Ofwat forward programme
2007-08 to 2009-10

Ofwat – Protecting consumers, promoting value and safeguarding the future

www.ofwat.gov.uk

OFWAT

Ofwat forward programme 2007-08 to 2009-10

April 2007

Contents

We will protect consumers by:

- wherever appropriate, promoting effective competition;
- determining each company's price limits at each price review and, if necessary, between price reviews to make sure that customers pay only the costs of efficiently delivered water and sewerage services;
- making sure that companies' annual charges comply with their price limits and are neither unduly preferential nor unduly discriminatory;
- protecting the interests of the vulnerable, those in debt and those who receive resale services;
- handling complaints fairly, efficiently, and within the published targets where possible;
- making sure companies deliver good service to their consumers and make improvements where necessary;
- making sure companies reduce sewer flooding in the short and longer term using approaches that deliver best value for consumers;
- challenging companies and quality regulators to show investment proposals provide sustainable good value for consumers;
- safeguarding both the financial ring fence and managerial independence of the regulated businesses and making sure that costs are not inflated by cross-subsidy to other companies in the same group;
- making sure that consumers of the monopoly water companies are protected from any undue additional risk arising from a particular financial structure or merger and that incentives are maintained for improved efficiency and performance; and
- making sure that companies' information returns are subject to independent scrutiny and audit by auditors and reporters.

We will promote value by:

- incentivising continued improvements in company service, financial performance, compliance, security of supply, capital and operating efficiency by the use of comparative competition and international benchmarking;
- making sure leakage is controlled efficiently in the best interests of consumers and the environment;
- making sure that companies are operating within the expectations set out in price limits using information on revenues, expenditure and overall financial performance;
- providing effective economic challenge on the costs and benefits of new schemes or proposals put forward by stakeholders; and
- fully researching consumers' expectations of value.

We will safeguard the future by:

- making sure the companies' water and sewerage systems continue to deliver reliable service to consumers into the future;
- enabling water companies to improve drinking water quality and the environment efficiently and effectively, and making sure the expected work programmes are carried out;
- making sure companies manage the supply and demand for services sustainably over the long term. This includes leakage reduction, resource development and sharing, and by promoting the efficient use of water; and
- playing our part in encouraging assessment of the carbon impact of the industry, and appropriate mitigation and adaptation to address climate change.

Overview by Chairman and Chief Executive

This forward programme identifies the strategic outcomes we want to see delivered in the interests of consumers. These outcomes are the building blocks for the delivery of good value, sustainable safe and secure water and wastewater services to consumers now and in the future. Alongside our forward programme, we are also publishing our sustainable development action plan. This sets out how we intend to embed our duty to contribute to sustainable development in all that we do.

We consulted on our draft forward programme in December 2006. Many of our stakeholders commented on that draft in writing and at a workshop. We are grateful for all their contributions, which are reflected here and set out in more detail on our website at www.ofwat.gov.uk.

We look forward to working with stakeholders to protect consumers, promote value and safeguard the future.

Philip Fletcher
Chairman

Regina Finn
Chief Executive

1. Executive summary

The strategic focus of our work in the next three years will be on the following areas. For each area we have identified the outcomes we want for water consumers in the long term and the outputs we will deliver in the short term to arrive at these outcomes. We consulted on our draft forward programme in December 2006. The results of that consultation are reflected in this final document.

1.1 Security of supply

We want:

- a safe, sustainable and reliable water supply for consumers;
- each water company to finance and efficiently deliver the service its customers want and are willing to pay for; and
- evidence-based decisions on the best value way of balancing supply and demand for water and drainage, including water efficiency.

We will achieve this by:

- contributing to the work of the Water Saving Group;
- challenging water companies' water resource plans;
- developing guidance for 25-year sewerage supply/demand plans;
- investigating changes to our mechanisms to better incentivise the companies to promote water efficiency; and
- investigating changes to the price control mechanism, including a revenue cap, to better incentivise fair sharing of revenue outperformance between companies and customers.

1.2 Leakage

We want:

- leakage targets that consumers understand and accept; and
- companies that meet leakage targets that reflect the financial, environmental and social cost of leakage and leakage control.

We will achieve this by:

- reviewing leakage target setting; and
- taking action if necessary to enforce leakage targets.

1.3 Harnessing market forces, incentives and innovation

We want:

- each company to own its long-term strategic approach to delivering value, in the same way as it would in a competitive market;
- an industry that is efficient and innovative in seeking to deliver service to its consumers;
- incentives which encourage fresh thinking and innovation; and
- incentives that both encourage outperformance and share fairly any benefits between companies and consumers.

We will achieve this by:

- reviewing and consulting on our incentive mechanisms; and
- reviewing the value of water and the cost that each company incurs at each stage of its process in delivering water and sewerage services so that we can better target our regulatory interventions.

1.4 Market competition

We want:

- effective market competition, which delivers the best outcome for consumers; and
- effective regulation where competition is not yet feasible or not yet effective.

We will achieve this by:

- reviewing the implementation of the water supply licensing regime; and
- reviewing the value of water and the costs that each company incurs at each stage of its processes in delivering water and sewerage services so that we can better target actions to promote effective competition.

1.5 Better regulation and simplification

We want:

- effective and efficient regulation that achieves optimal outcomes for consumers while imposing no more burden than necessary;
- regulation that meets the better regulation principles of transparency, accountability, proportionality, consistency and targeting;
- an appropriate balance to be struck between monitoring performance and compliance enforcement; and
- reliable, accurate and complete data from companies.

We will achieve this by:

- developing and implementing a simplification plan;
- reviewing our annual publications;
- challenging and justifying the need for information requirements at the 2009 price review;
- developing our impact assessment tool; and
- completing investigations into company data issues and making sure that lessons are learnt by all.

