.
- Any future leakage targets incorporating significant reductions in leakage levels would need to be matched by allowance in price limits for the step change in resources and investment required to achieve lower leakage. The long term economic level of leakage (ELL) analysis is yet to be finalised but the short run analysis suggests that the current levels remain economic, albeit the latter does not fully incorporate social and environmental costs.
- As at previous price reviews, issues around efficiency, financeability and leakage will feature prominently in the Business Plan for the Company. We are strongly of the view that the structure and processes adopted by the Company do not allow scope for major efficiency savings going forward. It is the intention to present evidence of the continued need for a small company premium to Ofwat at the next review.

- At present the key issues for the Company to address at PR09 are:-
 - Leakage
 - Supply Continuity
 - Opex Efficiency
 - MNI
 - Financeability

Chapter 1 Key Outputs and Service Delivery – (Table A)**Operational measures****DG2 (low pressure)**

DG2 performance continues to be excellent. For a considerable number of years the Company has been able to minimise low pressure disruption such that the percentage of properties receiving low pressure has not risen above 0.05%. The performance of 0.00% for 2006-7 matched the Company's performance for 2005-6. In fact at the year end there were no properties out of a customer base of 560,104 properties remaining on the DG2 register.

DG3 (supply interruptions)

DG3 performance continues to be very good with an overall score of 0.16, albeit deterioration on the 2006-7 score of 0.09, mainly due to the impact of a small number of high impact incidents.

DG4 (water restrictions)

DG4 water restrictions were once again avoided. The Company has not imposed a hose pipe ban in its area for over 30 years.

Customer Services measures**DG6 (billing contact)**

Applying the changes to the reporting requirements for DG6 has seen the percentage of enquiries actioned within 5 days falling from 99.4% (previous year) to 98.3%. Prior to applying the reporting changes the percentage would have out-turned at 99.94% for the reporting year.

It is also worthy of note that even allowing for the amended guidelines the number of contacts closed in more than 10 working days was 68 which is a reduction on last year's figure of 139 against a back drop of an 8% increase (nearly 40,000 contacts) in the number of billing contacts as compared to 2005-6.

DG7 (response to written complaints)

The performance of DG7, percentage of written complaints dealt with within 10 working days remained at 100%, albeit there was one complaint not dealt within 10 working days.

DG8 (meter reading)

DG8 meter reading performance has remained very high at 99.8%, a performance that has been achieved for the last three years. For the year an additional 11,779 accounts have added to the metered customer file.

DG9 (telephone contact)

During the year there has been significant improvements in DG9 performance, from the previous year, both in terms of calls abandoned (3.2% down to 1.8%) and calls receiving the engaged tone (7.7% down to 0.34%). These reductions are due to the increased number of dedicated lines into the contact centre and levels of manpower, plus an increase in opening hours of the centre and reflects a very significant effort being made to improve performance over the last two years.

Drinking water quality measures and outputs

The water quality compliance rate, the Mean Zonal Compliance, for the calendar year 2006 was 99.973%, maintaining the Company's high level of performance over recent years. (The compliance rate has always been at or above 99.7% since 1993).

For the Operational Performance Index (OPI) the Company's performance was 99.899%.

During the year there have been no enforcement actions placed on the Company.

There is no large water quality improvement programme required for the Company in AMP4 and therefore no associated treatment works improvements for quality. For plumbosolvency control, phosphate dosing is included rather than a strategic lead communication pipe (cp) replacement programme. Upon receipt of guidance from the DWI, a review will be undertaken to assess the extent to which lead cp replacements are required in AMP5 to meet the 10ug/l standard for 2013.

There has been one lead communication pipe replacement required to comply with the 25ug/l lead standard.

Monitoring for the potential groundwater sustainability scheme at Checkhill Bogs has continued during the year. Whilst the data will shortly be reviewed in order to identify the next stages, there is no allowance in the 2004 Determination for any subsequent appraisals or sustainability reductions that may need to be pursued and therefore if any are required, a mechanism for funding will be needed other than in price limits at present.

Serviceability – Underground assets

Following the increased investment over the first two years of AMP4 both the leakage and burst mains rate are now considered to be demonstrating enhanced stability in performance. It is however recognised that the relatively mild weather over the last 12 months supported this achievement.

The Company has seen the following asset serviceability performance during 2006-7:

- Burst mains – now considered to have achieved stable performance (10% reduction on average of previous 6 years)
- Underlying operational leakage – now considered reasonably stable over last 5 years
- Achievement of 2006-7 regulatory leakage target
- DG2 levels of service – maintenance of an already high level of service
- DG3 level of service – increased numbers reported, but primarily down to two incidents on strategic mains, not necessarily reflective of asset condition, with underlying numbers still representing good service
- Water quality – continued to maintain high level of performance

As a result the Company consider that stable serviceability has now been achieved and this should support achievement of future regulatory targets.

