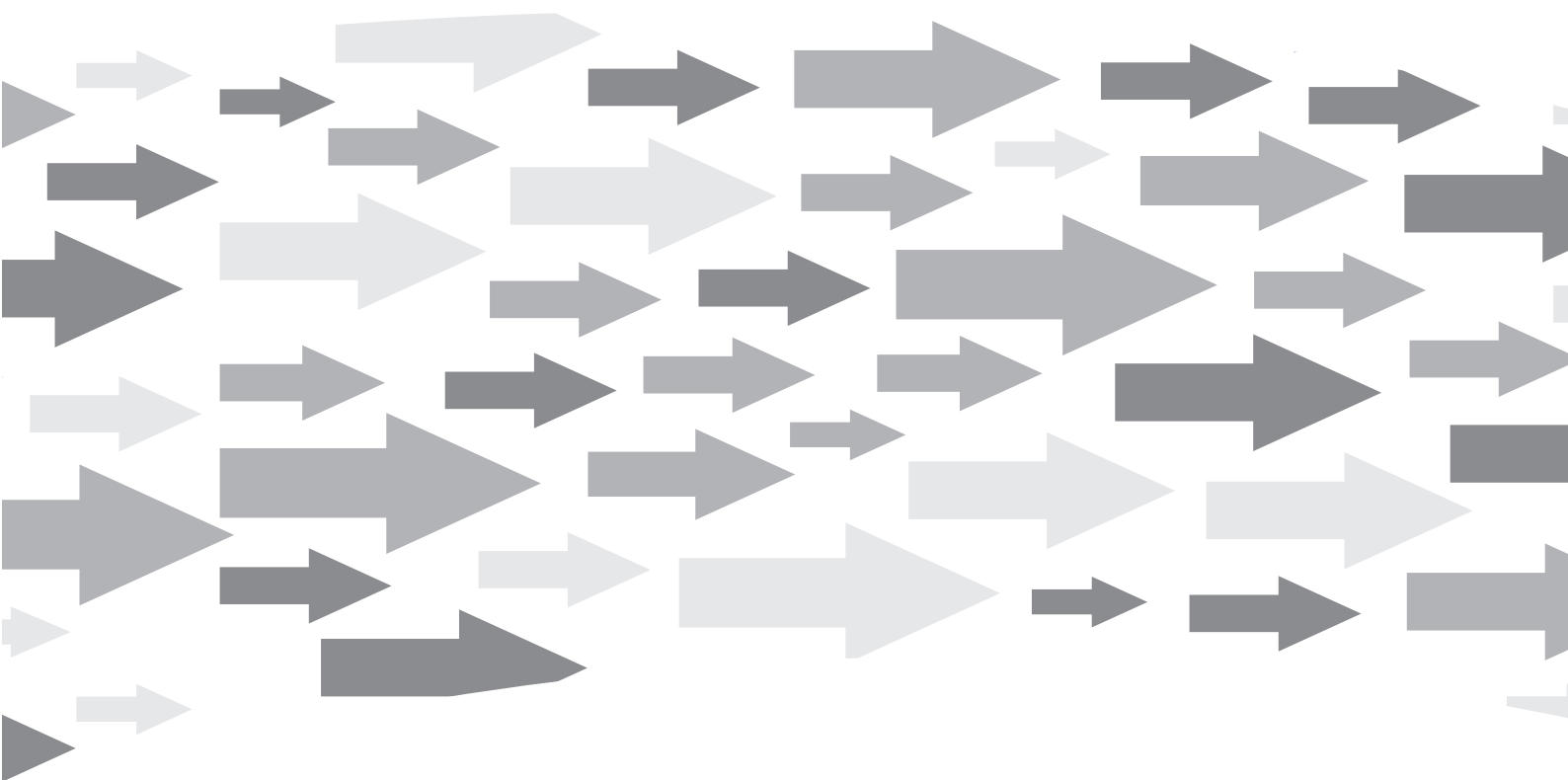


Ofwat

Forward Programme 2006-07 to 2008-09 draft for consultation



Draft forward programme 2006-07 to 2008-09

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In December 2005, Ofwat published its open letter RD21/05 setting out its main objectives and outputs for 2006-07. This consultation provides an update on our plans for 2006-07 and the following two years.

Ofwat will publish its final forward programme by 30 June 2006.

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Division: Operations

Deadline for responses: 25 May 2006

Target audience: All stakeholders

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Our vision

A water industry that delivers a world-class service, representing best value to customers now and in the future.

Our mission

To regulate in a way that provides incentives and encourages the companies to achieve a world-class service in terms of quality and value for customers in England and Wales.

How do we do it?

By:

- Setting price limits at levels which:
 - enable well-managed companies to finance the delivery of services in line with relevant standards and requirements;
 - provide incentives for companies to improve efficiency and service delivery; and
 - share the benefits between customers and investors.
- Ensuring that we are aware of stakeholders' views and priorities by consulting with customers' groups, the industry and others, and undertaking customer surveys.
- Promoting the development of effective competition to allow, where practicable, further choice for customers.
- Working with the quality regulators to ensure that Ministers have the information they need to set the quality improvement programme within a long-term framework.
- Taking into consideration all of our statutory duties, for example in relation to sustainable development.
- Ensuring that customers' tariffs are fair and do not unduly discriminate or show preference to any class of customer.
- Handling disputes and complaints involving the companies economically, effectively and fairly.
- Monitoring the companies' performance and taking action, where necessary, to protect the interests of customers and other stakeholders.
- Openly and transparently publishing information, which allows customers and other stakeholders to have their say in regulatory decisions.
- Making sure that Ofwat delivers best value in its regulatory role, and by valuing and encouraging the development of its entire staff.
- Assessing company performance by making appropriate comparisons between the regulated companies, drawing on relevant information from other sectors and from international comparisons where available.

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Foreword

I am pleased to publish this consultation on our forward programme. We would like the opinions and ideas of others on whether our plans are proportionate and reflect the key regulatory priorities for the next three years.

This consultation is later than normal because it did not prove possible to establish the Board of the Water Service Regulation Authority (WSRA) ahead of its implementation on 1 April 2006. Following consultation, the Board will approve the final forward programme. This consultation builds on the initial plans published in December in an open letter (RD21/05). In that letter we emphasised the need for continuity of approach and stability during the transition to the WSRA. The new Board of the WSRA endorses this approach.

In the year ahead the Board will carefully consider Ofwat's strategy and regulatory approach. It will review the medium and long-term issues affecting the industry, taking into account for example, uncertainty over security of supplies in the south-east of England, the implications of the Water Framework Directive on the next price review, affordability of services and long-term financing. These are covered further in chapter 1.

The opportunity for water supply price competition under the Water Act 2003 began in December 2005. We want the new market to be a stimulus for competition, to provide better value for eligible large user customers. We will monitor how competition develops and in the medium term work with Defra in its review of the supply threshold. Customers who cannot choose their supplier should not be disadvantaged by the new regime.