1.6 Protecting consumers' interests and promoting good service

We want:

- a clear understanding of what "good consumer service" means to consumers;
- each company to strive to achieve the same level of good consumer care that would be needed to attract and retain consumers in a competitive market;
- effective incentives to companies to achieve good standards of consumer service; and
- good value for customers in all aspects of investment.

We will achieve this by:

- reassessing the overall performance assessment and other service indicators to ensure that more aspects of customer experience are visible and that we can recognise improvements which deliver consumer expectations;
- considering the extent to which formal company performance standards might be useful in securing specific aspects of service;
- reviewing our policy on charging mechanisms for the future;
- working with others to develop the market research strategy for the 2009 price review to make sure it delivers a clear understanding of consumers' views; and
- challenging each company to demonstrate sound analysis of the benefits from its investment in raising environmental service standards.

1.7 Setting price limits for 2010-15

We want:

- price limits that deliver the best value for consumers and allow efficient companies to provide a sustainable service into the future; and
- each company to take ownership of its business plans to deliver best value for its consumers.

We will achieve this by:

- requiring each company to produce its own long-term strategic direction statement, and long-term draft and final business plans;
- challenging each company to demonstrate sound analysis of the benefits from its investment in raising environmental and service standards;
- consulting on, and publishing, our approach to the 2009 price review and our information requirements;
- carrying out research, with other stakeholders, on consumers' views arising from the companies' draft business plans;
- publishing our price limit decisions for comment; and
- setting price limits in November 2009.

2. Our strategy for the next twelve months and beyond

This forward programme sets out our strategic priorities for the next three years. It follows our consultation on a draft forward programme in December 2006 and a successful workshop event that many of our stakeholders attended. A summary of the consultation responses, the responses themselves and our response will be placed our website alongside publication of this plan.

Our plan is based on our key objectives and duties (set out in, for example, section 2 of the Water Industry Act 1991 [WIA91]). Under section 2 WIA91 we are required to act in a way that we judge will:

- protect the interests of consumers, wherever appropriate by promoting effective competition;
- enable water and sewerage companies properly to carry out their functions;
- enable them to finance their functions, in particular by securing a reasonable rate of return on their capital;
- have regard to the interests of vulnerable groups;
- promote economy and efficiency on the part of companies;
- secure that water and sewerage companies do not show undue preference or discrimination in their charges; and
- contribute to the achievement of sustainable development.

We also take due account of our general environmental and recreational duties.

Three strong themes dominate our strategy going forward:

- understanding and addressing the reasons for the failure of the current competition regime;
- protecting consumers who, in the absence of competition, receive a service from a monopoly supplier; and
- promoting value and safeguarding the future.

A fundamental element of our work is price setting. In 2007-08, we start the intensive process of work leading up to our final determinations in 2009. The price review is an effective tool that will bring together many of the strategic issues we intend to address.

2.1 Security of supply

Outcomes

- A safe, sustainable and reliable water and sewerage supply for all consumers now and in the future.
- Water companies that can finance and efficiently deliver the service their customers want and are willing to pay for.
- Evidence-based decisions on the best value way of balancing supply and demand for water and drainage, including water efficiency.

Guaranteeing a safe and reliable water supply service is a priority for consumers.

Although winter 2006-07 was wetter than average and the immediate concerns about another very dry year have receded, the sector needs to learn from the experience of the last two dry years. Consumers in the south-east of England had restrictions (such as hosepipe bans) on their water use for months. Future rainfall patterns remain uncertain. Climate change presents a major challenge for the future. Each company will prepare an updated water resource plan for 2010-35 in 2008. We will challenge each company to show that its plan reflects the preferences of its consumers and the needs of the environment. In particular, each company's plan should demonstrate that it balances the willingness of its customers to pay higher bills to avoid restrictions against the cost of reducing restrictions.

Effective leakage management (see section 2.2) and efficient use of water are both important parts of water management. We are members of the Water Saving Group, where we are working with other stakeholders, particularly the companies, the Environment Agency, the Department for Environment, Food and Rural Affairs (Defra), the Consumer Council for Water (CCWater) and Waterwise. Our work will include updating regularly the water efficiency good practice register, which identifies best practice in the delivery of water efficiency advice and support. We will take the lead in reviewing the practicality and benefits for setting water efficiency targets for companies.

We welcome the proposals in recent consultations launched by the Environment Agency and Defra to identify and encourage compulsory metering in areas of serious water stress. Increased metering will enable implementation of more innovative tariffs to provide customers with the ability to make more effective choices about their consumption of water and drainage services.

Currently, only about 30% of customers across England and Wales have meters and the incentives to switch to a meter favour those who use less water. This has consequences for company revenue. We are investigating whether a change to the price control mechanism, to control prices according to forecast revenue, or a mechanism to share revenue outperformance, including a revenue cap, could lead to more appropriate incentives for companies.

This will include consideration of the interaction of incentives around revenue and water efficiency. We will set out our findings in the summer of 2007 and consult on any proposed changes.

In January 2007, the National Audit Office (NAO) reported on 'Ofwat – Meeting the demand for water'. The NAO made a number of recommendations about our approach to water efficiency, leakage, incentives and enforcement. We have accepted the NAO's recommendations and have already initiated a number of pieces of work to address them. For example, we are clarifying our guidance for including water efficiency projects in water resource and business plans. We are also undertaking a project to review the inclusion of environmental and social costs in the economic level of leakage.

Twenty-five-year water resource plans have encouraged the industry to plan effectively to meet supply and demand for water resources. We now want to extend these benefits into sewerage planning by seeking long-term sewerage plans in sewerage companies' business plans.

