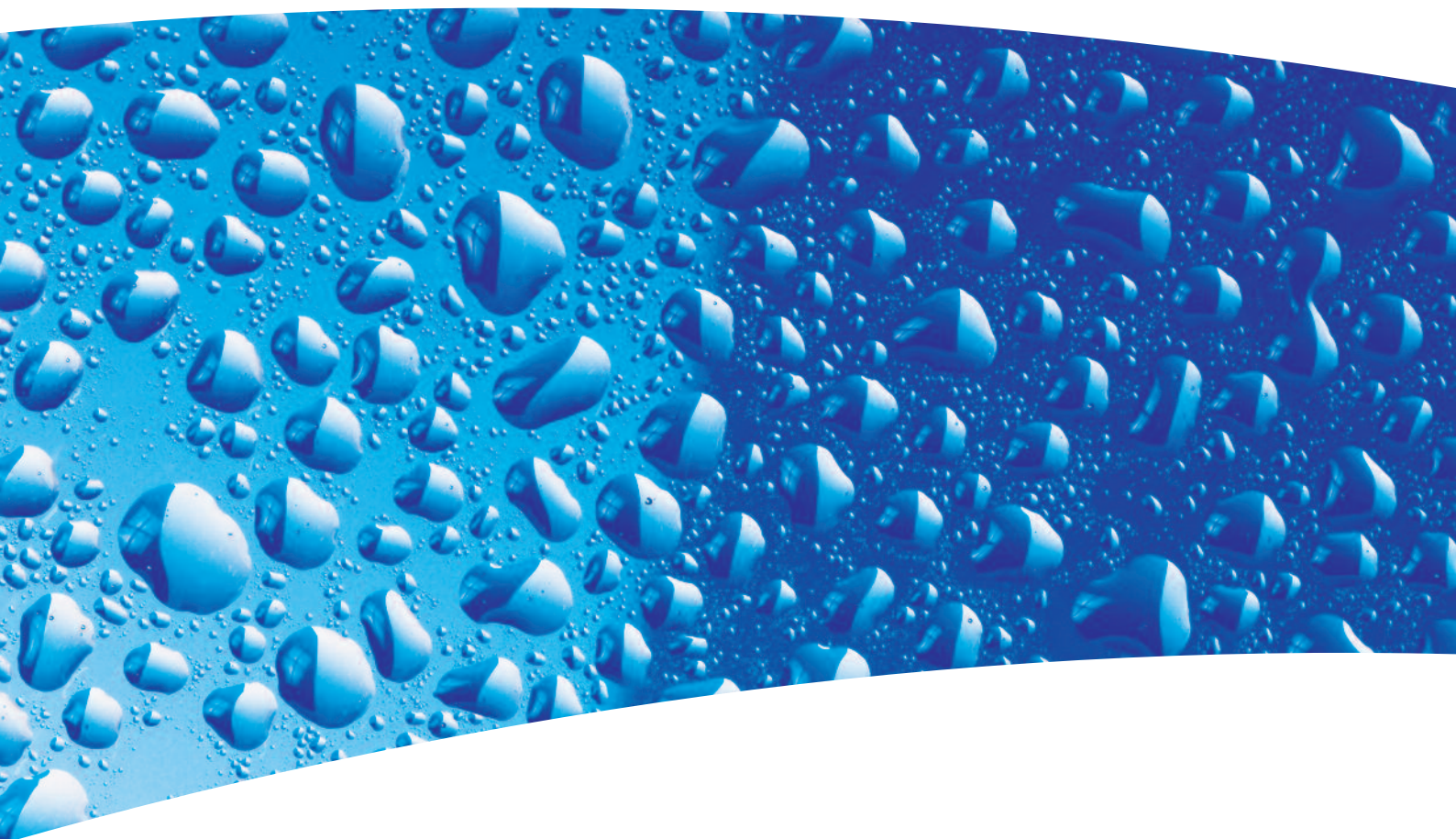


Setting price limits for 2010-15: Overview of companies' draft business plans

Ofwat – **Protecting** consumers, **promoting** value and **safeguarding** the future



www.ofwat.gov.uk



Contents

Foreword	2
1. Setting price limits in the long-term context	3
2. The right outcome for consumers	10
3. Proposals for service and investment	14
4. Understanding the costs of delivery	30
5. Financial assumptions for setting price limits	33

List of tables

Table 1	Drivers of change in average bills 2010-15 (2007-08 prices)	4
Table 2	K factors from each company's strategy	6
Table 3	Company projections of average annual household bills from 2009-15 (£s)	7
Table 4	Companies' strategies: Total projected expenditure 2010-15	14
Table 5	Total net capital investment (2007-08 prices)	16
Table 6	Summary of companies' sewer flooding plans, including expenditure	22
Table 7	Quality enhancement, supply/demand balance and enhanced service levels capital investment and potential bills impacts arising from companies' strategies	24
Table 8	Companies' views on the cost of capital	36

List of figures

Figure 1	Key stages in the price review process	3
Figure 2	Average water and sewerage bills	5
Figure 3	Industry proposals for capital investment	15
Figure 4	Capital maintenance investment	25
Figure 5	Past operating expenditure and draft business plan assumptions	27
Figure 6	Increases in AMP5 base opex	28
Figure 7	The capex incentive scheme process	32

Foreword

We have now completed our initial review of the draft business plans submitted to us by each water and sewerage company on 11 August 2008. In this document we provide a picture of the company proposals across England and Wales, including the potential impact on customers' bills. These proposals would increase water bills by an average of £29 over the five-year period.

This document summarises the companies' proposals and we do not, at this stage, make judgements on the degree to which the proposed plans meet statutory requirements, deliver value for money or are acceptable to customers. These issues, along with a range of other important factors, will be assessed thoroughly over the coming weeks. We will explore the draft plans with fellow regulators and the companies themselves, providing feedback and advice to companies to help them prepare their crucial final business plans, which they must submit in April 2009. We will use those final business plans to set price limits.

The development of the business plans is taking place against a backdrop of ever greater focus on water as a valuable resource. The impact of climate change remains a topic of concern, including increasing weather volatility and the carbon impacts of the sector. At the same time the economic climate is turbulent, and value for money and meeting consumers' needs remain core objectives. The final phase of the joint consumer research, now under way and due to report at the end of the year, will help us to understand how consumers see the issues raised by companies in the new economic environment.

We will continue to keep these issues in mind as we proceed through the price review process and work towards our aim of protecting consumers, promoting value and safeguarding the future. We will do this by continuing with our initiatives to promote effective competition where it benefits consumers, while regulating effectively where that is not possible or has not yet happened.