During the past year the independent Consumer Council for Water was launched successfully. We look to develop a positive and constructive relationship with the Council. We will also build effective communications and relationships with other key parties involved with our work. Some of these will be formalised in memoranda of understanding.

In June we will receive from the companies their annual returns. These will report on the first year covered by the 2004 price determination. We will analyse the performance of the industry and take action as appropriate. In particular we will review progress on the early start programme of capital investment. We will publish our analysis and findings in our standard reports. Details of these and other outputs are set out in chapters 2 and 3.

The special investigations involving Severn Trent Water Ltd and Southern Water Services Ltd continue. Companies must provide accurate information and run systems that consumers and regulators can trust. We issued our interim report on allegations made against Severn Trent on bad debt and income last month. We will consider what further action is required in the Severn Trent case when the Serious Fraud Office has completed its work. We have had to widen our investigation into Severn Trent to cover misreporting of customer relations data that has recently come light.

We aim to provide value for money to consumers and will keep a firm control of our own expenditure, subject to such additional pressures as rising litigation. The new Board will establish its rules of procedure and other governance arrangements. The aim is to provide a strong and transparent process of decision making, with appropriate powers delegated to the senior team. There is more detail in chapter 4.

On 25 April we are hosting our forward programme workshop at the NEC in Birmingham. Most members of the Board will be present, although the Chief Executive will not be known at that point. Over the next three years we will face a range of interesting and important challenges. We look forward to hearing your views on our plans and any other points you wish to contribute. The final document will be published by the end of June.

A handwritten signature in black ink that reads "Philip Fletcher". The signature is written in a cursive style with a large initial 'P'.

Philip Fletcher
Chairman

1. Emerging issues

This forward programme covers the main areas of Ofwat's work over the next three years. Routine planned work is set out in chapters two to four. This chapter provides background on the emerging issues over the next two to three years. The policy approaches, timetable and outputs will be developed further during the coming year.

We have set out a few longer-term issues but this is not a comprehensive assessment. We are seeking your views on both the issues that we raise here and those that you think we need to consider going forward. Please raise these at our workshop, in your written response to this consultation or in the accompanying questionnaire.

In this and subsequent chapters we set out a range of objectives and outputs covering the full range of regulatory issues. We approach regulation in a holistic manner that does not address matters in isolation. For example in relation to sustainability, supply and demand for services, leakage reduction and efficient use of water, we integrate our policy, recognising the interdependencies of these issues. This important principle applies to all our work.

1.1 Regulatory certainty

From 1 April 2006 the statutory duties of the Director General of Water Services transferred to the Water Services Regulation Authority (Ofwat). The role of the Director General is replaced by a Board, which takes responsibility for the economic regulation of the water and sewerage industry. The Board comprises:

Non-executive Chairman: Philip Fletcher

Non-executive Directors: Penny Boys, Peter Bucks, Jane May, and Lord Whitty

Chief Executive: To be appointed

Executive Directors: Melinda Acutt and Keith Mason

Until the Chief Executive is appointed, Philip Fletcher will be acting Chief Executive.

The Board met for the first time on 3 April 2006. The rules of procedure including matters reserved for the Board will be published on our website during May.

The Board in its first year will consider Ofwat's strategy and determine any policy changes or new strands of work. We will consult stakeholders and make regulatory impact assessments where it is appropriate to do so.

Our aim is to reduce regulatory risk and build on Ofwat's reputation and track record. It is incumbent on the companies to make their own contribution, not least by providing reliable information to the regulator. In line with our new statutory duty we will continue to adopt the principles of better regulation and best practice.

The workshop on 25 April will be an opportunity to meet some of the Board members and to set out what you consider should be our priorities. We will hold a seminar on the 6 July 2006 to give the Managing Directors of the companies an opportunity to meet Board members.

The Board looks forward to engaging with stakeholders on the broad range of issues affecting our work.

1.2 Security of supply – south-east England

The drought in south-east England presents a serious challenge for companies and regulators in providing services and in seeking the help of consumers. Our objective is to take any necessary action within our duties to help safeguard supplies in drought affected areas. We will continue to work with the other key stakeholders including the Environment Agency on this important matter. Our approach integrates supply and demand assessment, leakage control, and promoting efficient use of water by consumers.

Over the longer term demand is likely to grow in the south-east of England partly as a consequence of new housing development. This will increase pressure on water resources and infrastructure. We will work with Government and companies to assess the impact and ensure that appropriate and efficient steps are taken to secure supplies whilst safeguarding the environment.

1.3 Price review 2009

The next price review will commence in the autumn of 2007. Over the next eighteen months we will develop our outline approach to the review. This will take into account lessons from the independent review of the 2004 price review (PR04) chaired by John Baker. The emerging issues include:

- The length of the period to be covered by the 2009 price review (PR09). We consulted on this in January 2006 and will report back on this consultation later in the year.
- The financing of substantial capital programmes which has led to increased gearing across the industry. In February 2006 we issued with Ofgem a discussion paper, 'Financing Networks'. This considers key issues around the role of equity for regulated companies, implications for regulators and approaches to ensure companies can finance their functions. Further study and debate on this matter will be important in developing our policy for the next price review.
- Affordability. Water customers are paying higher bills than previously to meet the cost of environmental improvements, network maintenance and better drinking water. In some parts of the country there is growing concern with some customers having difficulty affording their bills. The demands of the Water Framework Directive (WFD) and other cost pressures could put a greater focus on the affordability of water and sewerage services. Defra is reviewing the issue, which will be an important consideration in PR09.
- Timetable issues arising from the implementation of the WFD and the price review. We are working with Defra and the Environment Agency on the implications of river basin plans and subsequent programmes of measures for customers and how costs and benefits can be determined.
- Whether companies' licences need to be modified as part of the PR09 process, particularly in relation to interim and substantial effects determinations.

1.4 Market competition

The new water supply licence regime started in December 2005. To date we have issued four new licences. At present, only the largest customers who use more than 50 megalitres of water per year, around 2,200, may choose their water supplier. Defra is committed to reviewing in 2008 the threshold in the light of the experience of the new regime. We will advise Defra in due course and discuss this matter with interested parties. We will seek to promote competition actively, removing or reducing barriers to entry and encouraging progress, particularly in the new water supply licensing regime. We will monitor closely the progress of the new regime and if necessary resolve disputes and take action to avoid unnecessary delays.

1.5 Consumer Council for Water

The new independent Consumer Council for Water (CCWater) was established on 1 October 2005 with a transfer of staff and resources from Ofwat. We welcome the independence of CCWater. We are working with CCWater to develop a memorandum of understanding to guide how we work together going forward.

We will continue to develop a constructive relationship with CCWater so that consumers have an input to the regulatory regime and that we take due account of consumer views in reaching decisions. We will co-ordinate our work programmes with CCWater to identify areas of common cause and to avoid duplication.

2. Protecting consumers

We have a duty to protect consumers. Each year we monitor the quality of service delivered to consumers by companies and take action if required. We publish the results in our five annual reports on company performance.