Outputs (2007-08)

- We will contribute to the work of the Water Saving Group by:
  - consulting on reductions in infrastructure charges where developers build water-efficient homes;
  - updating the water efficiency best practice register; and
  - developing other incentives for companies to improve promotion of water efficiency, including the role of targets.
- We will challenge each company to produce a water resource plan that seeks value for consumers and the environment.
- We are working with stakeholders to develop guidance for 25-year sewerage supply/demand plans, which take into account the developing scenarios on climate change and their potential effect on future services.
- We will investigate changes to our mechanisms to better incentivise the companies to promote water efficiency.
- We will investigate changes to the price control mechanism, including a revenue cap, to better incentivise fair sharing of revenue outperformance between companies and customers.

2.2 Leakage

Outcomes

- Leakage targets that consumers understand and accept.
- Companies that meet leakage targets that reflect the financial, environmental and social costs of leakage and leakage control.

During the dry summer of 2006 some consumers, particularly in the south-east of England, were asked to conserve water and restrictions were placed on their use of water in their gardens. Consumers generally responded well to these requests but they questioned, rightly, whether their water companies were doing all they could to reduce leakage to complement these water-saving initiatives. In this context, we are reviewing, with the companies, the Environment Agency, Defra and CCWater, how leakage targets are set. This will include:

- a new look at assessing environmental and social costs, including an assessment of the leakage carbon footprint (working with the Environment Agency);
- explaining variations in per capita consumption;
- alternative approaches to the economic level of leakage (working with the Environment Agency), that would retain the dynamic flexibility of the present approach;
- lessons learnt from using leakage performance indicators (Water UK);
- understanding consumers' priorities, working with CCWater; and
- explaining leakage targets to consumers.

The initial phases of the work will focus on issues relevant to the 2009 price review and water resources plans which companies will consult on in 2008.

These projects will form a thorough review of leakage target setting and regulation. The initial phase will be completed in the summer of 2007, with subsequent work complete by the end of 2007.

Outputs (2007-08)

- A review of the way leakage targets are set, and guidance to companies on assessing future leakage targets.
- We will continue to monitor and take action where companies fail to meet existing leakage targets.

2.3 Harnessing market forces, incentives and innovation

Outcomes

- Companies that own their long-term strategic approach to delivering value, in the same way as they would in a competitive market.
- An industry that is efficient and effective in seeking to deliver service to its consumers.
- Incentives which encourage fresh thinking and innovation.
- Incentives that both encourage outperformance and share fairly any benefits between companies and consumers.

The prime reason for regulation, which acts as a proxy for market competition, is the absence of competitive pressures. Spurred on by incentive-based price cap regulation, the water companies have become much more efficient since privatisation and this has delivered bills to customers that are lower than they would otherwise have been. However, with the exception of the limited competition as described in 2.4 below, the water companies are virtual monopolies in their regions.

The number of companies allows us to compare performance and it is this comparative competition that provides the mechanism for competition in the absence of market competition. We compare companies' performance using a number of techniques, such as league tables, econometrics, incentive mechanisms and peer pressure.

Our aim is to continue to promote efficiency, innovation and improvements in services. We also want to see each company taking ownership of its long-term strategic approach, delivering value in the same way as it would in a competitive market. The strategic direction statements that each company will produce at the start of the process for reviewing price limits will need to demonstrate a clear understanding of consumers' priorities.

Significant efficiency gains and service improvements have been achieved through the incentive-based regulatory framework to date. For the future, incentives may need to be strengthened further to promote further efficiency. We will consider the outcome of the UK Water Industry Research (UKWIR) study on techniques for assessing comparative efficiency. We will also review and consult on our incentive mechanisms as we prepare for the 2009 price review.

As private companies, the water companies should be seeking best value in all their areas of operation, for example open market testing of business activities and outsourcing of services where this is the best solution. The most efficient approaches will deliver best value for consumers over time.

To underpin a number of strategic areas, we believe it is essential to identify clearly the value of water and costs that each company incurs at each stage of the process to deliver water and sewerage services. Understanding this is essential to the development of a number of our strategic issues. For example, understanding the costs at each stage of production would help us to identify where competitive pressures could be most effective, allowing us to design regulatory interventions in a proportionate and targeted manner. Understanding the value of the water lost through leakage is already fundamental to our approach to the economic level of leakage.

A clear and consistent allocation of costs will allow price limits to be set on a fair basis, reflecting the costs that each group of customer incurs. It will also enable customers to better understand the service they are buying and what they are paying for each component of that service. Ultimately, where market competition develops, it will allow eligible customers to understand, compare and choose different options for the components of the service they wish to buy.

Outputs (2007-08)

- We will review and consult on our efficiency and incentive mechanisms as we prepare for the 2009 price review.
- We will challenge each company to produce a strategic direction statement that sets out its long-term vision and why this is best for its consumers and the environment.
- We will challenge each company to produce investment plans that are clearly part of a long-term cost-beneficial plan for its consumers and environment.
- We will consult on business plan reporting requirements in November 2007.
- We will begin a review of the value of water and costs that each company incurs at each stage of its process in delivering water and sewerage services so that we can better target our regulatory interventions.

2.4 Market competition

Outcomes

- Effective market competition which delivers the best outcome for consumers.
- Regulation where competition is not feasible or not yet effective.

In the absence of competition, we regulate as a proxy to deliver the consumer benefits that would otherwise be derived from competition. Our aim is to promote effective competition wherever possible in the water sector. Until December 2005, we had to rely mainly on general competition powers. Since then, we have had the new water supply licensing (WSL) regime, but it is open only to consumers who are likely to buy at least 50 megalitres of water a year (approximately 2,200 businesses). More than a year later, we are concerned that there has been little or no progress in the development of market competition.

Defra is committed to reviewing the effectiveness of the WSL regime by 2008, including the 50 megalitre threshold. In light of our experience to date, we believe that a more extensive review, wider than simply the threshold, is required to identify how we should capture the benefits of competition for consumers. We wrote to Ministers to this effect on 28 November 2006. We will contribute to any wider government review of the issues.