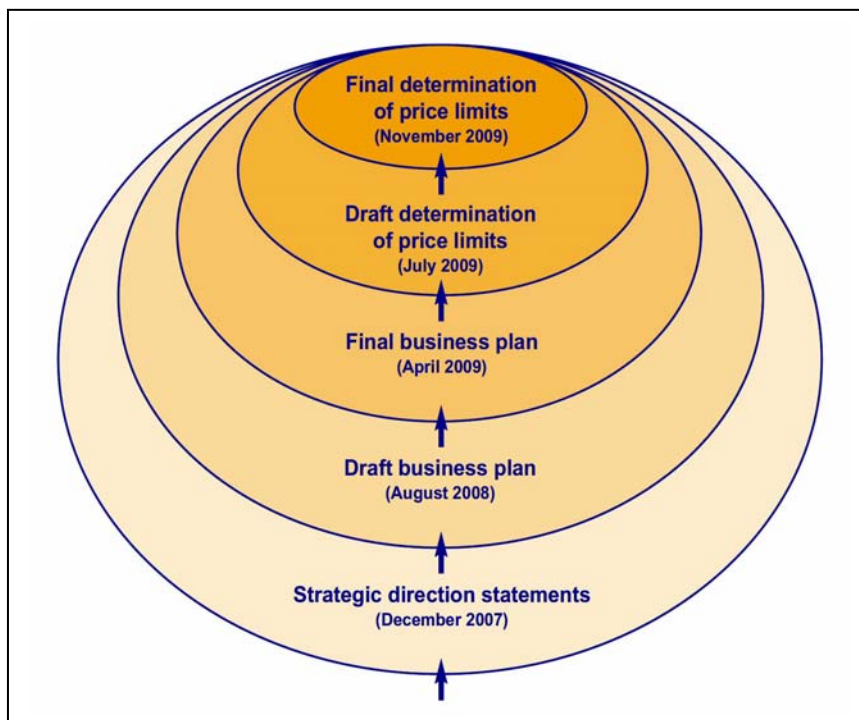
Regina Finn
Chief Executive

1. Setting price limits in the long-term context

1.1 The framework for setting price limits

We wanted each company to submit a draft business plan that was consistent with the vision set out in its [strategic direction statement](#). We expected companies to put forward plans that deliver for their consumers and the environment and make proposals that are sustainable in the widest possible sense. While some of the proposals put forward by the companies have very high bill consequences, we now have draft business plans that are broadly in line with the strategic direction statements and allow us to move forward in line with our plans for setting price limits in 2009 as set out in figure 1 below.

Figure 1 Key stages in the price review process



1.1.1 Draft business plans

Each company submitted its [draft business plan](#) to Ofwat on 11 August 2008; at the same time it published the key elements of its proposals to provide and enhance services in the 2010-15 period. The draft business plans allow us to:

- challenge companies' proposals and provide each company with feedback to inform the development of the key final business plans (due in April 2009);
- conduct, jointly with key stakeholders, the final phase of consumer research which will seek consumers' views on company proposals; and
- develop the draft capital expenditure incentive scheme (CIS) baseline for each company (December 2008).

1.2 Bill impacts of draft business plan proposals

Table 1 below sets out the industry-level bill impacts of the draft business plan proposals. We have developed this from the tables put forward by each company in the public version of its business plan. It helps to show what is happening behind the headline proposals for bills and expenditure. In particular, it shows that, despite proposals for investment having a strong upward influence on bills, there are other factors which are currently expected to mitigate these impacts.

Table 1 Drivers of change in average bills 2010-15 (2007-08 prices)

Average bill in 2009-10		Total (£)	(£)
		326	
Less	(1) past efficiency savings and outperformance	-6	
Plus	(2) maintaining base services	4	
	of which: a) changes in revenue		-7
	b) changes in operating costs		12
	c) changes in capital maintenance		16
	d) changes in impact of taxation		-5
	e) changes in the cost of capital		-12
	(3) maintaining and enhancing security of supplies to all consumers	17	
	(4) the impact of improvements in services	25	
	of which: a) drinking water quality		5
	b) environmental improvements		16
	c) improvements in service performance		4
Less	(5) scope for reduction through future efficiency improvements	-11	
Average bill at 2014-15		355	
Change from end of the last period		29	

We can see that while companies have made proposals for higher levels of investment to maintain base services, with a combined bill impact of £28, this is offset by adjustments to take account of increased revenue expectations, of changes in the impact of taxation, and by a lower company assumption on the cost of capital. However, in each case, there is significant uncertainty. For example, revenue assumptions are linked to future housing growth, which seems less certain now than just a few months ago. The impact of taxation relates to the timing of capital

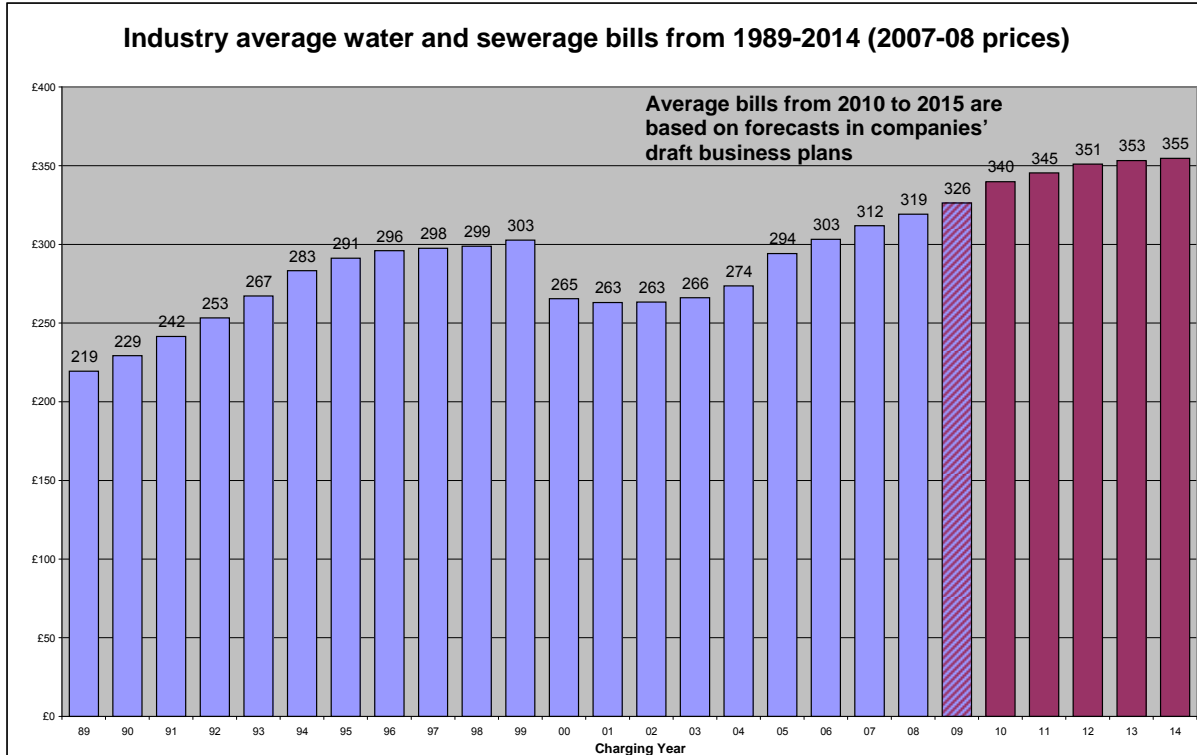
investment, which can change as business plans are finalised. The continually changing state of the financial markets means that the companies could put forward a different cost of capital in the final business plans.

The companies have put forward proposals for the biggest-ever programme of new capital investment. This has an impact on bills of £42 before future efficiencies are taken into account. However, the proposals for increases in bills are more equally spread between the areas of quality enhancement and supply/demand balance than we have seen at previous price reviews. This reflects an increased focus on meeting growing demand and protecting future supplies, against the backdrop of climate change.

1.3 Bill profiles

Figure 2 below sets out the trend in average bills since 1989 (in 2007-08 prices). Draft business plan proposals for the 2010-15 period continue the rise in bills, albeit at a slower rate than seen in the current period.

Figure 2 Average water and sewerage bills



There are variations around this at company levels relating to the proposed annual increase in price limits (the K factor). We have set these out in table 2 below.