However, from events during the year, it is clear that the condition of the pipe network remains fragile and as such is vulnerable to weather impacts that can lead to an apparently disproportionate impact on performance.

Therefore, although the Company believe stable asset serviceability has now been

achieved, the need to continue with the current rates of mains renewal is also clear for the foreseeable future. This is required to support the long-term objective to improve asset condition, removing vulnerability to these external weather impacts, and to ensure maintenance of high levels of customer service in the future.

Serviceability – Overground Assets

During the year there have been no water quality failures where the Drinking Water Inspectorate has considered any enforcement actions. With regard to microbiological failures at Treatment Works there was only one failure, which the DWI consider trivial.

As a consequence of continuing good operational practice, including distribution and treatment hygiene and the low level of microbiological failures, it is considered that the non-infrastructure serviceability assessment will again be identified as 'stable'.

Overview of Health and Safety Activities in 2006/07

South Staffordshire Water recognises its duties to make proper provision for the health, safety and welfare at work of its employees and is committed to maintaining the highest standards of health and safety across all of its business activities.

The Company has the Managing Director to act as champion for health and safety at Board level. The involvement of employees is also critical to the success of any health and safety programme and the Company has in place an active Health and Safety Committee, which meets quarterly at which both management and employees are equally represented. Members of the committee continue to undertake specific health and safety initiatives which have included the areas of hazardous substances, slips, trips & falls, control of contractors together with a review of previous projects.

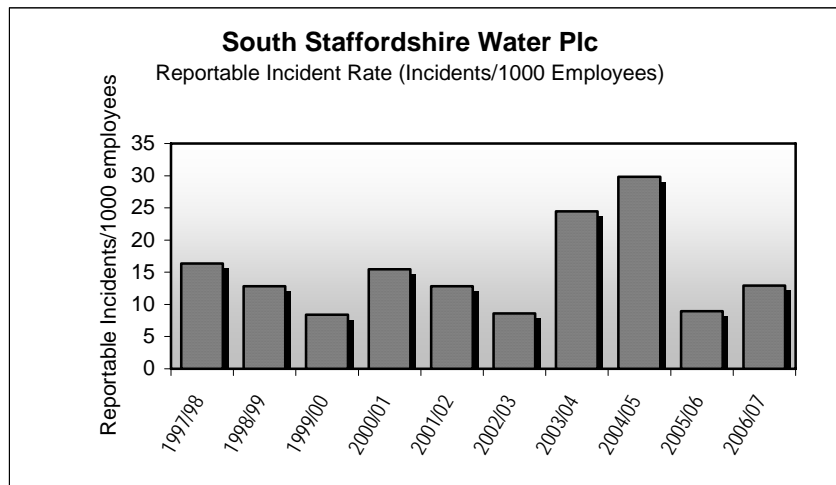
The Company works very closely with *Water UK* in dealing with industry wide issues and initiatives, which also applies to health and safety matters. Consequently the Company continues to support *Water UK's* 'Water Ahead' occupational health reduction initiative. The Company Health & Safety and Emergency Planning Manager was part of the *Water UK* team that delivered the revised guidance in respect to stress.

During the year, initiatives aimed at improving awareness to health and safety issues at all levels of the business have continued. Health and safety awareness training for managers and supervisors in particular includes the Institution of Occupational Safety & Health (IOSH) Managing Safely training. Specific training for employees has continued

with First Aid, CDM, Manual Handling and Confined Spaces training all being undertaken by relevant employees this year. The Company also subscribes to the water industry safety passport scheme provided by Energy & Utility Skills.

The Company has access to a range of health & safety support services, from the provision of information and legislation, to the new appointment of an external consultant who provides an independent view on health & safety governance established through a thorough audit of activities.

During the year the Company Health & Safety and Emergency Planning Manager was installed as a Chartered Member of the Institution of Occupation Safety & Health.



The Company strives to achieve an incident and injury free environment wherever it operates, and this continues to be demonstrated in the consistently low number of incidents reported under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR). The majority of these reportable incidents are under the 3-day absence-reporting category.

The above data includes incidence of industrial diseases reported under RIDDOR, in 2006/07 there was one case of Hand Arm Vibration (HAVS) reported. HAVS continues to be a high priority initiative, which includes training, awareness and health monitoring.

We continue to closely monitor trends in accident statistics and near miss data to provide early warning of areas of concern, which we can then focus on and develop a suitable response strategy.