In light of our concerns, we are conducting an internal review of the WSL regime. The review will focus on the implementation of the WSL regime. In addition, we will publicly consult on changes to our guidance documents and to conditions of appointment that can be made to improve the way the current regime works in the short term.

This will be followed by a more extensive public consultation later in 2007 on all aspects of market competition including issues such as the 50 megalitre threshold and access pricing rules (the costs principle). We will be looking to identify any barriers or obstacles to competition and how these might be addressed. The review will aim to address concerns raised by stakeholders.

We are consulting customers through CCWater and directly to better understand attitudes to competition within the industry across different customer groups.

This review is separate from, but linked to, the project on a better understanding of the value of water and the costs incurred by companies at each stage of the chain of supply (see section 2.3). A better understanding of costs will enable us and others to see where effective competition can be beneficial.

The current competition framework also allows for inset appointments. The criteria for these have meant their take up has been largely confined to larger consumers. More recently, however, there have been tentative proposals for inset appointments involving new housing developments and, as such, domestic consumers. These pose novel questions for the potential inset appointee, the ultimate consumer (the householder), the developer, ourselves and other regulators, which we will explore further.

Outputs (2007-08)

- We will review the implementation of the WSL regime, including:
  - consulting on options for change within the current framework;
  - consulting on changes to conditions of appointment;
  - publishing updated WSL guidance following consultation;
  - consulting on wider changes to the industry to facilitate competition (this will include a review of inset appointments); and
  - consulting on detailed options for the water industry to promote effective competition.
- We will begin a review of the value of water and costs that each company incurs at each stage of its processes in delivering water and sewerage services so that we can better target actions to promote effective competition.

2.5 Better regulation and simplification

Outcomes

- Effective and efficient regulation that achieves optimal outcomes for consumers while imposing no more burden than necessary.
- Regulation that meets the better regulation principles of transparency, accountability, proportionality, consistency and targeting.
- An appropriate balance between monitoring performance and compliance enforcement.
- Reliable, accurate and complete data from companies.

We are committed to the principles of better regulation and keeping the regulatory burden to the necessary minimum. However, in this monopoly industry, we need sufficient information to protect consumers by monitoring the delivery of service and taking regulatory or enforcement action if a company fails to deliver.

We are committed to protecting consumers and need to demonstrate, through our use of key measures, outputs and comparative competition, that consumers are receiving service at least as good as that which would be provided in a competitive market. We do not take regulatory action lightly but we believe that this is an important tool available to ensure that consumers have confidence in the protection we are providing.

Setting price limits necessarily requires companies to provide draft and final business plans. We will balance the data burden on companies with our need for sufficient data to determine robust price limits. Our requirements should be similar to the information companies need for their own planning purposes. We are committed to providing efficient, fit for purpose information collection and modelling systems to our stakeholders to support annual monitoring and price review outputs. We will complete our investigations into problems with data supplied to us by some companies and work to learn and share lessons for the future.

We will be working closely with our stakeholders to implement new and improved information collection and modelling systems under Project Reservoir for annual and price setting purposes.

Outputs (2007-08)

- We aim to develop and implement a simplification plan for consultation in the late summer of 2007.
- We will review our annual publications in light of the outcome of our simplification proposals and comments received from our stakeholders.
- We will robustly challenge and justify the need for information requirements for the 2009 price review. We will consult on our proposals in November 2007.
- We will develop our impact assessment tool.
- We will complete our investigations into company data issues and make sure that lessons are learnt by all.

2.6 Protecting consumers' interests and promoting good service

Outcomes

- Clear understanding of what "good consumer service" means to consumers.
- Companies that strive to achieve the same level of good consumer care that would be needed to attract and retain consumers in a competitive market.
- Effective incentives to companies to achieve good standards of consumer service.
- Good value for customers in all aspects of investment.

In the absence of market competition in the water sector, we seek to protect consumers by creating incentives and by regulating in a manner that is an adequate substitute for market pressures.

Consumer service has improved significantly since privatisation. We want now to consider whether our existing approaches to promoting good service remain appropriate. We will review our overall performance assessment (OPA) and service measures to make sure that the water industry service is compatible with good service provision in other service sectors, and that minimum service levels are protected. Where a company is providing a different level of service for its customers, we will seek to reflect this in our performance measures. We will also engage with deliverers of excellent customer service in other sectors to help inform our view of the OPA standards.

We will also undertake research, both with CCWater and directly, to understand what matters to customers when they interact with their water and sewerage companies.

We will review internally options for the way that companies charge their customers. Building on the work that we commissioned with Defra and UKWIR, we will look at the effects of different options on the bills of different customer groups, including vulnerable customers. We will also assess the options against other criteria, including how easy the charges are for customers to understand and what potential they have to contribute to a more sustainable use of water. We intend to report our findings, and consult on any proposed changes in 2008-09.

Through the 2009 price review, we will seek to make clear to consumers the issues associated with different levels of service provided across the industry, and the consequences in terms of costs and impact on the reliable supply of water. We will work with CCWater, companies, other regulators and Government to understand and consult on consumers' priorities for the price review.

We will continue to challenge each company to demonstrate the benefits of investment in raising environmental and service standards.

The views of consumers are important to our work and CCWater plays a key role in helping us to understand consumers' needs. Government has announced that it will review the future of CCWater in 2008. We will contribute to the review and make any necessary changes to our work in light of this review, to make sure that consumers' interests are protected.

Outputs (2007-08)

- We will reassess the overall performance assessment and other service indicators to ensure that more aspects of customer experience are visible and that we can recognise improvements which deliver consumer expectations.
- We will consider whether formal company performance standards might be useful to secure specific aspects of service.
- We will review our policy on charging mechanisms for the future.
- We will work with others to develop the market research strategy for the 2009 price review to make sure it delivers a clear understanding of consumers' views.
- We will challenge each company to demonstrate sound analysis of the benefits from its investment in raising environmental or service standards.