Table 2 K factors from each company's strategy

	2010-11	2011-12	2012-13	2013-14	2014-15	Annual average ¹
Water and sewerage companies						
Anglian	6.3	1.0	2.4	1.5	1.9	2.8
Dŵr Cymru	-2.2	0.7	2.3	1.0	2.3	0.8
Northumbrian	1.3	1.3	1.3	1.3	1.3	1.3
Severn Trent	-0.1	1.0	1.0	0.3	0.3	0.5
South West	4.1	3.6	3.6	3.6	3.6	3.7
Southern	14.8	2.7	2.8	3.4	-0.3	4.6
Thames	6.3	3.8	5.6	1.2	1.8	3.7
United Utilities	4.2	4.4	3.1	1.3	0.7	2.7
Wessex	1.3	1.3	1.3	1.3	1.3	1.3
Yorkshire	0.6	0.6	0.6	0.6	0.6	0.6
Water and sewerage companies average²	4.0	2.3	2.7	1.4	1.2	2.3
Water only companies						
Bournemouth & West Hampshire	12.6	2.9	1.8	1.4	1.3	3.9
Bristol	16.2	3.3	4.1	3.4	3.3	5.9
Cambridge	9.0	2.2	3.9	2.8	2.7	4.1
Cholderton	8.0	3.2	3.1	2.0	1.5	3.5
Dee Valley	2.6	2.2	2.2	-0.2	-0.6	1.2
Folkestone & Dover	7.2	12.7	8.0	4.8	1.0	6.7
Portsmouth	0.3	0.0	2.3	1.0	1.3	1.0
South East	13.7	4.0	1.3	2.4	2.3	4.6
South Staffordshire	14.0	1.2	1.0	-0.7	-1.7	2.6
Sutton & East Surrey	12.6	3.3	5.1	3.0	1.0	4.9
Tendring Hundred	9.2	2.8	1.7	0.6	0.0	2.8
Three Valleys	9.6	1.5	2.2	1.1	1.6	3.2
Water only companies average²	11.5	2.7	2.5	1.8	1.5	3.9
Industry average²	4.5	2.3	2.7	1.4	1.2	2.4

Notes:

1. Each average is the geometric average of the annual price limits.
2. These averages are weighted by company turnover.

Using these K factors leads to the average annual bills set out in table 3 below.

Table 3 Company projections of average annual household bills from 2009-15

£ 2007-08 prices	2009-10		2010-11		2014-15	
	Water	Sewerage	Water	Sewerage	Water	Sewerage
Water and sewerage companies						
Anglian	160	200	162	214	164	209
Dŵr Cymru	159	217	145	221	152	224
Northumbrian	138	159	142	159	148	157
Severn Trent	147	142	153	137	154	138
South West	194	268	193	276	205	291
Southern	122	230	141	261	146	281
Thames	171	113	189	114	195	134
United Utilities	160	191	180	186	186	203
Wessex	188	194	191	194	199	190
Yorkshire	145	167	140	173	139	177
Water and sewerage companies average¹	158	171	166	175	171	185
Water only companies						
Bournemouth & West Hampshire	125		140		147	
Bristol	143		164		187	
Cambridge	114		124		137	
Cholderton	190		206		228	
Dee Valley	121		123		127	
Folkestone & Dover	180		187		218	
Portsmouth	88		88		93	
South East	160		182		192	
South Staffordshire	115		130		128	
Sutton & East Surrey	153		173		193	
Tendring Hundred	162		180		186	
Three Valleys	150		164		172	
Water only companies average¹	142		158		168	
Industry average¹	155	171	165	175	170	185

Note:

1. Total household revenue divided by total number of household properties.

The impact will be different for metered and unmetered customers – and will change as increasing numbers of customers move from unmeasured to measured charges.

Strategic direction statements



Setting the scene for 25 years

Each company published its [strategic direction statement](#) in December 2007. These have provided a new and welcome long-term context, laying a sound foundation on which to base and develop the draft business plans.

How these have informed draft business plans

Strategic direction statements are by their nature living documents and will develop in response to changes in the environment. Since the companies worked with their stakeholders to develop the strategic direction statements the world has already changed; energy prices have continued to rise and the financial markets are changing almost daily, possibly having a greater impact on consumers than the companies. At the same time companies must rethink how developments in the housing market might change the assumptions on growth in demand for the price review period.

It is not clear if all companies have reconsidered their strategies in this new light; we will discuss this point with each company when we meet in the autumn of 2008. We will also discuss when companies might re-issue an updated strategic direction statement. Our current view is that companies should respond to the new price limits by issuing a strategic direction statement early in 2010, which includes details of the outputs for delivery in the 2010-15 period and an outline of what the strategy is and what it will deliver in the period to 2035.

1.4 Risk and uncertainty

We wanted each company to take a central and balanced view of risk across all business plan areas, including capital cost estimates, the cost of capital assumption, input price risk and proposals for notified items. In some instances it has been difficult to determine exactly how companies have undertaken this. We will ask each company to explain how its view on the cost of capital links to the approach to risk underpinning its cost estimates and its proposals on risk-mitigating mechanisms when we meet to provide feedback on its proposals.

1.4.1 Notified items

Notified items are items whose costs we identify and exclude from (or only partially include in) price limits because of their uncertain nature. Their purpose is to help define the business risk at a level that is consistent with our final decisions on the cost of capital.

In their draft business plans companies identified areas where they believed the costs they faced were uncertain enough to require a notified item. Among the most commonly cited were the costs arising from:

- introducing competition and accounting separation;
- changes to the tax regime;
- increases in bad debt, and the management of bad debt;
- charges for lane rental or traffic management as a result of the Traffic Management Act 2004; and
- fluctuations in energy prices.

Companies expected some issues to be resolved by the time we set price limits next year. Consequently, many companies intend to review their proposed notified items before they submit their final business plans.

2. The right outcome for consumers

We are now in the final stage of the PR09 consumer research. We are working with the companies, the Consumer Council for Water, Countryside Council for Wales, Defra, Drinking Water Inspectorate, Environment Agency, Natural England, Water UK and Welsh Assembly Government on a three-stage consumer consultation process.

We are currently managing research on behalf of the stakeholders into consumers' views on each company's draft business plan proposals. Our consultants will ask 6,000 consumers for their views on the content and value of their supplier's plans for water and sewerage services and on their ability to pay the resulting bill. The results will inform companies' final business plans and our decisions on price limits. We will publish the results early in 2009.

2.1 Taking account of consumers' views

Companies and regulators will need to review and take account of the priorities and preferences of consumers. We will also need to consider the views of different groups of consumers, such as those on low incomes.

In their draft business plans all companies say that their proposals reflect, as far as possible, consumers' preferences on the nature, extent and timing of investment. Companies say they have considered a range of information, including consumer research and causes of complaints. We will examine the evidence that companies have provided and challenge any company where we are concerned that elements of their plan lack clear consumer support.

Consumer research also provides important evidence for companies' assessments of the costs and benefits of specific investment proposals. We asked all companies to demonstrate that their plans offer value to consumers by applying a cost-benefit test to all aspects of their plans, including the investment required to meet statutory standards. We will not normally make price limit allowances for non-statutory investment where the benefits to consumers and the environment are less than the costs of investment. Where company solutions to statutory outcomes are not cost-beneficial, we will first ask companies to demonstrate that their option development and appraisal approach is soundly based and that their cost-benefit analysis (CBA) methodology is robust. We will also explore with the appropriate regulator and standard setter if there are options to improve the cost-benefit outcome.