Chapter 2 Financial Performance Measures – (Table C)**Profitability**

The current cost operating profit of £16.111m compares to £14.599m in the Final Determination. Pre tax return on capital before exceptional items is 8.50% compared to a determination of 7.70%.

Financing of investment

Net Debt increased to £136.4m (2005-06 as restated: £119.5m). The Company's index-linked loan is recorded in the balance sheet at its amortised cost including the premium and costs of issue of £130.9m. For covenant purposes the premium of £15.4m is excluded from debt and therefore the net debt for covenant purposes is £121.0m, being 62.0% of Regulated Asset Value (RAV), rather than £136.4m of debt as recorded in the balance sheet and a debt to RAV of 70%.

CCD and IRC

Net Current Cost Depreciation (CCD) for the year is £11.268m compared with £10.651m the previous year. This charge is £0.448m lower than the Final Determination; predominantly due to a different mix of capital spend resulting in longer average asset lives.

The Infrastructure Renewals Charge (IRC) for the year is £8.165m compared to £7.596m in the Final Determination and represents the Company's view on the medium to long term maintenance needs of its infrastructure assets. The Company believes that a replacement rate of 70km per annum is sufficient for the next 15 years as submitted in its Final Business Plan.

Dividends

The total dividend for the year was £18.421m compared to £6.020m in the previous year. However, in 2005-06 the exceptional loss on refinancing with respect to the index-linked bond restricted the dividend payment that could be paid by £6.7m. This was distributed in 2006-07 along with the dividend for the current year. After adjusting for this timing between years, the dividend for 2006-7 is £11.7m compared to £12.7m in the prior year.

The Company policy is to pay dividends that maintain the level of debt to Regulated Asset Value (RAV) at 65%. This dividend policy is designed to reward the efficient management of our operations and the management of economic risk. Furthermore, it meets our licence condition by ensuring that our dividends do not impair our ability to finance our functions as a water undertaker.

By adopting a dividend policy based on 65% of our regulatory asset value, the Company ensures that there is appropriate headroom maintained against the covenants in our bond and bank borrowings. There are also incentives to improve our efficiency, to control debt levels and to generate cash. These incentives ultimately benefit customers and contribute to the Company's profitability.

Chapter 3 Key Supporting Information – (Table D)**Capital Expenditure**

Following the slow start to AMP4 capital investment in 2005-6, a good level of recovery was achieved in the report year, such that the spend over the first two years of the investment cycle has now recovered to within 5% of the cumulative two year expenditure as included in the Determination. It is the Company's intention to match the three year cumulative Determination by the end of 2007-8 and to invest the full Determination over the AMP4 period.

In addition, for the second successive year, the Company's expenditure on underground mains has increased significantly over the previous year. Although good progress has been made there continues to be difficulties with recruiting and maintaining the necessary expanded workforce.

Capital Works Activity

One of the Company's most significant capital projects (circa. £2m) for the first two years of the AMP4 period is the replacement of the bulk chlorine installation at Hampton Loade Treatment Works. This entails the removal of a 60 tonne storage bulk liquid chlorine installation and replacement with an onsite generated disinfection chemical, which is far less of a health and safety risk in its storage and use. The project is substantially complete and is undergoing final commissioning and take over at the present time.

Mains Rehabilitation

A total of 80.9km of mains were renewed / relined during 2006-7, including mains diversionary works for third parties. This is a significant increase on the levels for 2005-6 and is consistent with the AMP4 Determination, which incorporates the 40% uplift in the renewal of mains infrastructure. There are some concerns about the rising costs of mains rehabilitation and trunk main replacements; however regulatory outputs are being maintained.

Metering

The Company has continued to experience a high level of free household meter optants. The actual number of optants in the report year was 6,185 compared to the

AMP4 Determination assumption of 3,242 optants per year. Over the first two years of the AMP4 period, the total number of optant meters installed is 11,409 which is substantially above the cumulative two year 6,484 Determination assumption. It is anticipated that optant levels will continue to be higher than the Determination throughout the AMP4 period. Ofwat have indicated that the log up process is likely to be the same as that at the end of the AMP3 period and that based on the figures provided, log up will be allowable. Based on the view of continued higher number of optants, the total log up value is currently estimated at £1.7m (2002-3 prices).