2.1 Tariffs and charges schemes

Objective

Our statutory role is to approve each company's charges scheme. We will ensure that companies' charges comply with their price limits, reflect costs and are neither unduly preferential nor unduly discriminatory so that customers pay the correct price for the service they receive.

Approach

To meet our objective, we will:

- Follow our established policy set out in MD152, 'Approval of companies' charges schemes in 2000-01'.
- Review and approve companies' 2007-08 charges schemes in consultation with CCWater.
- Contribute to Defra's review of household charging mechanisms.
- Review our policy on the structure of household charges in the light of Defra's review of household charging mechanisms.
- Update the register of 'special agreements', in April and November.

Outputs	Period
Special agreements register	April and November
Publish the outcome of our review of companies' charges schemes for the current year in our 'Water and sewerage charges report'	May 2006, 2007 and 2008
Approve charges each year	February 2007, 2008 and 2009
Publish the leaflet 'Water and sewerage bills 2007-08' on average bills	Quarter 4

2.2 Vulnerable consumers and social issues

Objective

To protect the interests of all consumers, including the vulnerable, those in debt and those who receive resale services.

Approach

To meet our objective, we will:

- Continue to develop policy on affordability and play an active role in advising Government on debt and affordability issues.
- Continue to monitor debt levels, debt recovery activity and commercial disconnections.
- Monitor the introduction of the new powers (from 1 April 2006) requiring water resellers to provide more information to purchasers.
- Encourage companies to make services accessible to those requiring special assistance.
- Continue to encourage companies to promote the availability of the Vulnerable Group Tariff as part of our monitoring process.
- Review our debt guidelines.
- Participate in the Defra-led affordability pilot study to assess the benefits of targeting assistance to low-income customers. Results are expected in summer 2007.
- Continue to work with Defra and other stakeholders to review the effects on various customer groups of different ways of charging.
- Participate in the Water UK Steering group to undertake further debt research in 2006-07.
- Work with Defra, Water UK and CCWater to organise a workshop promoting good practice in the way in which companies offer the Vulnerable Group Tariff.
- Continue to contribute our thinking to the Public Utilities Access Forum and Water UK's Debt Focus Group.

Outputs	Period
Pre-consultation workshop on review of debt guidelines	May 2006
Publish on our website data on commercial disconnections, domestic debt recovery activity and debt levels	August 2006
Monitor and publish on our website annual data on the numbers of customers registered with companies as requiring special assistance and those receiving the vulnerable group tariff	September 2006
Consultation on review of debt guidelines	June-September 2006

2.3 Disputes and complaints

Objective

To handle complaints fairly, efficiently, and within agreed time limits where possible.

We have particular responsibilities in relation to complaints about:

- connection charges;
- requisition of water mains;
- sewers and lateral drains;
- adoption of and financial arrangements relating to self-laid mains supplying water for domestic purposes;
- a company's refusal to install an optional meter;
- sewer appeals;
- trade effluent appeals;
- pipe laying in streets and in private land;
- Guaranteed Standards Scheme (GSS) payments; and
- allegations of breach of duty by a company.

Approach

To meet our objective, we will:

- Meet performance standards for all categories of dispute and complaints within our jurisdiction and reduce the number of outstanding cases.
- Provide advice on complaint handling to CCWater on a case by case basis or through workshops.

Performance standard

80% of non-investigated cases dealt with within 10 working days

65% of investigated cases resolved within 3 months (65 working days)

80% of investigated complaints resolved within 6 months (130 working days)

2.4 Levels of service to consumers

Objective

To safeguard the quality of services that companies provide to their consumers and encourage companies to make improvements where necessary.

Approach

To meet our objective, we will:

- Take action to secure improvements where service falls below regulatory expectations.
- With CCWater, continue to monitor more qualitative aspects of service through assessments of company practice.
- Continue to hold companies to account for the reliability of the information we collect, and look for opportunities to improve the quality of information from companies, for example on the recording of complaints received by telephone.
- Consider any implications for the overall performance assessment (OPA) for price setting beyond 2009-10 once the review of the length of PR09 is complete.
- Continue to work with stakeholders to develop OPA performance measures. This will reflect the changes in the way the Drinking Water Inspectorate (DWI) and the Environment Agency report performance.
- Recommend to Defra any changes to the guaranteed standards scheme (GSS) arising from our 2005-06 consultation.
- Formally review companies' complaints procedures with input from CCWater.

Outputs	Period
Monitor and publish information on the levels of service provided in our 'Levels of service for the water industry in England and Wales:' including industry level performance against the revised measure for handling telephone calls	October 2006, 2007 and 2008
Recommend any changes to the GSS arising from our 2005-06 consultation	December 2006

2.5 Reducing sewer flooding

Objective

To ensure companies tackle sewer flooding in the short and longer term using approaches that deliver best value for customers in line with the expectations set out at the 2004 price review.

Approach

To meet our objective, we will:

- Continue to work with CCWater and other stakeholders on companies' strategies and policies for preventing sewer flooding and the handling of incidents when they occur.
- Recommend any changes to the GSS and develop practical guidelines arising from the 2005-06 consultation on dealing with sewer flooded customers.
- Work with the industry to continue to improve the quality of data about external flooding and the lesser risk of internal flooding.
- Continue to work with stakeholders to develop best practice for mitigation measures.

- Contribute to the development and implementation of the Government's strategy for flood management.
- Assess feedback from companies on how they educate their customers about the common causes of blockages and how to avoid them. We will share best practice with the industry.

Outputs	Period
Share best practice on educating customers about sewer blockages	Quarter 1
Monitor the delivery of sewer flooding outputs, and report on this in the 'Financial performance and expenditure of water companies in England and Wales' and the 'Levels of service for the water industry in England and Wales' reports	September 2006, 2007 and 2008 October 2006, 2007 and 2008

2.6 Maintaining serviceability

Objective

To ensure the companies' water and sewerage systems continue to deliver reliable service to customers into the future.

Approach

To meet our objective, we will:

- Take action with companies where we judge their serviceability (ability to maintain existing standards of service) is marginal or deteriorating, requiring action plans and more frequent reporting as appropriate.
- Consult on developing our process for assessing capital maintenance requirements in the light of the UK Water Industry Research (UKWIR) review of the capital maintenance planning common framework, the Mott Macdonald review of our approach to capital maintenance, and the independent steering group review of the 2004 price review. We will initiate collaborative follow up work as appropriate.
- Work with the industry to refine serviceability indicators, following publication of the UKWIR review of serviceability indicators, and publish more details of our serviceability assessment process.
- Contribute to joint research initiatives with the UKWIR programme, as appropriate, including ongoing work on sewer deterioration rates.
- Continue to use the June return to inform our understanding of the long-term capital maintenance requirements for each company.
- Review our tools for assessing capital efficiency factors – currently the cost base and econometric models.
- Work with Defra and the industry to develop understanding of best practice in managing odour from sewage treatment activities, including improved cost benefit analysis techniques in this area.