Joint stakeholder consumer research 2007-08



In October 2007, the stakeholder group commissioned [deliberative research](#) to explore consumers' views on current water and sewerage services and their priorities and preferences for the future. More than 300 consumers of different ages and economic groups across England and Wales were consulted. Respondents were first asked for views based on whatever knowledge of the water and sewerage sectors they already had. They were then provided with general background about the water and sewerage sectors and were asked to carry out their own research or discussions before attending workshops for more detailed exploration of their views.

Initially, respondents had a range of knowledge and experience of the water and sewerage sectors. Although other issues, such as the cost of living, were at the top of their minds, when prompted many responded with comments about leakage, profits and other issues which they had seen covered in the press. Most took a reliable water and sewerage service for granted. However, when they subsequently carried out their research, many realised for the first time what was involved in providing water and sewerage services and engaged with the challenges facing the industry.

In lively workshop debates consumers expressed sophisticated views about current service and issues or priorities for the future. In summary:

- current service was satisfactory and reasonable value;
- there was limited appetite for improvement, especially if it meant prices would increase faster than inflation;
- drinking water supplies were reliable and safe – any problems were temporary and generally well handled, but leakage must be reduced further;
- water supplies and safety standards must be preserved, but improvements were only desired by a few with concerns about taste, colour or odour;
- the sewerage service was largely invisible – respondents empathised with the few who experienced sewer flooding but less with those who bought houses near sewage treatment works and experienced smells;
- the water environment was generally satisfactory and not the sole responsibility of water companies; and
- companies need to show they are planning for climate change.

2.2 Sustainability

Long-term sustainability is a key feature of the draft business plans. Most companies' proposals for investment have considered sustainability issues.

2.2.1 Climate change adaptation

Climate change adaptation features predominantly in the areas of:

- water resources;
- sewerage;
- sustainable urban drainage (SUDS); and
- resilience.

In most cases companies have taken account of recent guidance, such as our [PR09 letter on drainage standards](#). We will work with companies to improve, where necessary, climate change adaptation proposals, in particular making sure that they follow our principles of being evidence based, appropriately timed and cost beneficial.

2.2.2 Climate change mitigation

Mitigating climate change by reducing carbon emissions is a common theme in companies' draft business plans. Many companies expect that requirements for additional investment will lead to an increase in their total emissions during the price review period, albeit at a slower rate than before. Where possible, they propose measures to reduce emissions, for example increasing their use of anaerobic digestion. The impact of the social cost (or "shadow price") of carbon within all PR09 proposals is encapsulated within the application of CBA.

2.2.3 Carbon emissions and CBA

This is the first time whole-life carbon emissions have been taken into account in a price review. Both operational and embedded carbon costs have been included in CBA, using Defra's shadow price of carbon. This approach promotes a greater understanding of the carbon implications of investment decisions and allows carbon mitigation strategies to incorporate the emissions embedded in built assets, which is particularly important in asset-intensive sectors. All companies have submitted embedded and operational carbon data for 2010-15. This data is relatively immature, as this is the first time it has been reported, and we expect this will improve in the final business plans.

2.2.4 Resilience

The companies propose significant investment to improve the resilience of their water distribution systems and treatment works in the event of extreme circumstances (such as the flooding experienced in Gloucestershire in 2007). Some companies will address this as part of their ongoing maintenance; others propose specific large schemes at particular sites.

Resilience



The effective performance of critical assets is crucial to the delivery of safe and reliable water and sewerage services. The summer floods of 2007 exposed this when assets failed to cope with the extreme rainfall, while others continued to perform well.

In our [methodology paper](#) we asked each company to review the risk to its critical assets from flooding and how it will meet the challenge of supplying consumers in extreme situations. Subsequently, we published an [analytical framework](#) for asset resilience to flood hazards to provide additional guidance to companies. Resilience was identified as one of the main areas in our recent '[Climate change policy statement](#)'. We expect companies to understand the resilience of their assets in respect to a range of potential hazards, both under current and changing climate conditions.

All companies have considered resilience in their draft business plans. The plans vary, as expected, reflecting the size of the company and the specific challenges presented by their locations. Most companies focus on two types of resilience – protection of assets from flooding and network interconnectivity. A number of the water only companies focus on just the former. In total, almost £1 billion of investment has been proposed to increase resilience, with more than two-thirds assigned to network interconnectivity projects.

We will consider whether each company can demonstrate a clear understanding of its current level of risks to service and can show how its proposals increase resilience. We will take into account the additional wider benefits that may be realised from network interconnectivity schemes. Our analytical framework will be used to provide a basis for assessing proposals. This will help us to identify where companies have made effective plans to deliver increased protection and value to consumers.

3. Proposals for service and investment

The companies have put forward proposals for a major programme of capital investment. Totalling more than £27 billion over the price review period, the companies are proposing the biggest-ever capital programme, 40% higher than that included in the 2004 price review (PR04). Table 4 below summarises the investment at industry level.

Table 4 Companies' strategies: Total projected expenditure 2010-15

Total expenditure for 2010-15 by purpose (£m) ¹		Net capital expenditure	Operating expenditure
Base service	Water	6,779	10,138
	Sewerage	6,857	7,976
	Total	13,636	18,114
Improved levels of service	Water	446	14
	Sewerage	1,098	18
	Total	1,545	32
Supply/demand balance	Water	3,005	213
	Sewerage	1,937	142
	Total	4,942	355
Environmental and drinking water quality improvements	Water	1,757	146
	Sewerage	3,661	362
	Total	5,419	507
Individual large projects	Water	493	0
	Sewerage	1,317	4
	Total	1,810	5
Total	Water	12,480	10,511
	Sewerage	14,871	8,501
	Total	27,351	19,012

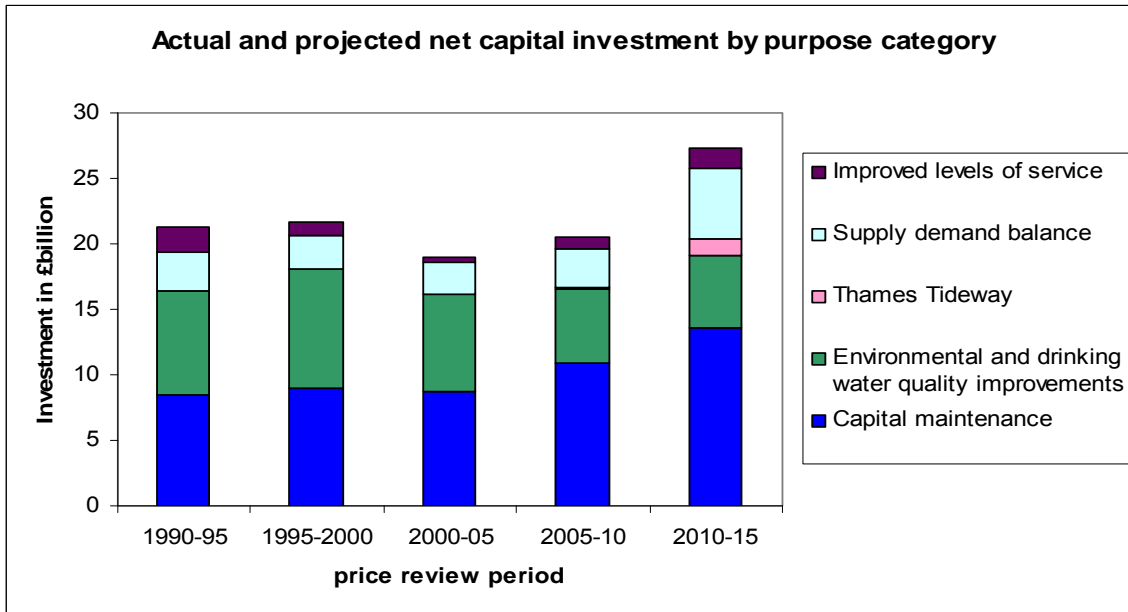
Note:

1. Expenditure is net of grants and contributions.

3.1 Capital investment

Figure 3 below shows the draft business plan proposals for capital investment and compares them to the allowed investment from previous price review periods.