2.7 Setting price limits for 2010-15

Outcomes

- Price limits that deliver the best value for consumers and allow efficient companies to provide a sustainable service into the future.
- Companies that take ownership of business plans that deliver best value for their consumers.

The current set of price limits cover the period 2005-10. In November 2009, we will set price limits for the period 2010-15.

We intend to do this by building on the strengths of the process we followed in 2004, and the lessons learned from the independent steering group review of that process. In particular, we intend to set a framework that will enable us to set price limits within a longer-term context. To achieve this, we will ask each company to consult with its customers and publish a strategic direction statement before it prepares its draft business plan. The strategic direction statement will set out the priorities the company sets itself for the next five years and beyond, with an early indication of what that will mean for consumers.

The purpose of the strategic direction statements is for us to understand each company's "direction of travel". We expect each company to set out its vision, including:

- its plans for consumers and the environment in the long term;

- the impact this has on, among other things, the management and stewardship of assets, innovation, and the approach to issues such as climate change and sustainability;
- its charging strategy;
- its consumers' priorities; and
- what it considers are the major risks and how it will manage these.

We expect companies to show that their strategies are supported by stakeholders and grounded in consumer priorities. Companies should consult consumers and other stakeholders on their strategies as they develop them.

Companies can choose their own format for the strategic direction statements. We expect them to be published in a consumer-friendly way. Each company should send us its strategic direction statement by no later than 14 December 2007. We will discuss each company's statement with that company.

For the 2004 price review companies provided longer-term views on capital maintenance and 25-year water resource plans. For the next price review in 2009, we will require companies to submit draft and final business plans for the period 2010-15, including a 25-year forward look. We will consult later this year on the business plan reporting requirements. We will expect each company to review the costs and benefits of its proposals and to set these out clearly. We will challenge companies to produce investment plans that are clearly part of a long-term cost-beneficial plan for consumers and the environment.

We expect companies to propose work to contribute to meeting the environmental objectives in the River Basin Management Plans required as part of the Water Framework Directive. We will be working with companies, government, fellow regulators and CCWater to co-ordinate their input to the price review. We will engage consultees early in the process to help shape our project plan, priorities and the focus of our resources.

We are currently reviewing specific methodologies in advance of the 2009 price review. This will take into account particular issues raised by the independent review of the 2004 price review led by John Baker. It will include:

- the joint UKWIR review of efficiency (see section 2.3);
- work with UKWIR on the assessment of companies' forward looking asset management planning, long-term sewerage planning, and on the regulatory cycle and patterns of capital investment;
- the potential use of a revenue cap or the sharing of revenue outperformance (see section 2.1);
- long-term incentives; and
- guidance for delivering good cost-benefit analysis.

Outputs

In 2009, we will set price limits for the period 2010-15. We will set price limits within a longer-term context that will enable each company to deliver the services required of it in a sustainable and efficient way.

We plan to conduct the price review in four phases. This timetable shows our outputs (highlighted), company deliverables and, where possible, key stages in the process for Government.

Phase one – Preparation

March 2007	Publish MD letter setting out expectations for long-term strategic direction statements.
June 2007 to December 2007	Companies develop and publish strategic direction statements following consultation with stakeholders.
Summer 2007	Defra to publish new Water Strategy, which will outline the Government's priorities for water. Welsh Assembly Government to publish Water Policy Statement.
October 2007	Consultation on our approach to the 2009 price review.
November 2007	Consultation on our information requirements for the price review.
Late 2007 to March 2008	CCWater-led/joint stakeholder research.
December 2007	Defra – Statement of Obligations. Welsh Assembly Government – Statement of Obligations.
January 2008	Consultation on our approach to the 2009 price review ends.

March 2008	Defra to publish social and environmental guidance. Possible Welsh Assembly Government social and environmental guidance.
March 2008	Publication of decisions on approach and information requirements.

Phase two – Gathering information

June 2008	Companies submit annual June returns.
August 2008	Companies submit, and publish summaries of, draft business plans, informed by cost-benefit assessments and including a 25-year forward look.
September 2008 to January 2009	Joint stakeholder research into consumers' views on issues arising from draft business plans.
September 2008	Publication of industry-level summary of key issues arising from draft business plans.
October/ November 2008	Feedback to companies on draft business plans. Welsh Assembly Government to publish possible further guidance on water policy priorities.
January 2009	Issue final business plan reporting requirements.

Phase three – Decisions and determinations

April 2009	Companies submit, and publish summaries of, final business plans including 25-year forward look.
June 2009	Companies submit annual June returns.

July 2009	Publish draft determinations for comment.
September/ October 2009	Meet companies and CCWater to consider representations on draft determinations.
November 2009	Final determinations.

Phase four – Implementation of price limits and evaluation of the price review

January 2010	Companies decide whether to accept price limits or to seek a referral to the Competition Commission.
January/ February 2010	Approval of charges schemes, setting out how new price limits affect consumers' bills.
April 2010	New price limits take effect.
April 2010	Companies publish monitoring plans.
April to September 2010	Evaluation of price review process.

This timetable will be placed on our website and added to as plans for the price review are developed.

3. Regulating a monopoly industry

In chapter 2 we identified our current strategic issues. We undertake a wide range of other important work to deliver our commitment to protect consumers, promote value and safeguard the future.

To do this, we:

- monitor each company's compliance and performance;
- draw comparisons between companies' performance; and
- where necessary, take regulatory or enforcement action.

3.1 Performance reporting

We collect information in the June returns, principal statements and regulatory accounts. It is the responsibility of each company's Board to make sure that the information we collect is accurate and reliable. We rely on the companies' auditors and reporters independently to verify this information.

We have put in place a five-step process for checking that the information that each company provides meets our requirements. All five steps need to work effectively, otherwise there is a risk to the quality of the information we receive and use to regulate the companies.