Outputs	Period
Monitor trends in levels of service and asset performance (serviceability indicators) as reported in the June returns. We will publish our analysis in our 'Financial performance and expenditure of the water companies in England and Wales report'	September 2006, 2007 and 2008
Publish the capital maintenance updated econometric relative efficiency analysis in our 'Water and sewerage service unit costs and relative efficiency 2005-06 report'	December 2006, 2007 and 2008
Issue consultation paper 'Developing our process for assessing capital maintenance requirements' and hold workshop	Quarter 1 and 2
Develop and publish our detailed response to the UKWIR review of serviceability indicators	Quarter 2 and 3

2.7 Improving drinking water quality and the environment

Objective

To enable efficient water companies to improve drinking water quality and the environment. We monitor companies' outputs to make sure that they carry out expected work programmes to meet enhanced standards and deliver better water quality and a cleaner water environment. The 2004 price determination set out work for each company, with specific improvements we expect them to deliver by specified dates.

Approach

To meet our objective, we will:

- Work with the DWI to ensure that companies carry out the expected improvements to their water treatment works and distribution systems.
- Work with the Environment Agency to ensure that companies complete the projects to improve the environment in 2005-10 on time, and in a cost-effective way.
- Work with the Environment Agency to ensure that companies achieve and maintain appropriate levels of environmental performance.
- Ask companies to report whether they have completed other projects included in the 2004 price determination, which are not enforced by the quality regulators, for example projects to connect properties to the public sewerage system for the first time.
- Seek assurances from companies on the progress they are making with the early start schemes confirmed in December 2003 and January 2004, and included in our 2004 final determinations. We have asked companies and Reporters to report on progress in their June returns.

- Work with the Environment Agency to hold joint environmental performance meetings with the ten water and sewerage companies. We will also discuss with the DWI companies' progress with improving drinking water quality, and when necessary have joint meetings with companies.
- Continue to participate in Government-led and other groups' initiatives on environmental issues which involve the operation and performance of the water companies.
- Provide input on Government policy initiatives, notably discussion on the ownership and maintenance of sustainable drainage systems; and the Governments' proposals for the possible adoption of private sewers and lateral drains.
- Participate in the Defra-led working group to develop an action plan to address pollution concerns in the River Lee (East London) which may affect the Olympic Games site, as well as considering longer-term initiatives on sewer overflow issues in the Thames Tideway.

Outputs	Period
Publish information on company performance in 2005, 2006 and 2007 in 'Levels of service for the water industry in England and Wales report'	October 2006, 2007 and 2008
Publish information on company progress and expenditure on delivering the AMP4 quality programme in 'Financial performance and expenditure of water companies in England and Wales report'	September 2006, 2007 and 2008

2.8 Water Framework Directive

Objective

The Secretary of State for Environment, Food and Rural Affairs and the Welsh Assembly Government will in December 2009 confirm the river basin management plans and programmes of measures to achieve environmental objectives under the Water Framework Directive (WFD). We will support the implementation of the WFD with the aim of securing an outcome that is fair, proportionate and in the interests of consumers.

Approach

To meet our objective, we will:

- Continue to participate in steering and working groups with Defra and the Environment Agency.
- Provide the information and analysis necessary to allow Defra to report to the European Commission.
- Continue to participate in the collaborative research programme led by Defra. This includes developing the economic analysis to inform the river basin planning process.

-
- Continue to contribute to the cost-effectiveness analysis and the development of cost benefit evaluation.
 - Encourage the development of cost-benefit analysis of proposed environmental improvements.
 - Continue to develop the estimates of the potential cost of implementing the WFD for companies and customers.

2.9 Supply and demand for services

Objective

To assess companies' performance in meeting demand for water services by delivering the right blend of leakage reduction, resource development and demand management, and by promoting the efficient use of water. To support and monitor the industry in promoting the efficient use of water by consumers.

Approach

To meet our objective, we will:

- Jointly with the industry and the Environment Agency, continue to monitor the water resources position during the current drought and the companies' response to it, particularly in the south-east of England.
- Monitor companies' delivery of supply/demand balance outputs, including improvements to the security of water supplies through reviewing June returns and annual water resource plan updates.
- Continue our participation with the Government, the industry, the Environment Agency, CCWater and others in the Water Saving Group, on collaborative work to improve understanding of the drivers of the supply/demand balance and long-term options to secure public water supplies.
- Continue to monitor meter uptake and assess trends.
- Determine disputes about the terms of bulk supply agreements as appropriate.
- Contribute to the industry's assessment of the need for the sewerage system to meet future demand, allowing for changes in weather patterns and new housing development.
- Provide input to any future consultations on water scarce area status applications.
- Contribute to the National Audit Office (NAO) study on meeting demands for water.
- Work with the industry, the Environment Agency, Defra, CCWater and waterwise, in particular as a member of the Water Saving Group, to improve our understanding of the cost-effectiveness of companies' activities to promote the efficient use of water by their customers.

- Continue to support the Ofwat economic research category in the Environment Agency's water efficiency awards. We will also participate in shortlisting and judging entries.
- Review the companies' June returns and publish our analysis of their promotion of the efficient use of water in our 'Security of supply, leakage and efficient use of water: 2005-06 report'.

Outputs	Period
Contribute to and publish 'Security of supply, leakage and efficient use of water report'	October 2006, 2007 and 2008

2.10 Reducing leakage

Objective

To ensure companies carry out their duty to maintain an efficient and economic system of water supply based on reducing leakage to its economic level.

Achieving and maintaining the economic level of leakage forms a key plank of companies' delivery of security of supply for customers. Where security of supply is under pressure, either in the short term due to drought, or in the longer term due to pressures such as growth, companies' approach to leakage is particularly important. In such cases we will place particular emphasis on understanding and monitoring companies' approaches to managing leakage and take any additional measures as necessary.

Approach

To meet our objective, we will:

- Analyse the 2006 June return leakage results, recommend action where necessary, and publish the leakage performance press notice at the end of July 2006.
- Continue to monitor closely the performance of Thames Water and United Utilities on their leakage recovery programmes (as set out in our 'Security of supply, leakage and efficient use of water: 2005-06 report') and take additional measures if necessary.

Outputs	Period
Publish leakage performance data	July 2006
Publish 'Security of supply, leakage and efficient use of water report'	October 2006, 2007 and 2008

2.11 Sustainable development

Objective

Since 1 April 2005 we have had a new duty to 'exercise and perform our duties in the manner best calculated to contribute to sustainable development'.

Approach

To meet our objective, we will:

In June, review responses to our published consultation on sustainable development. We consulted on:

- Our initial interpretation of what sustainable development means to us.
- How we think we can contribute to sustainable development.
- What we think the key issues will be for the next price review and beyond.

Based on the consultation we will develop proposals on our approach to our new sustainable development duty. We expect to announce our findings in the third quarter of 2006-07.

Sustainable development is an inherent part of our working practices; for example we reviewed our own operations to encourage more recycling and cut energy use. We will continue to review our working practices.

Outputs	Period
Issue response document	Quarter 3

2.12 Company reporters and auditors

Objective

We take seriously the quality of the information that companies submit to us. We expect this information to be reliable, accurate and complete. We also expect high standards of corporate governance including rigorous systems of internal controls that operate throughout the company. We will ensure companies' information returns are subject to independent scrutiny and audit.