Figure 3 Industry proposals for capital investment



The figure shows Thames Water's Tideway proposal of £1.3 billion (for investment in the period 2010-15) as a separate item because of the importance of this project. The figure shows clearly how expenditure on capital maintenance has grown in significance. To some degree this is to be expected – population growth and the need for higher standards of service have an impact on both areas, and the assets put in place in earlier periods will begin to need investment in their maintenance. However, the proposals have a significant impact on customers' bills and we will work to understand and challenge the costs and scope of company plans.

Table 5 below shows the total capital investment (quality enhancement and capital maintenance) proposed by each company.

Table 5 Total net capital investment

Water and sewerage companies	Total capital investment (£m)	Water only companies	Total net capital investment (£m)
Anglian	2,544	Bournemouth & West Hampshire	59
Dŵr Cymru	1,414	Bristol Water	318
Northumbrian	1,316	Cambridge	52
Severn Trent	3,058	Cholderton	0.2
South West	779	Dee Valley	38
Southern	2,555	Folkestone & Dover	67
Thames	6,539	Portsmouth	63
United Utilities	4,036	South East	600
Wessex	1,140	South Staffordshire	160
Yorkshire	1,929	Sutton & East Surrey	134
		Tending Hundred	21
		Three Valleys	527
Total	25,310	Total	2,041

Note:

Numbers may not add up due to rounding.

Cost-benefit analysis



Companies have used cost-benefit analysis (CBA) to inform and justify their plans to deliver what consumers want, though few have provided sufficient evidence to **fully** support their CBA results. They have assessed the majority of enhancement projects – but there are significant elements of both discretionary and statutory investment which have negative CBA results.

The majority of companies have assumed that consumers are not willing to accept a downward change in service and have formed their plans accordingly. However, there is variation across companies with respect to the level of improvements customers are willing to pay for. This has had a significant impact on the results of companies' analysis.

Next steps

We will assess the costs and benefits of investment alongside any additional evidence the companies provide. We will identify whether each company has demonstrated that its proposals maximise benefits relative to costs. We will also identify whether companies have assessed alternative proposals to ensure there are no better-value investment options.

Most companies have not used CBA mechanistically, by which we mean including all schemes with positive net present value (NPV) and excluding all those with a negative NPV. There are schemes that are not cost beneficial where companies have used additional research to justify the decision to include it. We will consider any additional evidence to identify whether it supports the inclusion of investment. We will also ascertain whether the company's findings are consistent with other research, such as stage three of the joint stakeholder research.

We will review the willingness to pay values arising from companies' benefits assessments and identify where there are different valuations across companies. We will scrutinise these differences to understand whether they are the result of variances in regional preferences or are caused by methodological issues.

For some companies, we cannot reach a view on the economic justification for their proposals because of a lack of evidence. We will identify these gaps and recommend the company provides further evidence to support its proposals. We will work with stakeholders to consider the next steps on statutory schemes where the current CBA is not positive.

Each company should use its final business plan to present and explain investment plans that are an affordable aggregation of programmes that customers are prepared to pay for. CBA allows equity and distributional issues to be identified and we expect each company to consider how these issues, such as different willingness to pay across socio-economic groups, affect the results of its CBA and factor these into its decision making for the final business plan.

3.2 The scope of the quality programme

A fundamental requirement of the draft business plans was that companies' quality programmes should be consistent with the Government's [water strategy](#) and '[Statement of Obligations](#)'. Companies achieved this by taking account of and aligning their proposals to the expectations and views of the quality regulators as set out in the Environment Agency's initial National Environment Programme (NEP) and a series of Preliminary Assessment Letters recently issued by the Drinking Water Inspectorate (DWI).

3.2.1 Drinking water quality

While the industry's proposals to invest to improve drinking water quality are about the same as our PR04 final determination, they form a significantly smaller proportion of companies' overall investment programme.

In the water service the Security and Emergency Measures Direction and consumer acceptability schemes account for more than half of the total proposed expenditure. Other significant cost drivers are:

- nitrates;
- lead pipe replacement;
- cryptosporidium; and
- environmental schemes to protect raw water quality.

Drinking water quality



Companies' proposals in their draft business plans for improvements to drinking water quality were largely in line with those made in initial submissions to the DWI by March 2008. The DWI communicated its opinion on the proposals to the companies in Preliminary Assessment Letters. In justifying their proposals, companies have generally either confirmed the DWI's support for schemes or stated that they are continuing to work with the quality regulator.

Next steps

We will monitor the continuing discussions between the DWI and individual companies and take account of any changes in the level of its support for companies' proposals in the light of new evidence provided to justify them. In particular, we will review the outcome of the comprehensive risk assessments that the companies are carrying out, and which will be reported to the DWI by October 2008. It is expected that this process may result in changes to the extent to which the DWI supports companies' proposals, and as a result to the set of schemes companies put forward in their final business plans.

3.2.2 Environmental improvements

The major cost drivers and areas for investment in the sewerage service include:

- the Urban Waste Water Treatment Directive;
- unsatisfactory intermittent discharges;
- the Habitats Directive; and
- the Water Framework Directive.

National environment programme



As expected, companies' proposals for quality enhancements to the sewerage service were largely based on the initial national environment programme (NEP). Overall, companies included 95% of the actions identified in the initial NEP in their draft business plans. Six of the ten water and sewerage companies included all the requirements of the initial NEP. The main reasons given by the other four water and sewerage companies for excluding actions were that either the scope or costs of the requirements were not yet fully clear or that the need for further work will depend on the extent to which schemes being implemented in AMP4 improve water quality.

It is likely that there could be some significant changes between draft and final business plans, reflecting changes to the NEP. These could include:

- the ongoing river basin planning process for the Water Framework Directive;
- the outcome of AMP4 investigations relating to the Groundwater and Habitats Directives;
- the outcome of the consultation on the new Bathing Waters Directive; and
- new requirements driven by the introduction of Environmental Permitting Regulations or the proposed revision of the IPPC Directive.

Next steps

We will monitor the development of the NEP and discuss with the Environment Agency and the companies any actions in it that give us concern, because of doubts over the need for investment, the value to customers that the action represents, or whether it is the responsibility of the water and sewerage sectors to deliver the action.

We will challenge companies where we believe their proposals may not offer the most cost-effective package of schemes to deliver the NEP. We will explore opportunities to maximise the value of the quality investment programmes to customers and to the environment.

3.3 Security of supply

We asked companies to submit draft business plans that set out how they would deliver water and sewerage services in a sustainable way under a changing future climate.

3.3.1 Water

All companies operating wholly or mainly in England have consulted on their draft water resource management plans (WRMPs); these set out how they intend to maintain a balance between the supply and demand for water in the period up to 2035. While the Welsh Assembly Government has not required Dŵr Cymru and Dee Valley to follow the same consultation process, both companies have prepared WRMPs on the same basis. All companies have based their expenditure proposals for the period 2010-11 to 2014-15 on these longer-term plans.