Leakage related activities

The Company policy for leaks identified on customer premises has been amended for 2007-8 to a process where the customer arranges for the leak location and repair service and is then offered a contribution provided the repair is activated within 30 days. The Company will still detect suspected leaks on premises and follow through with compulsory repairs if there is no customer response. Customers will be notified of four recommended local companies capable of location and repair activity. The contribution is £100 for a repair and £200 for a supply pipe replacement. One of the main benefits of this revised policy is that it allows more activity to be undertaken and it should encourage more customer co-operation. With the previous approach many customers did not respond when notified of a potential leak on their premises.

Water resources, supply and demand

During the report year 2006/7 the Company experienced no major water supply or water resource difficulties. Rainfall for the year as a whole was average. As a result of this refilling of reservoirs and recharge of groundwater was as expected.

Average demand for the year was lower than last year and thought to be below 'normal' as a result of customer response to media interest in the drought in the south of England during the summer. However, peak demand over the summer was higher than last year reflecting the hot dry spell and did lead to specific areas of supply stress on the network, which are being investigated for future resolution.

There were no selective meters installed during the report year. However, the Company was once again active in raising the profile of the sprinkler metering policy. A dedicated summer inspector was employed to police the policy within the Company's area. Wherever possible the opportunity has also been taken to outline the policy in media messages and Company literature throughout the year.

As reported above, the number of meter optants for the report year was significantly higher than for JR06 (6185 compared to 5224) and continues to be higher than the Ofwat notified item assumption of 3242 per annum. The higher level of optants is attributed to an increase in customer confidence towards metering, heightened awareness of metering both locally and nationally and as a way of reducing water bills and saving water.

The Company did not operate a policy of metering on change of occupier during the report year. However, this policy is to be introduced in 2007-8 in selective areas of supply stress where there are considerable evening peak demands driven by discretionary domestic water use particularly in the garden.

The Company continued to encourage the efficient use of water through a range of water efficiency activities. The primary focus of these activities is to ensure customers have access to information and advice on water efficiency measures when needed. The Company has reviewed its range of water efficiency literature and introduced a new 'Water use in the garden' leaflet and also has advice available for commercial customers in offices and hotels.

Sustainable procurement

SSW are fully committed to achieving a sustainable and efficient supply chain by the adoption of good practices by all parties in the supply chain to ensure that purchasers obtain value for money and suppliers are able to maintain a fair and profitable trading position. Procurement is involved in all expenditure throughout the Company (opex and capex) and always has the highest priority for supporting this objective.

I-Procurement and Contract Management training (as well as the legal issues relating to forming a basic contract and the implications of EU Legislation) has been delivered throughout the Company, during the year, to raise awareness of staff who are involved directly with suppliers and contractors.

Many of the key points within the 'Guide to Sustainable Procurement' are already in place, examples of which are: -

- SSW subscribes to the Achilles UVDB supplier database since November 2001 to facilitate supplier sourcing and to utilise the system as an EU compliant qualification system under the EU Utilities Procurement Directives. In 2006, SSW also subscribed to the Verify package of the Achilles UVDB.
- Partnering arrangements are negotiated, wherever practicable, with shared objectives to drive efficiency and innovation throughout the process.

In terms of other areas of good practice, the Company implemented electronic requisitioning through the implementation of the self-service Internet procurement module in January 2003. Further upgrades to the system are planned for 2007, which could potentially facilitate bar coding of products, reducing paperwork transactions to almost zero.

The overall efficiency of the requisitioning process has been enhanced with a greater degree of control on expenditure. Preferred supplier agreements have been set up to ensure that mutually agreed terms and conditions between the supplier and SSW are traded on. This will reduce contract leakage as more and more companies are added to the database.

Awareness sessions have been held during the year, led by Procurement, with all relevant managers with responsibility for authorising expenditure. The sessions have covered commercial best practice in the area of procurement and contract management and the governance processes required by the Company's Financial Regulations.

An Industry procurement forum on chemical supplies, which reports to Water UK, has been set up to address concerns regarding monopoly chemical suppliers. The task and finish group will work to improve market knowledge in order to mitigate against the security of supply of chemicals, along with sourcing alternatives and the current / future prices of chemicals.

SSW head up a consortium, for the procurement of chemicals, with Dee Valley Water, Isle of Man Water and Guernsey Water. It is hoped that Jersey Water will also join the consortium later this year.

The Achilles Steering Group meets on a quarterly basis and as the predominance of subscribing Utilities are water companies; this facilitates an open and transparent exchange on best procurement practices and market intelligence, which supports sustainable procurement.