Approach

To meet our objective, we will:

Reporters

- Keep under review the quality of information provided to us by companies and if necessary take action to secure improvements.

- Continue to use appropriately experienced consultants to act as our independent reporters to help us obtain reliable comparable regulatory information from each company, for example in the June returns and for any interim determination of price limits.
- Approve the appointment of reporters when contracts end or reporters resign, and manage the transition to new reporter appointments.
- Ask reporters, where appropriate, to assist us in special investigations or regulatory action and to support the auditors in their examination of regulatory accounts.
- Review and approve reporters' audit plans and set ceiling costs for their work.
- Review reporters' performance in liaison with companies in quarter 4 of 2006-07.
- Review the role and performance of reporters during the 2004 price review to inform our expectations for future price reviews.

Outputs	Period
Continue to hold workshops and briefings for the reporters and auditors in order to maintain their awareness of regulatory priorities and policies, and ensure an effective dialogue between us	Quarter 3 2006
Give feedback and make awards for the best reporters for their reports on the 2006 June return	Quarter 3 2006

Auditors

- Require auditors to provide an audit opinion on the regulatory accounts.
- Continue to use auditors to carry out agreed procedures (and report their findings to us) on information to help us obtain reliable comparable regulatory information from each company, for example the June returns, principal statements and any interim determinations of price limits.
- For all companies ahead of the 2006-07 June return submission:
 - Review the role of auditors and our co-ordination of their work to ensure we maximise added value.
 - Review our guidance to auditors to ensure this is sufficiently detailed and carefully drafted.
 - Consider issuing company-specific guidance to auditors in the same way as we do for reporters.
 - Request each auditor for each company to identify a named individual who will take responsibility for reporting to us.
 - Require an annual meeting with auditors to ensure our requirements are fully understood.
 - Hold an induction meeting when a company changes its auditors in the same way as we do for reporters.

Outputs	Period
Continue to hold workshops and briefings for the reporters and auditors in order to maintain their awareness of regulatory priorities and policies, and ensure an effective dialogue between us	May 2006

2.13 Special investigations

Objective

Our objective is to ensure that all stakeholders have confidence in the regulatory process and that where problems emerge, we will investigate. Where appropriate customers will be compensated and penalties imposed on the companies.

During 2006-07 we will take forward investigations relating to Severn Trent Water Limited (Severn Trent Water) and Southern Water Services Limited (Southern Water).

Approach

Severn Trent

We have been conducting an investigation into allegations made against Severn Trent Water. In May 2005 we referred our concerns to the Serious Fraud Office (SFO) about the reliability of certain regulatory information provided by Severn Trent Water. The SFO concluded that the matter was sufficiently serious to warrant a separate investigation by it. It commenced this investigation in October 2005.

In March 2006 we published a report setting out our interim conclusions on some of the issues raised. We found that Severn Trent Water's failure to meet its obligations in respect of the provision of information would have led to the overcharging of customers by £42m over the period 2004-05 to 2009-10.

Prior to commencing our investigation we obtained a written assurance from the company that if it were ever found that customers had been overcharged, any necessary corrections would be made. Severn Trent has agreed to return the £42m to customers promptly.

When the SFO's investigation is complete we will:

- Set out our conclusions in full including our findings on those matters currently being considered by the SFO.
- Consider with the company what further redress to customers is appropriate.

We have identified a number of other actions that Severn Trent must take to ensure we can have confidence in its data in the future. We will continue to monitor Severn Trent's progress in addressing our requirements.

We have also identified some actions needed to strengthen the data collection across the industry and have either already implemented or have set out a timetable for implementing them (MD213 'Interim report on allegations made against Severn Trent Water').

In late February 2006, Severn Trent Water informed us it was conducting an internal investigation into irregularities in customer services data. In April 2006, we launched an independent review into these matters using forensic accountants who will report both to us and the company. It is too early to say what the financial implications of misreporting are or when we expect to complete our investigation. Severn Trent Water has given us an undertaking that customers who have been disadvantaged will be reimbursed.

Southern Water

In October 2005, Southern Water notified us of irregularities regarding the reporting and handling of response levels to customer enquiries and complaints. We have begun an investigation into these irregularities and together with Southern Water have appointed independent forensic accountants, KPMG LLP, to work on our behalf. The company has also referred the issues to the SFO.

We have obtained an undertaking from the company that it will not benefit to the detriment of its customers from any irregularities found by the investigation. We have issued a notice to the company of our intention to fine in respect of the failure to meet performance standards which have occurred since 1 April 2005. Our power to fine does not cover performance failures prior to that date.

Our outputs in respect of this investigation are dependent upon the completion of our investigation and whether the SFO decides to take this matter forward itself. We cannot say exactly when this will be. The issues raised are complex and it is likely to take some time to investigate these irregularities.

We will carry out a thorough review of the matters raised when we have completed our investigation, including:

- Considering the need for and amount of any penalty to be imposed upon the company.
- Identifying any actions that we will require Southern Water to take to ensure we can have confidence in its data in the future.
- Considering whether there are any industry-wide actions that we need to take as a result of our findings.

Outputs	Period
Determine level of penalty adjustment for Severn Trent and publish final report	Dependent upon SFO investigation
Modify Severn Trent's Licence Conditions F/add Condition P to Severn Trent's Licence	Quarter 2
Monitoring of Severn Trent's improvements to its internal systems and controls	Ongoing on a quarterly basis
Investigate and monitor the performance of Southern to ensure improvements are made	Ongoing on a quarterly basis
Investigate the misreporting of customer relations data by Severn Trent	Ongoing

3. Company finance and incentives

Our approach to regulation provides a broad range of incentives – carrot and stick – to companies to improve their efficiency and service. These are based on a framework of comparative competition using a range of quantitative and qualitative indicators. We make appropriate comparisons, drawing on relevant information from other sectors and international comparisons where available. Our analysis and policy approach aims to incentivise companies to improve performance and deliver the requirements set out in price determinations.

3.1 Comparative competition

Objective

Our objective is to promote continued improvements in company service, performance, compliance, leakage, security of supply and efficiency by the use of comparative competition.

Approach

To meet our objective we will:

- Carry out a thorough analysis of operating and capital maintenance expenditure data provided in the June returns.
- Continue to encourage efficient and effective procurement practices in the water industry, and report on the industry's progress in attaining efficient procurement.
- Use the comparative information available to us to ensure that there are strong incentives to improve performance in the post-2005 period.
- In quarter 2 of 2006-07, review the sewage sludge econometric models for operating costs and capital maintenance in the light of new approaches to sludge management.
- Continue sponsorship of a postgraduate research project (with Aston Business School) into the regulatory use of panel data analysis for assessing company and industry efficiency.
- Participate in a thorough review of our approach to efficiency assessment in collaboration with UKWIR, in response to recommendations made in the independent steering group report on the 2004 price review.