Companies have:

- generated their plans using the methodology set out in 'The Economics of Balancing Supply and Demand' (UKWIR, Environment Agency, 2002);
- considered explicitly the likely impact of climate change;
- updated their assessments of the economic level of leakage; and
- considered supply-side and demand-side solutions.

Our responses to companies' draft WRMPs, which we have published on our website, also apply largely to their draft business plans. They show that companies still have work to do to improve the quality of their plans, and to demonstrate that they have identified the best-value solution to maintaining a balance between the supply and demand for water. This additional work will include:

- providing robust evidence that consumers support their plans;
- comparing options on a level playing field, rather than pre-selecting certain schemes;
- identifying an appropriate level of metering by comparing the costs and benefits of metering with the costs and benefits of other options, to find a solution that provides the best value to customers and the environment. Companies must make sure that they take into account the wider costs and benefits of metering, as well as the narrow financial impacts.
- improving their assessment of the sustainable economic level of leakage;
- providing more detailed evidence on the impact of climate change; and
- incorporating the outcome of our [consultation on water efficiency targets](#), which we will publish before the end of November.

3.3.2 Wastewater

We expected sewerage companies to use the framework of the UKWIR report, 'Long term least cost planning for wastewater supply/demand'. All companies have followed the guidance, but our initial assessment is that none has followed it fully. We will provide companies with feedback and guidance on how to overcome these shortcomings.

3.4 Sewer flooding

The sewerage companies have proposed investment totalling £1.6 billion to address flooding caused by a lack of capacity in the sewerage network and new problems which are expected to emerge during the period up to 2015. Part of the proposed investment (£821 million) is put forward as enhanced service level investment (see table 6). The remainder is included in the proposed investment plans for supply/demand balance (£545 million) and capital maintenance (£236 million).

Table 6 Summary of companies' sewer flooding plans, including expenditure

Company	Number of properties at risk of flooding internally at least once in ten years		Number of external areas at risk of flooding at least once in ten years		Other problems to be solved	Additional investment required to deliver sewer flooding outputs above base service and supply/demand 2010-15 (£m)
	2007-08	2014-15	2007-08	2014-15		
Anglian	422	149	389	636	100 internal properties and 100 external areas mitigated. Reduce other causes internal flooding from 144 to 100 a year.	65
Dŵr Cymru	365	51	2,276	4,265	5 internal properties mitigated. Reduce other causes internal flooding from 120 to 100 per annum and external from 4,000 to 3,000 a year.	16
Northumbrian	454		266		150 internal properties mitigated.	0
Severn Trent ¹	1,372	612	2,729	2,131	1,590 internal properties and 2,190 external areas mitigated. Reduce other causes internal flooding from 600 to 572 a year.	0
South West	77	28	195	206	30 internal properties and 5 external areas mitigated. Reduce other causes internal flooding from 80 to 72 per annum and external flooding from 1,200 to 1,100 a year.	4
Southern	251	141	478	4,560	500 internal properties mitigated.	160
Thames ²	2,630	1,411	3,673	4,296	648 internal properties and 372 external areas mitigated. Reduce other causes internal flooding from 850 to 688 a year.	485
United Utilities ³	434	260	1,258	1,275	767 internal properties and 501 external areas mitigated.	20
Wessex	343	134	688	1,707	20 external areas mitigated.	49
Yorkshire ⁴	196	126	1,077	3,242	Reduce other causes internal flooding from 235 to 141 incidents a year.	23
Total	6,544	2,912	13,029	22,318	3,790 internal properties and 3,188 external areas mitigated. Reduction in other causes internal flooding of 356 a year and 1,100 a year reduction for external flooding.	

Notes:

1. Includes £10.3 million for work to separate storm water from system.
2. Includes £18.5 million for planning and development of strategic schemes and £1.5 million for unsatisfactory intermittent discharge (UID).
3. Includes £28.8 million for modelling and £1.2 million for SUDS.
4. Includes £20 million for drainage area and surface water studies.

All companies have carried out 'willingness to pay' studies and CBA in order to size their programmes. Most companies found that solving sewer flooding was a high priority for customers. Under companies' proposals the number of properties at risk of flooding internally at least once in ten years would fall from approximately 6,500 (as at March 2008) to about 2,900 by March 2015.

A number of companies are also planning a programme of mitigation measures to reduce the risk of flooding to properties and areas where it is not cost beneficial to provide a permanent solution. About half are proposing improvement to reduce the flooding caused by other causes such as blockages and collapses.

3.5 Other service improvements

Companies have recognised the need to improve their operations to continue delivering a better service and experience for consumers without increasing bills. They have proposed a range of schemes to address problems with the taste, colour or smell of drinking water at consumers' taps, or to reduce the impact of supply interruptions. Companies have also recognised consumers' concerns about bill increases and their limited appetite for further service improvements. Most companies say their proposed customer-driven improvements to the water service will increase bills by less than £1 and to the sewerage service by less than £5.

In addition to work to reduce sewer flooding (see paragraph 3.4), four companies have proposed work to reduce odour from sewage treatment works. Other proposals include:

- protecting assets from flooding;
- drainage studies; and
- mitigating greenhouse gases.

3.6 Bill impacts of capital enhancement proposals

Table 7 below shows the individual impacts on bills of the company proposals for capital enhancement expenditure.

Table 7 Quality enhancement, supply/demand balance and enhanced service levels capital investment and potential bill impacts arising from companies' strategies

	Water enhancements ¹		Sewerage enhancements	
	Capital investment (£m)	Impact on bills by 2014-15 ² (£m)	Capital investment (£m)	Impact on bills by 2014-15 ² (£)
Water and sewerage companies				
Anglian	565	3	745	7
Dŵr Cymru	214	8	227	16
Northumbrian	265	11	220	13
Severn Trent	499	13	701	16
South West	156	10	135	9
Southern	223	16	1,014	43
Thames	1,639	38	2,880	30
United Utilities	740	20	1209	32
Wessex	314	60	281	42
Yorkshire	188	4	603	15
Water only companies				
Bournemouth & West Hampshire	18	7		
Bristol Water	179	21		
Cambridge	27	14		
Cholderton	<0.1			
Dee Valley	6	2		
Folkestone & Dover	25	7		
Portsmouth	21	8		
South East	361	20		
South Staffordshire	28	3		
Sutton & East Surrey	57	17		
Tendring Hundred	5	3		
Three Valleys	172	15		

Notes:

1. Includes replacement of water sources which are having an unacceptable environmental impact.
2. Reflects both operating and capital expenditure.