Providing guidance to companies

We have reviewed and clarified our guidance for reporters, auditors and companies for the 2007 June returns.

In addition, we are also looking at identifying any further improvements that may be required ahead of the 2008 June returns.

Companies' responsibility to provide accurate information

Our investigations into performance failures at Severn Trent Water, Southern Water and Thames Water have revealed issues with the companies' corporate governance arrangements, in particular with internal control failings around the reporting of non-financial data. In November 2005, we published MD209, 'Reliability of regulatory information', which reminded each company of its responsibility to provide accurate information to us, and have rigorous systems of internal control in place.

Since then, we have carried out work to make sure that we can be confident that each company has an appropriate corporate governance system in place. We now require each company's Board to confirm:

- that its systems of internal control were sufficient for the provision of information to us; and
- how it had satisfied itself that the information was reliable, accurate and complete.

Independent expert challenge – reporters and auditors

Our investigations into company performance identified an expectation gap between us and our auditors and reporters. As well as having a consistent approach, we need to make sure that we provide good quality feedback to the auditors and reporters.

We have also begun to review the role of the reporter. We have held workshops with reporters and the companies to identify key issues for change. We will analyse the outputs from these workshops to provide further guidance to reporters ahead of the 2008 June returns.

Our review and challenge of companies' information

We scrutinise and challenge the information that companies provide to us through the June returns. We will ensure a consistent and proportionate approach across Ofwat to our review and challenge of regulatory information.

Our feedback to companies, reporters and auditors

We will provide feedback to companies, reporters and auditors following each June return.

3.2 Monitoring and reporting

We fully analyse the information we receive from companies, the Environment Agency, the Drinking Water Inspectorate (DWI), CCWater and other stakeholders. We assess this information to identify performance and compliance issues. To provide transparency and make sure stakeholders are well informed, our findings are published in the following reports.

- 'Financial performance and expenditure of the water companies in England and Wales'.
- 'Security of supply, leakage and water efficiency'.
- 'Levels of service for the water industry in England and Wales'.
- 'Water and sewerage service unit costs and relative efficiency'.
- 'Water and sewerage charges'.

As mentioned in chapter 2, we will review the format and timing of these reports. This will form part of our work on a more wide-ranging simplification plan. The review will take account of responses received during the consultation exercise.

3.3 Regulatory action

Where we have concerns over a company's performance or the quality of the information it provides, we will take regulatory action, which can include for example:

- special investigation;
- enforcement, including seeking a formal undertaking; and
- imposing financial penalties.

While we will use our powers of enforcement, including formal undertakings and penalties where appropriate, we believe it is often appropriate to take proportionate and early action before considering formal enforcement steps. For example, we use quarterly reporting and action plans where we identify actions that companies should undertake. Where we identify improvements or refinements to the systems of reporting and regulation, we will implement them.

During 2007-08, we will complete our investigations into aspects of Severn Trent Water, Southern Water Services and Thames Water Utilities' performance. In due course, we will set out our conclusions for each investigation in full and consider what redress to consumers is appropriate and whether to impose a penalty.

3.4 Changes of ownership and mergers

We will review all restructuring proposals and introduce licence modifications to strengthen the financial ring fence, where necessary, so that customers are protected from any undue additional risk arising from a particular structure.

The Competition Commission is currently considering the merger of South East Water and Mid Kent Water. We are pleased that in its provisional findings the Competition Commission has found that the merger will prejudice our ability to make comparisons and that it is considering possible remedies. We will seek guaranteed remedies that will benefit all customers. Once this reference is complete (the Competition Commission's deadline is 2 May), we will examine the findings and take any necessary action.

4. Governance, communications and resources

4.1 Governance

The establishment of the Water Services Regulation Authority (Ofwat) in April 2006 gave us new corporate governance arrangements. Our Board now comprises:

- Philip Fletcher, Chairman;
- five other non-executive directors;
- Regina Finn, Chief Executive; and
- two executive directors.

The structure of the executive office is set out in appendix 1.

We published rules of procedure for the Board in February 2007. We will publish a revised code of practice on how we carry out our duties for consultation by April 2007. We will also complete Memoranda of Understanding with Defra, Welsh Assembly Government, CCWater, the Environment Agency and the DWI.

4.2 Communications

We seek to demonstrate through all our communications that we protect consumers' interests, promote value and safeguard the future. We listen to the views of stakeholders and explain our decisions to them through:

- meetings;
- workshops;
- events;
- letters;
- the media;
- publications; and
- our website.

We value our relationships with stakeholders and the contribution they make to our regulatory processes.

During 2007-08 we will be developing our website and reviewing our annual publications to make sure that they reflect what we do and meet stakeholders' needs.