Outputs	Period
Publish our 'Financial performance and expenditure of the water companies in England and Wales report'	September 2006, 2007 and 2008
Participate fully in steering the joint review of the approach to efficiency assessment in regulating the water industry	Quarters 1 and 3

3.2 International benchmarking

Objective

Our objective is to collect information to help us to develop and improve incentives for companies to become more efficient and to provide better services to customers.

Approach

To meet our objective, we will:

- Develop benchmarking contacts with the Scandinavian 'six cities' group and other countries.
- Contribute regulatory inputs to Defra-supported programmes in developing countries.
- Continue to welcome visits from overseas visitors. We are keen to use such opportunities to develop our international comparisons.

Outputs	Period
Publish International comparisons report	March 2007, 2008 and 2009

3.3 Financial performance and regulatory accounts

Objective

To ensure that companies are operating within the expectations set out in price limits. In July 2006 companies will submit their regulatory accounts. These provide information on revenues, expenditure and overall financial performance. These accounts are underpinned by regulatory accounting guidelines (RAGs).

Approach

To meet our objective, we will:

- Analyse the regulatory accounts and publish our findings in our 'Financial performance and expenditure of the water companies in England and Wales 2005-06 report'.
- Hold six-monthly City briefings to explain our policies to investors and analysts.
- Consult on proposed changes to the regulatory accounts tables in the June returns and on changes to RAGs 1 and 3. The changes will be effective for the 2007 June returns and regulatory accounts. We will review the responses and issue revised guidance later in 2006.

Outputs	Period
Publish 'Financial performance and expenditure of the water companies in England and Wales report'	September 2006, 2007 and 2008
Issue revised guidance on RAGs and June returns	Quarter 3
City briefings	Six monthly

3.4 Independence of the regulated businesses

Objective

To safeguard both the financial ring fence around, and managerial independence of, the regulated businesses. To ensure that the price limits we set reflect the true operating costs of the regulated companies and that these are not inflated by cross-subsidy to other companies in the same group.

Approach

To meet our objective, we will:

- Monitor compliance to ensure the financial ring fence is maintained.
- Liaise with companies on the appointment of new non-executive directors to ensure that licence requirements on their independence and experience are satisfied.
- Monitor transactions between companies and associates, and investigate areas of concern.
- Ensure companies comply with their licence requirements on arm's length trading and ring fencing.
- Take appropriate remedial action where instances of failing to trade at arm's length are identified.

Outputs	Period
Publish a summary of our work on transfer pricing in our 'Financial performance and expenditure of the water companies in England and Wales 2005-06 report'	September 2006, 2007 and 2008

3.5 Financial restructuring

Objective

To make sure that customers of the monopoly water companies are protected from any undue additional risk arising from a particular structure. Since the final determinations in December 2004, companies have continued to increase gearing and return capital to shareholders, albeit on a more limited scale than the restructuring that followed the 1999 review.

Approach

To meet our objective, we will:

- Respond to any further restructuring proposals as they arise. These proposals may arise as a result of a strategy adopted by new owners of a regulated company or as the result of internal restructuring.
- Consider whether it is appropriate to strengthen the financial ring fence by making licence modifications, for example cash lock-up provisions, to protect customers following restructuring activity.

Outputs	Period
Respond to restructuring proposals	Case-by-case basis

3.6 Mergers

Objective

To ensure that the ownership structure of the companies maintains incentives for improved efficiency and performance. To ensure that customers are protected when there is a change of ownership for a regulated company.

Approach

To meet our objective, we will:

- Assess with an open mind each merger proposal within the industry and submit evidence to the Office of Fair Trading (OFT) and to the Competition Commission on the potential detriment to the comparative regime and any proposals to offset that detriment.
- In the event of other mergers leading to a change of ownership for a water company, publicly consult on the regulatory issues arising from the transaction, providing advice to the OFT as necessary.

During 2005, RWE announced its intention to divest both RWE Thames Water and its US water operation American Water, in order to focus on its energy business. Its intention is to complete the sale of both entities during 2007, satisfying all regulatory requirements.

The view of the market appears to be that, going forward, debt finance will play a significant part in any proposed financing structure for Thames Water. We will look at any individual proposal on its merits, recognising that Thames Water has significant uncertainty relating to future capital requirements and therefore it needs a strong financial and credit position. We would expect it to remain comfortably within investment grade under any new ownership.

We will consult on the regulatory issues arising from this proposal.

Outputs	Period
Issue consultation papers on proposed mergers	Case-by-case basis
Issue position notes on proposed mergers	Case-by-case basis
Respond to sale of Thames Water by RWE	As required depending on divestment timetable

3.7 Interim determinations of price limits

Objective

Either we or a company can initiate an interim determination of price limits by following the criteria in the company's licence. We can reassess a company's price limits between price reviews if its costs or revenues change materially in specific areas.

Approach

To meet our objective, we will:

- In quarter 1 of 2006 issue a MD letter detailing the process to be followed for processing any interim determination applications which may be triggered by us or received on or before 15 September 2006.
- Discuss with companies any potential issues that need handling through the change protocol or interim determination process.
- Take account of material changes (relevant changes of circumstances and notified items) from the assumptions on relevant items on which price limits were based at the last price review.
- Review the AMP4 change protocol by quarter 4 of 2006-07 to make sure that it continues to perform as intended in relation to the price limits for 2005-10. We will report on the findings.

Outputs	Period
Issue an MD letter detailing the process to be followed for processing any interim determination applications	Quarter 1

3.8 Promoting competition

Objective

The WA03 requires us to protect the interests of consumers, wherever appropriate by promoting effective competition. Competition includes water supply licence arrangements, self-lay and inset appointments. We will seek to promote competition actively, removing or reducing barriers to entry and encouraging progress, particularly in the new water supply licensing regime.

Approach

To meet our objective, we will:

- Monitor the operation of the new water supply licensing (WSL) regime, which came into effect on 1 December 2005, to assess its effectiveness and to assess areas for improving our guidance and processes. We will continue to use our WSL advisory groups to help us. We will if necessary take action to deal with avoidable delays.
- Work with CCWater to survey WSL stakeholders in 2006-07. This survey will focus in particular on eligible customers and seek their views on the new WSL regime.
- Resolve disputes, make determinations and respond to enquiries about the WSL regime while continuing to communicate the opportunities provided by the new WSL regime and the existing inset appointment and self-lay mechanisms.
- Continue to apply the Competition Act 1998 (CA98) to examine potentially anti-competitive behaviour and take appropriate and proportionate action wherever necessary.
- Encourage customers, developers, contractors and potential entrants to pursue competitive options where appropriate. Monitor developments in Europe, which may affect competition in the water sector in England and Wales.
- Consider what other actions we might take to protect the interests of consumers, wherever appropriate by promoting effective competition and challenging anti-competitive behaviour.
- Continue to promote a competitive mains-laying market, which now includes multi-lay where the contractor is responsible for installing more than one utility service to the site.
- Process completed applications for inset appointments and water supply licences, and provide advice to potential applicants on the process and criteria that they must meet.
- Develop our approach to non-routine inset applications which may require a different approach to regulation and price setting.
- Work with the industry in 2006-07 to revise our guidance on applying for inset appointments and any WSL guidance that needs amending in the light of practical experience.
- Respond to any appeals to the Competition Appeal Tribunal (CAT).