3.7 Base service outcomes – maintaining service

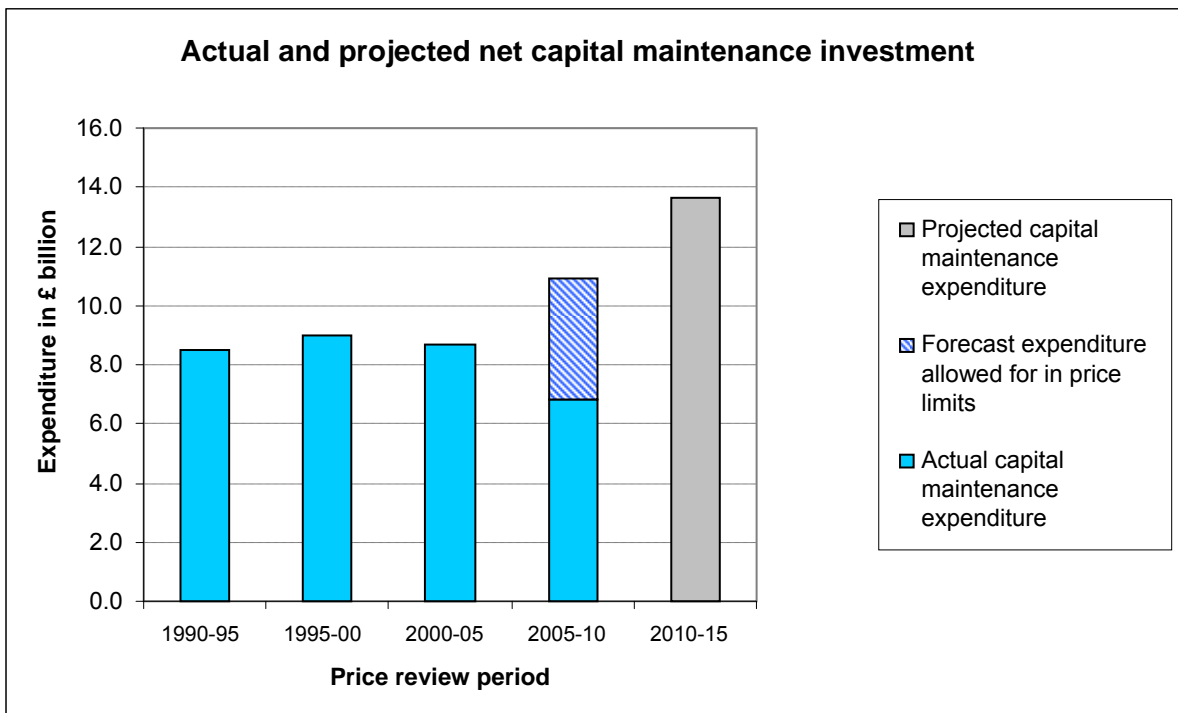
Each company has submitted its plan setting out how it proposes to maintain service standards to customers in a 25-year context. Companies have presented asset management plans to deliver at least stable serviceability and have clarified their targets for each serviceability indicator. In general, companies' plans are based on maintaining current levels of service and are accompanied by evidence of limited willingness to pay for any improvements. However, several companies have

proposed a marginal change to some of their service targets as a result of specific issues identified through their customer surveys and supported by the application of CBA. We are still reviewing the companies' proposals, but across the water and sewerage sectors customers appear more willing to pay for reductions in the number of interruptions to supply than for any other service improvement.

3.7.1 Projected capital maintenance investment

Figure 4 below shows that the companies have forecast that they will need a total of £13.6 billion to deliver at least stable serviceability during the period 2010-15. Almost 40% of this investment is needed to maintain their pipe networks.

Figure 4 Capital maintenance investment (2007-08 prices)



Most companies are forecasting a significant increase in the investment needed to maintain current levels of service (approximately 30% at industry level) when compared to our assumptions at PR04. There are a variety of reasons, but common themes across the water and sewerage sectors include:

- applying the [common framework](#), resulting in a reappraisal of the level of risk to service;
- the need to maintain infrastructure renewal rates previously funded as part of the section 19 programme; and
- the need to undertake strategic maintenance to the large asset base installed in the early 1990s, in particular to maintain high water quality standards.

We will work to understand the justification for these large increases in investment.

3.7.2 Good practice in asset management planning

We expect all companies to adopt sound practices in long-term asset management planning, in line with the conceptual framework set out in the capital maintenance planning common framework.

All companies have set out their plans and have in general made progress to improve their risk-based approaches, in particular in terms of developing robust processes and systems. Several companies have highlighted areas where further improvement is needed, in particular the consistent collection of robust asset data and improving their understanding of the relationship between asset performance and condition and service to consumers.

3.7.3 Odour from the sewage treatment process

In their draft business plans sewerage companies have put forward limited proposals to further reduce existing odour emissions from sewerage operations. These proposals reflect implementation by companies of the 2006 Defra ['Code of Practice on Odour Nuisance from Sewage Treatment Works'](#) and continuing difficulties with odour at some problem sites. We asked companies to assess costs and benefits for odour reduction proposals and we will examine company plans in the light of this. The pattern of odour problems varies between companies. We expect, however, that the benefits of the investments made to reduce odour during 2005-10 will be maintained and further improvements identified for 2010-15.

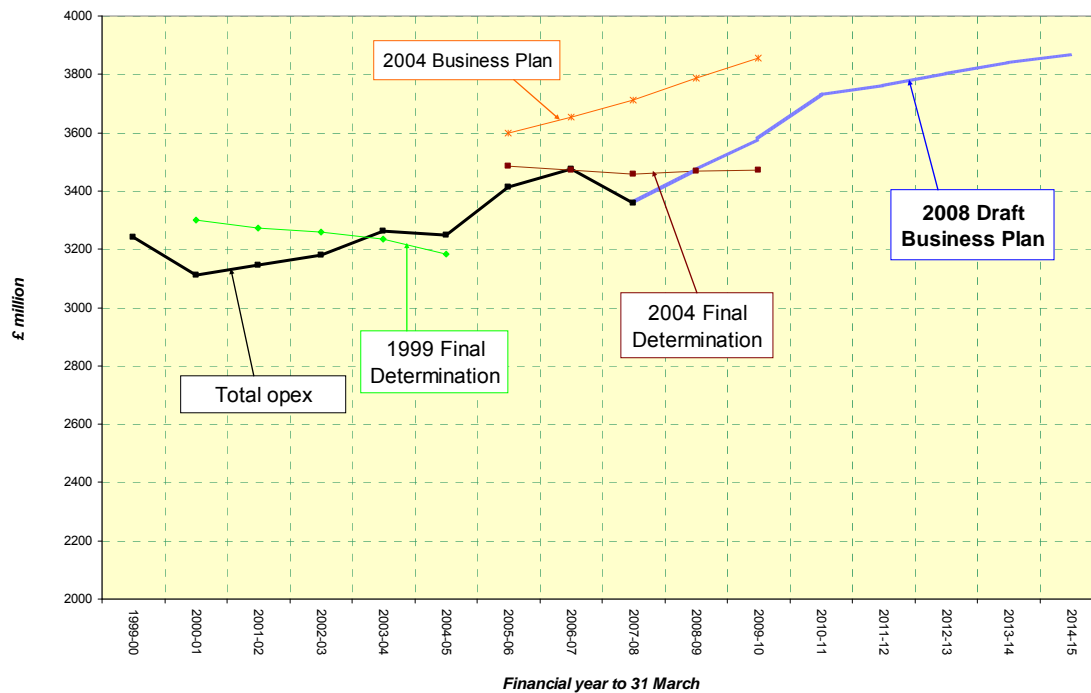
3.8 Operating cost proposals

The companies currently spend around £3.3 billion annually on operating expenditure – paying for items such as wages, power, pensions and licence fees.

3.8.1 Total operating expenditure

In their draft business plans all companies have put forward proposals for higher levels of future operating expenditure, principally to reflect increases in their input costs. This is shown in figure 5 below. By 2009-10 they expect their operating expenditure to rise to £3.9 billion.