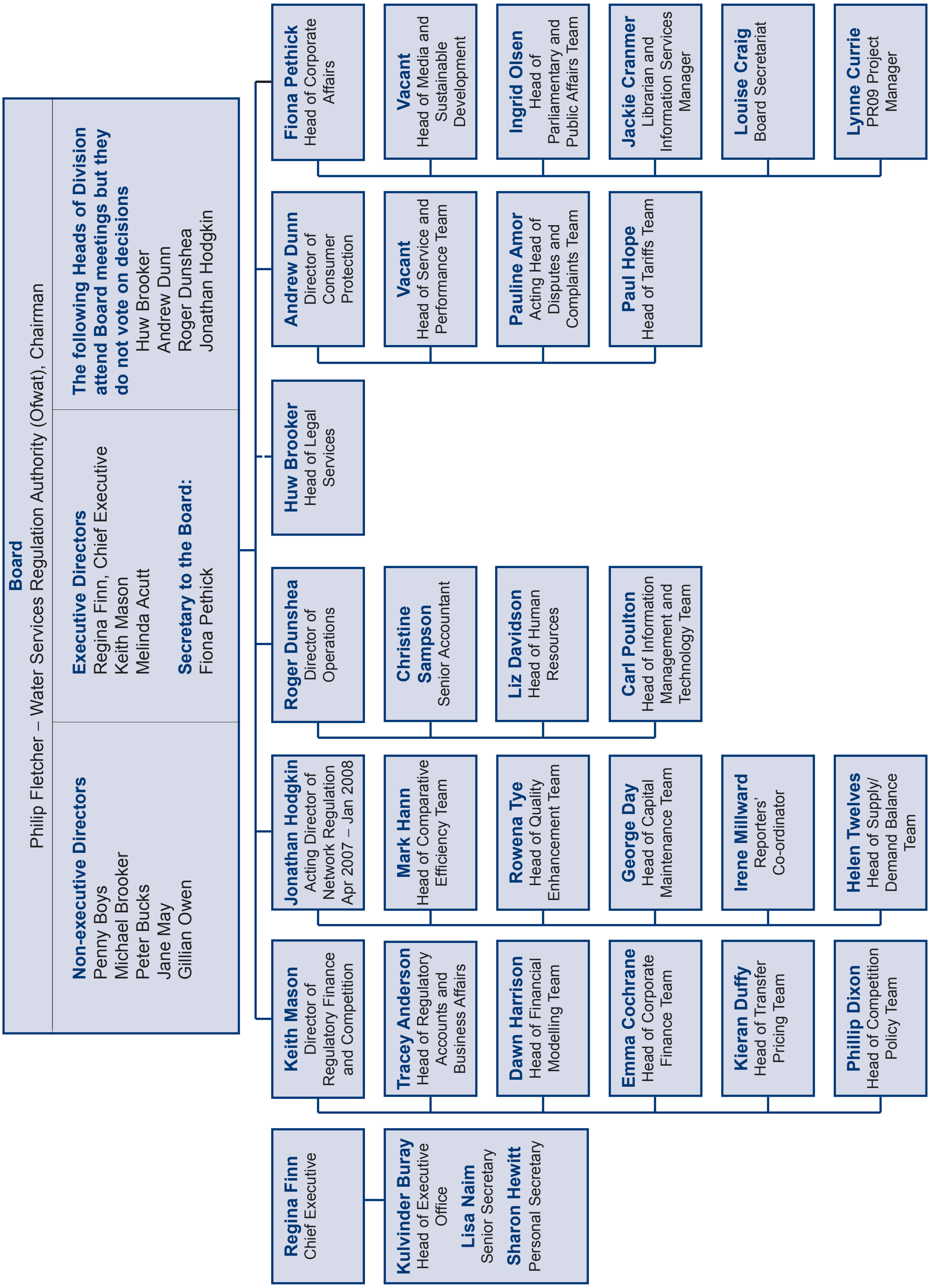
4.3 Resources

Our aim is to provide value for money for consumers and deliver our statutory duties effectively. We are accountable to Parliament and are required to meet government accounting standards. We are therefore careful to balance the requirement to control spending with the need to have available the resources necessary to meet our statutory duties.

The budget estimates are set out below. Due to growing cost pressures in the areas of competition development and the 2009 price review, we have set a budget of £13 million for 2007-08. This will be funded by £12.4 million licence fees recovered from companies in May 2007 and £0.6 million underspend carried forward from previous years.

	2007-08	2008-09	2009-10
Budget estimate	£13 m	£12.8-13.5 m	£13.2-14.0 m

Appendix 1: Ofwat structure



Appendix 2: Sustainable development action plan

In February 2006, we consulted on our approach to our new duty to contribute to sustainable development. We published the outcome of that consultation in MD219, 'A sustainable water industry – to PR09 and beyond', and identified a series of issues on which we planned to take further action. One of these was a commitment to publish a sustainable development action plan, as part of our forward programme, and to report on this each year. The action plan for 2007-08 is set out here, and should be read within the longer-term context outlined in MD219.

In 2007-08, we will continue to link sustainable development with our regulatory policy and operations. We have adopted the Government's five guiding principles of sustainable development to organise our thinking and describe our contribution.

We plan to make progress:

- in developing our policy for the next price review and beyond;
- in how we deal with stakeholders, including consumers;
- in contributing to the development of wider water sector policy;
- in our internal operations, procurement and sustainability footprint; and
- as an employer.

In developing our policy

Our major contribution in this area over the next three years will be to deliver a successful price review that has embedded within it our duty to sustainable development, taking into account environmental, social and economic concerns. We will make sure that the guiding principles of sustainable development inform our approach to the price review. We will set out how we propose to deliver this in our open consultation on the 2009 price review during 2007-08.

Living within environmental limits – key actions for 2007-08

- We will carry out a review of how we set leakage targets.
- We will work with the Environment Agency on the guidance for long-term water resource planning.
- We will participate fully in the Water Saving Group.
- We will work on incentives and water efficiency, including consulting on changes to infrastructure charges to promote water efficiency, and considering the interaction of incentives around water company revenues and water efficiency.
- We will make sure that climate change scenarios are made available to inform water resource and asset management planning at the 2009 price review.
- We will contribute to the development of long-term sewerage plans, taking into account future demand and capacity, and the potential impact of climate change.

Achieving a strong, healthy and just society – key actions for 2007-08

- We will develop our understanding of consumers' views, so that the 2009 price review is focused on consumers' priorities.
- We will reassess our policy on the overall performance assessment and other mechanisms for promoting and recognising consumer value.
- We will take account of affordability and debt in reviewing our policy on charging mechanisms for the future.
- We will explore, with CCWater, the requirements of consumers with special needs and business consumers on service levels.
- We will work with CCWater and others to improve the vulnerable groups scheme.
- We will monitor companies' work to reduce the number of properties at risk of sewer flooding, and take action where appropriate.