Output	Period
Publish revised guidelines on the application of the CA98 in the water and sewerage sectors for consultation in 2006-07	Quarter 4
Publish our annual report on progress on competition complaints	Quarter 1 2006, 2007 and 2008
In conjunction with CCWater, survey WSL stakeholders	Quarter 4
Issue water supply licences and grant inset appointments	Ongoing
Publish revised inset appointment guidance	Quarter 3
Publish a report on companies' indicative access prices	Quarter 3
Competition Appeal Tribunal (CAT) appeals	As they arise

4. Resources, communications and governance

4.1 Resource management

Objective

Our aim is to provide value for money to customers and keep the regulatory burden on companies to a minimum. We are accountable to Parliament and are required to meet Government accounting standards.

Approach

To meet our objective, we will:

- Review our budget on a regular basis and where possible make efficiencies.
- Benchmark our procedures and costs to other economic regulators.
- Provide shared services to CCWater seeking economies of scale where these are of mutual benefit.
- Prepare our resource accounts in line with the requirements of the NAO and HM Treasury.
- Develop our personnel strategy to ensure our effectiveness as a regulator.
- Manage our office accommodation efficiently and in line with our sustainability aims.
- Recover licence fees of £11.8 million to fund our expenditure budget and also use underspend from previous years of £0.6m (see below).

The budget estimates are as set out below.

	2005-06	2006-07	2007-08
Budget estimate	£12.1m	£12.4m	£12.4m

4.2 Information management

Objective

We balance our need for information to regulate with minimising the regulatory burden on companies. To do this we have established an industry-wide information requirements consultative group and work with CCWater to avoid unnecessary duplication of effort.

Approach

We have a range of computer-based tools to collect, process and store regulatory information, which need to be updated ahead of the next price review in 2009. We are now developing our information management systems with the aim of improving effectiveness and helping the office to work smarter. The new systems will enable the

office to accommodate an increasingly diverse user base including external stakeholders.

A study of current best practice within both Government and the wider public sector evaluated a range of alternatives, including open source software. As a result, we initiated a long-term project to restructure our entire software suite, called Project Reservoir.

Project Reservoir aims to build new systems that:

- maintain and improve on the current systems' functionalities and service;
- are better integrated;
- are easier to maintain; and
- have a seamless link between internal and external systems.

4.3 Governance

Objective

It is important that all our stakeholders have confidence in the rigour of our decision making and transparency of process. The establishment of the WSRA requires the implementation of a framework of new corporate governance arrangements. Our aim is to ensure stakeholders have confidence in our governance.

Approach

To meet our objective, we will:

- Publish the Board's rules of procedure.
- Publish our draft code of practice for consultation.
- Publish minutes of the Board's meetings.
- Establish a new Audit Committee.
- Establish a new Remuneration Committee.
- Develop our risk management procedure.
- Ensure regulatory impact analysis is carried out for new policy initiatives.
- Consult on our 'Forward programme 2007-08 to 2009-10' in October 2006.

4.4 Joint working

Objective

As required in the WA03 we will establish a number of Memoranda of Understanding between stakeholders to facilitate joint working.

Approach

To meet our objective, we will:

- Develop MOUs with Defra, the Welsh Assembly Government, the Environment Agency, and CCWater.
- Review and if necessary, update MOUs with the DWI and the Health and Safety Executive.

4.5 Keeping stakeholders informed

Objective

We are committed to publishing information to allow consumers and other stakeholders to understand what we are doing and have their say in regulatory decisions.

Approach

We work hard to ensure that our approach and the decisions we make are made available to our stakeholders in plain English in a timely fashion. We keep people informed about our activities through our website publications, leaflets, our newsletter 'H2Ofwat', media briefings, press notices and workshops.

Our library is the main point of contact with the public and handles the majority of enquiries.

Our website is our prime communications tool and we make sure that anything we publish is placed on the website as soon as it is available. We offer an e-mail subscription service that automatically notifies subscribers each time something new is added to the website.

As in previous years we monitor the activities of Parliament, the Welsh Assembly, the London Assembly and the European Union. We will respond to enquiries from elected representatives and provide written and oral evidence to committees where requested.

To meet our objective, we will:

- Continue to develop our website as a key part of our communications with the public, to ensure it is easily accessible.
- Strive to produce publications that are easy to read.
- Involve stakeholders in our activities through a range of consultations, publications, workshops and meetings.
- Consider how we can develop the way in which we engage with our stakeholders.

4.6 Better regulation

Objective

In accordance with section 39 of the WA03 we will have regard to the principles of best regulatory practice.

Approach

In developing our policy we take account of the principles of better regulation: accountability, transparency, proportionality, consistency and targeting. We are working towards achieving better regulation across the industry. We welcome suggestions on how this can be achieved.

To meet our objective, we will:

- Work with Defra and others to pull together better regulation activities and contribute to achieving these.
- Keep abreast of better regulation initiatives and take them forward wherever appropriate.
- Contribute to the NAO's work to develop criteria for best practice in regulatory information management. We will take account of its findings where appropriate.
- Consider the outcome of PricewaterhouseCoopers' study into the cost of regulation when its results are published.

