

RD 06/02

**TO THE REGULATORY DIRECTORS OF
WATER AND SEWERAGE COMPANIES
AND WATER ONLY COMPANIES**

14 March 2002

Dear Regulatory Director

LEAKAGE EXPENDITURE

Expenditure on leakage control is a continuing cost that you incur. There are costs associated with moving to economic levels and then maintaining leakage at economic levels. Further investment and continuing additional costs associated with leakage are likely to be part of a plan to meet a current or future supply demand deficit.

We have noticed increasing variability in the way companies are accounting for expenditure relating to leakage control. There is a tendency towards allocating expenditure to infrastructure renewals or capex even where it is clear that the activity is not related to replacing or upgrading the condition of the asset. As we move towards the periodic review I am concerned that the increased variability will make it more difficult for us to make robust judgements about relative efficiency in each expenditure area. Indeed, some companies have contacted me with such concerns in mind.

The purpose of this letter is to give you notice that we intend to issue more prescriptive guidance on how to allocate leakage expenditure with the reporting instructions for JR03.

In brief we will require you to code costs relating to maintaining leakage in steady state to opex unless they clearly fall in other areas. An example of this would be the replacement of depreciable capital items (such as data loggers) associated with leakage control. Where leakage is being reduced in line with a declining profile for the economic level of leakage it is conceivable that you could record some investment as infrastructure renewals expenditure.

.../...

RD 06/02
14 March 2002
Page 2

If leakage reductions are part of an agreed supply demand balance plan then you should code capital items associated with a step change in the level of leakage to SDB capex.

We will provide more detailed guidance in the year ahead. However, given the importance of 2002-03 as the base year for PR04 I thought that I should advise you of our intentions as early as possible.

I hope you support these proposals as they are aimed at providing you with a level playing field for the next price review. However, I would like to hear your views on this matter – please write to me before 1 June 2002.

Yours faithfully

W H EMERY
Director of Costs & Performance
and Chief Engineer