Achieving a sustainable economy – key actions for 2007-08

- We will brief the investor community on relevant regulatory developments, to reduce market uncertainty and assist financial sustainability.
- We will publish further details of our thinking on the 'polluter pays' principle in the context of the implementation of the Water Framework Directive.
- We will seek action plans and progress reports from companies whose assets are assessed to have deteriorating serviceability.
- We will consult on long-term incentives as part of the preparation for the 2009 price review.

Promoting good governance – key actions for 2007-08

- We will seek strategic direction statements from the water companies.
- We will consider the social, economic and environmental impact of our regulatory decisions when we make them.
- We will seek company Board involvement in key submissions to us and challenge companies to provide reliable, accurate and complete information.
- We will engage with Water UK to seek improved voluntary sustainability reporting across the sector.

Using sound science responsibly – key actions for 2007-08

- We will carry out a review of our business planning guidance, and consult the industry and other stakeholders on the practicalities of delivering cost-benefit analysis at both strategic and programme level.
- We will contribute to the development of benefits assessment methodologies by reviewing recent applications and drawing out lessons.
- We will, in collaboration with UKWIR, develop a tool to guide our assessment of companies' strategic asset management and investment planning at the 2009 price review.
- We will participate fully in Defra's collaborative research programme on delivery of the Water Framework Directive.
- We will carefully consider the scientific evidence on issues such as supply/demand forecasting, climate change, and water quality and its impact on health and ecology.
- We will make sure that our work to protect consumers is informed by soundly designed market research.

In dealing with stakeholders, consumers and the public

Key actions for 2007-08

- We will deal thoroughly and fairly with all complaints or disputes and will aim to meet our published targets.
- We will develop a communications strategy to focus our communication on consumers' needs in terms of education, information and consultation.
- We will review our annual publications during 2007, as part of the development of our simplification plan.
- We will use new media to engage more people and organisations in our work.
- We will initiate stakeholder groups to work on the 2009 price review.
- We will agree Memoranda of Understanding with CCWater, Defra, Welsh Assembly Government, the Environment Agency and the DWI.

In contributing to wider policy

Key actions for 2007-08

- We will contribute to Defra's work to review the wider water policy framework, including collaborative working on issues directly relevant to the 2009 price review.
- We will liaise with Department for Communities and Local Government on issues raised by the infrastructure requirements for major new housing developments.
- We will work with DTI and the industry to explore the scope for promoting innovation in the industry and for working within the ambit of a DTI innovation platform (as follow up to the 'Barriers to Innovation in the Water Industry' project).
- We will assist Defra and others in considering and analysing the UK'`s approach to implementing the Water Framework Directive.
- We will work with Government on developing competition in the water industry.

Internal operations

We are a small government department, but like many office-based organisations there is scope to increase the sustainability of the way we run our office environment. In the past two years we have worked to reduce our environmental impacts.

Reducing our environmental impacts

- Transport – we promote the use of public transport by being part of the Travelwise scheme, offering staff discounts off bus and train tickets; more than 70 staff take advantage of this opportunity. We have also reduced the number of car park passes that staff hold by 40%. We are also lobbying our landlords to install a shower to encourage more staff to cycle to work.
- Recycling – we recycle almost all the paper that is produced and unwanted in the office, which amounts to about 23 tonnes a year (the equivalent of 120 trees). We also recycle glass, plastic, aluminium cans and toner cartridges.
- Publications – we publish all our documents on our website, cutting down on the number of hard copies we need to print. In the last year, we have reduced the number of hard copies we produce by half. All our publications are printed on minimum 50% recycled paper.

Key actions for 2007-08

In the coming year we intend to step up activity in all these areas including:

- reducing our carbon footprint, by upgrading the video conference facility to encourage staff to use video or audio conferencing rather than travelling to meetings; and
- improving energy efficiency by buying new, more efficient IT equipment.

We are committed to embedding sustainable development into spending and investment decisions in line with the Government Sustainable Procurement Initiative.

As an employer

Sustainable employment practices

- We have a policy of flexible and family-friendly working, for example to help people balance work and home responsibilities we offer part-time work and job sharing.
- Our commitment to enhancing staff welfare includes lunchtime seminars on a range of subjects (such as nutrition and ergonomics), free flu jabs for all staff, and a counselling service available to all staff.
- Since 2005, we have sought to promote awareness of sustainable development among staff, through a sustainable development group and case studies, staff survey and lunchtime seminars.

Key actions for 2007-08

We will be introducing a number of measures to further improve in this area, including:

- IT support for home and remote working to further support our policy of flexible and family-friendly working; and
- adopting an internal communications policy to enhance staff involvement and understanding of key decisions by promoting effective communication.

Appendix 3: List of respondents

Water and sewerage companies

Anglian Water
Dwr Cymru
Northumbrian Water
Severn Trent Water
Southern Water
Thames Water
United Utilities
Wessex Water
Yorkshire Water

Water only companies

Bournemouth & West Hampshire Water
Bristol Water
Cambridge Water
Folkestone & Dover Water
Mid Kent Water
Portsmouth Water
South East Water
South Staffordshire Water
Tendring Hundred Water
Three Valleys Water

Quality regulators/ environmentalists/researchers

Countryside Council for Wales
Environment Agency
Natural England
WRc

Organisations representing consumer interests

Consumer Council for Water

Trade bodies, suppliers and contractors

Blaiklock Associates
Gemserv
House Builders' Federation
Society of British Water and Wastewater Industries
Water UK

Individuals

D Hewitt
Dr S J Ford

A summary of the views of respondents, our response to these views and all the responses are on our website at www.ofwat.gov.uk.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 625 1300
Fax: 0121 625 1400
Website: www.ofwat.gov.uk
e-mail: enquiries@ofwat.gsi.gov.uk

ISBN 1 904655 35 1

Printed on 75% minimum post- and pre-consumer waste paper