4.7 Freedom of Information

Objective

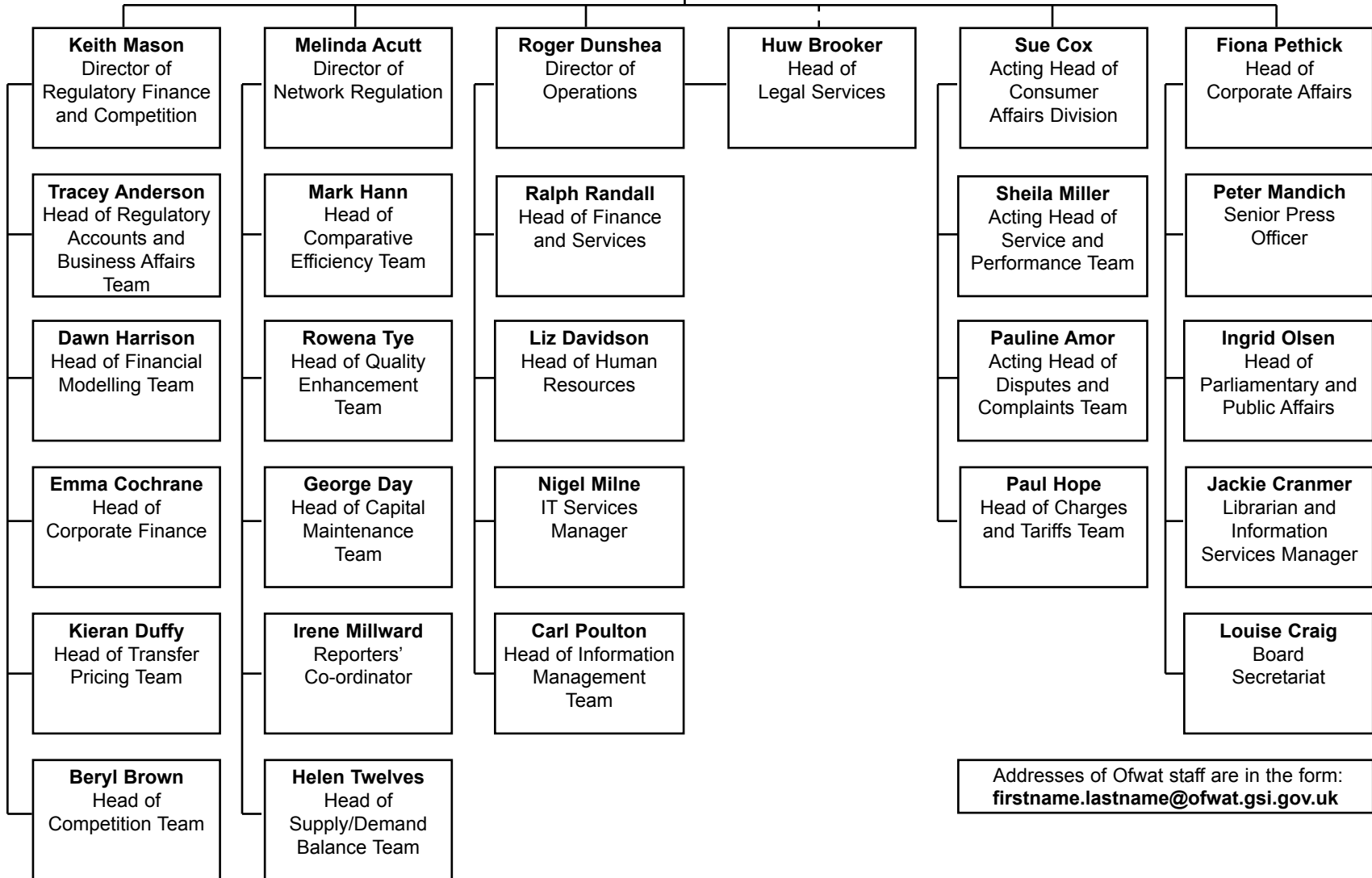
We handle information requests under the Freedom of Information Act 2000 (FOIA) and Environmental Information Regulations (EIRs). We handle any request on the presumption of disclosure, whilst paying due regard to the public interest and information provided by third parties.

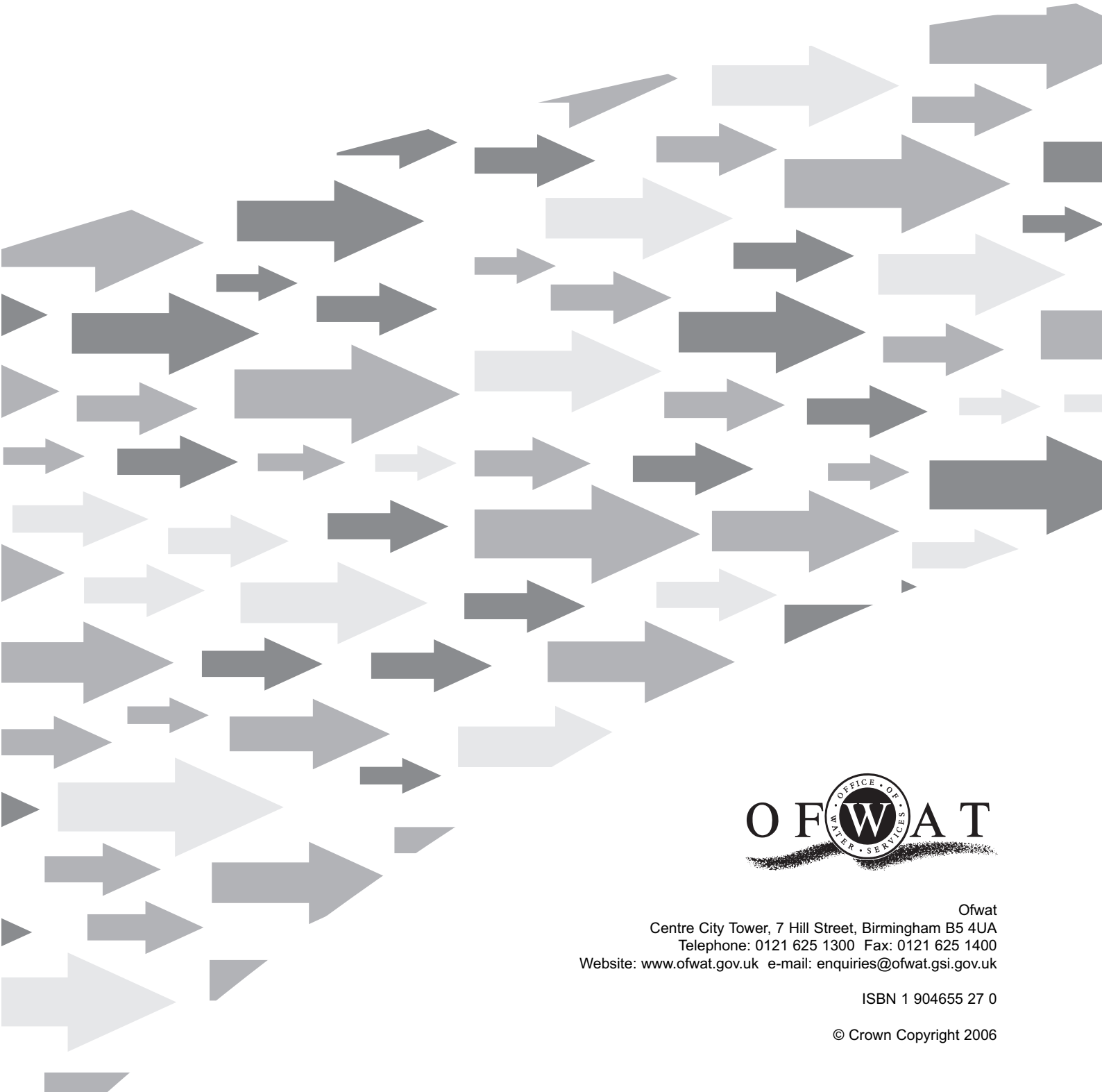
Approach

To meet our objective, we will:

- Respond to requests under the FOIA and EIRs.
- Place information on our website if it is of interest to the general public.
- Monitor and record FOIA and EIRs requests to ensure that we handle them properly and meet the deadline for responses. We make quarterly reports to the Department for Constitutional Affairs (DCA) on FOI requests.
- Keep abreast of all developments and guidance from the DCA, Defra and the Information Commissioner.
- Review our publication scheme annually.

Water Services Regulation Authority: Chairman – Philip Fletcher	
Non-Executive Directors Penny Boys Peter Bucks Jane May Lord Whitty	Executive Directors Acting Chief Executive: Philip Fletcher Keith Mason Melinda Acutt Secretary to the Board: Fiona Pethick





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