Chapter 4 Efficiencies**Efficiencies**

Operating costs for the year were £37.757m. This is £0.923m or 2.4% lower than the Final Determination of £38.680m (2006-7 prices). Year on year, operating costs have reduced by 0.4% (£0.166m) in 2006-7 prices compared with an annual efficiency target in the Final Determination of 0.3%. This reduction has been partly driven by a three-year fixed rate electricity contract with Eon that commenced in 2005-6 holding unit costs at £29/mwh. The position will worsen significantly in 2007-8 with the new contract signed with British Energy to commence in October being at around £36/mwh. Leakage costs and the level of bad debts continue to be above the levels allowed in the Final Determination. The Company, however, remains committed to achieving efficiency savings over the remainder of the AMP4 period and to continue to be one of the most efficient companies in the industry.

Despite a slow start in the delivery of capital investment for the first year of the AMP4 period, the cumulative two year position demonstrates a reversal in this deficiency and the Company remains fully committed to achieving its key outputs and levels of expenditure as defined in the 2004 Final Determination, including the challenging capital efficiency targets.

Chapter 5 Competition activities**Water Supply Licensing Activity**

From the 1st December 2005, the scope for competition in the water industry opened up considerably with the introduction of the Water Supply Licensing (WSL) regime. From this date commercial customers who use in excess of 50MI/annum can apply to an Ofwat approved Water Supply Licensee for transfer of their custom from the existing Water Supply Undertaker.

The Company has up to 35 customers who may be eligible to take up the option of transfer under the WSL regime.

During 2006-7 the Company revised its Access Code but the Indicative Access Prices remained unchanged from the originally published document of the previous year.

To date the Company has been approached by three new licensees under the auspices of their retail licences. Confidentiality Agreements have been signed in all cases and the Company's draft Master Wholesale Agreement (MWA) forwarded as requested. The Company is actively in the process of negotiating the MWA with one of the three licensees which it is hoped is approaching a conclusion and a signed document will be in place in the near future. The Company is still awaiting comments on the draft MWA from the other two licensees.

One licensee has indicated that it is interested in approaching the Company on the provision of secondary supplies under the WSL but no formal application has been received to date.

Self Lay Activity

Self Lay Activity, in the Company's area, has continued to be low throughout the year with only 2 developers requesting Self Lay mains requisitions and only one of those actually taking up the option of Self Lay. The low level of activity is seen as an indication of the developer's satisfaction with the service provided by the Company in this area.

During the period the Company had one other ongoing self lay development that commenced in 05/06. A recurrent issue that has affected every self lay development dealt with has been the timely and satisfactory provision of as-laid drawings from the

self lay organisation and the Company has needed to use the retention of asset payment as a lever to expedite a satisfactory result.

The self lay policy was amended in May 2006 with updates on charges and reference to the National Water Hygiene Scheme the notable changes. A meeting has been held during the year with Ofwat for a general discussion on self lay development within the SSW region and to seek feedback on the Company's Policy. Amendment of the policy with 07/08 price changes and Ofwat recommendations is in progress and should be completed by the end of June.

Board Statement and Approval

On the basis of the enhanced governance processes that the Company has undertaken as described above and the role they have played in that process, the Board is of the view that it has sufficient processes and internal systems of control, to fully meet its obligations for the provision of information to Ofwat.

Each individual who is a Director of the South Staffordshire Water plc Board has confirmed, and signed a statement to the effect, that:-

- they have taken all reasonable steps, as appropriate to their position as a Director of the Board, to satisfy themselves that the information provided in the June Return 2007 is reliable, robust and complete, to the appropriate degree of accuracy, by the processes described within this Board Overview
- as far as they are aware, having taken all reasonable steps, there is no relevant audit information of which the Company's Auditor or Reporter is unaware
- they have taken all reasonable steps, as appropriate to their position as a Director of the Board, to
 - make themselves aware of any relevant audit information and to establish that the Company's Auditor and Reporter are aware of the information
 - make enquiries of their fellow Executive Directors and of the Company's Auditor and Reporter to establish the above *
 - (additionally in the case of the Executive Directors,) make enquiries of a number of the table authors for the June Return; the process and content of which is described above and to communicate the key issues to their fellow Directors
- they have exercised their duties as a Director of South Staffordshire Water plc with the due care, skill and diligence consistent with the Companies (Audit, Investigations and Community Enterprise) Act 2004.

* Unfortunately, Mike Hughes, one of the Non-Executive Directors, was unavoidably called away from the June Return sign off Board meeting and was therefore unable to fully participate in the discussions on this point.

The Board Overview to the 2007 June Return has been reviewed and approved by the Board of South Staffordshire Water Plc. The individuals below have been given the authority of the Board to sign the Board Overview on their behalf.

Dr Jack Carnell
Managing Director
South Staffordshire Water plc

Mr Panton Corbett
Non Executive Director
South Staffordshire Water plc

June 2007