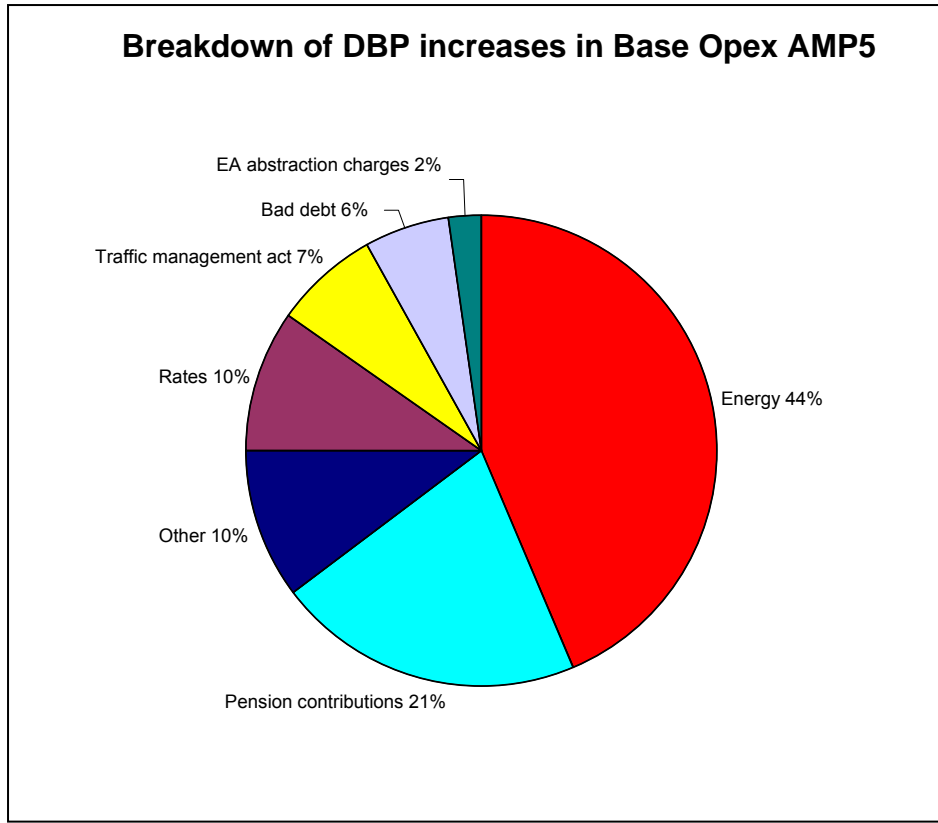
Figure 5 Past operating expenditure and draft business plan assumptions



3.8.2 Operating expenditure proposals

Each company has put forward proposals for future operating expenditure and identified the areas of operating costs expected to increase in the period 2010-15. In most cases, the increases (shown as the blue line on the graph) relate to energy and pension costs, which we discuss later. There are some other common areas where many companies see their costs increasing. Figure 6 below presents these as a pie chart.

Figure 6 Increases in AMP5 base opex



3.8.3 Energy

The water and sewerage sectors are large users of electricity, and energy costs form a significant and growing share of their operating costs. In 2007-08, the sectors spent around £370 million on energy. Companies are clearly concerned about the impact of rising wholesale energy prices, and the uncertainty about the level of future energy prices. All companies have included increases in energy costs in their plans, and energy costs are by far the single biggest driver behind operating cost increases. Many companies also wanted additional protection against future energy prices in the form of a notified item or an annual adjustment for energy costs to take account of fluctuations in future energy prices.

Companies have based their views on a work commissioned by the industry from consultants Bergen Energi, and their own assessments of future market prices. Some companies have offset part of the increase in energy costs by increasing the amount of energy they will generate themselves from renewable sources.

We will consider further how we will take account of any future rises in energy prices. We will do so in a way which maintains the incentives for companies both to manage and procure their energy efficiency.

Renewables and self-generation



The self-generation of renewable energy offers companies potential to reduce their carbon emissions. We recently summarised our position on renewable energy in our '[Climate change policy statement](#)' and provided more detail in [PR09/14](#), '[PR09 treatment of renewable energy](#)'. We would normally expect companies to develop renewable energy as a non-appointed business activity.

There are some cases where generating renewable energy has natural synergies with, and is intrinsically related to companies' core functions (for example, hydro or biogas from anaerobic digestion of sewage). In our [methodology paper](#) we stated generating renewable energy may be considered only in cases where these natural synergies exist and where they can be shown to be cost beneficial.

In their draft business plans all water and sewerage companies have proposed to expand their anaerobic digestion capacities. This expansion delivers around a 50% increase in renewable energy generation in the sectors. Most of the proposals are part of each company's sludge strategies, with a total cost of over £700 million. Water only companies have less potential to self-generate, and this is reflected in the submissions. A small number of companies have proposed to install wind turbines as a non-appointed business activity. Although anaerobic digestion makes up most of the proposals, various options for renewable generation are included in the business plans.

We expect companies to use renewable energy generation as part of their strategies to reduce emissions, although we do not expect consumers to bear all the investment costs and risks. We will continue to protect consumers by making sure that all schemes proposed within the appointed business meet our criteria and deliver value.

3.8.4 Pensions

Most companies have included additional operating expenditure in their plans for pensions. They argue that these increases are needed to take account of increases in future funding requirements, reflecting both the performance of their pension funds and the assumptions about the longevity of pension scheme members. In general, these figures are the companies' best estimates of future pension costs and are not supported by a full actuarial valuation. We expect any case for an increase to be supported by a full actuarial valuation of the pension fund and companies expect these to be available for including their final business plans.

4. Understanding the costs of delivery

We have changed some aspects of our approach to understanding the costs of delivering future water and sewerage services. While our approach to operating costs remains much as that used in 2004, we have made significant improvements to our approach to capital investment.

4.1 Future efficiency

We asked companies to provide us with their views of both operating and capital expenditure efficiency. For operating expenditure, we asked companies to provide assumptions for both continuing efficiency and catch-up efficiency. For capital efficiency, we asked companies to provide assumptions for continuing efficiency only (with comparative capital efficiency being assessed through companies' cost base submissions. See 4.2 below). When looking at the scope for future efficiency, companies have taken account of changes in both future productivity and input prices. It is the combined effect of these two elements which gives the overall efficiency scope.

For operating expenditure efficiency, most companies included forecasts for total efficiency of 0.5% to 1% a year, with a small number of companies forecasting negative future efficiency gains (that is, future rises in their input prices will be greater than their productivity gains). For capital expenditure efficiency, the forecasts of continuing efficiency are in a wider range, and it is difficult to draw any generalised conclusions. A significant number of companies believe that there is no scope for any continuing capital efficiency, but not all companies share this view. We will consider further what this wide range of views means for decisions on the scope for future efficiency.

These ranges reflect each company's view on both continuing efficiency and its view of its own efficiency in relation to the rest of the companies. The companies have also commissioned work from Frontier Economics on the scope for future frontier (continuing) efficiency for both operating and capital expenditure.

We will publish our assessments of operating expenditure relative efficiency in December 2008, and we have already published our feedback on companies' [first cost base submission](#). We have commissioned Reckon LLP to advise us on the scope for future efficiency, and it will provide us with its final report in September 2008.

We will use this report together with evidence from draft business plans, the cost base and our relative efficiency modelling to inform our decisions on the scope for future efficiency.

4.2 The cost base

In April 2008, each company made its initial cost base submission, containing cost estimates for a range of standard projects and breakdowns of projected AMP5 expenditure. This submission formed part of the companies' draft business plans. In general, most companies provided robust submissions and commendable detail and we are grateful for the work done by companies and reporters.

In August we published a [feedback report](#), explaining how we analysed these submissions and presenting our initial findings. In September we gave each company individual feedback to help them improve their final business plan submissions in April 2009.

We will take account of these findings and other evidence in setting the draft baseline level of capital expenditure for the new capital expenditure incentive scheme in December 2008. We will explain to each company the adjustments we have made in our baseline expenditure assumptions.

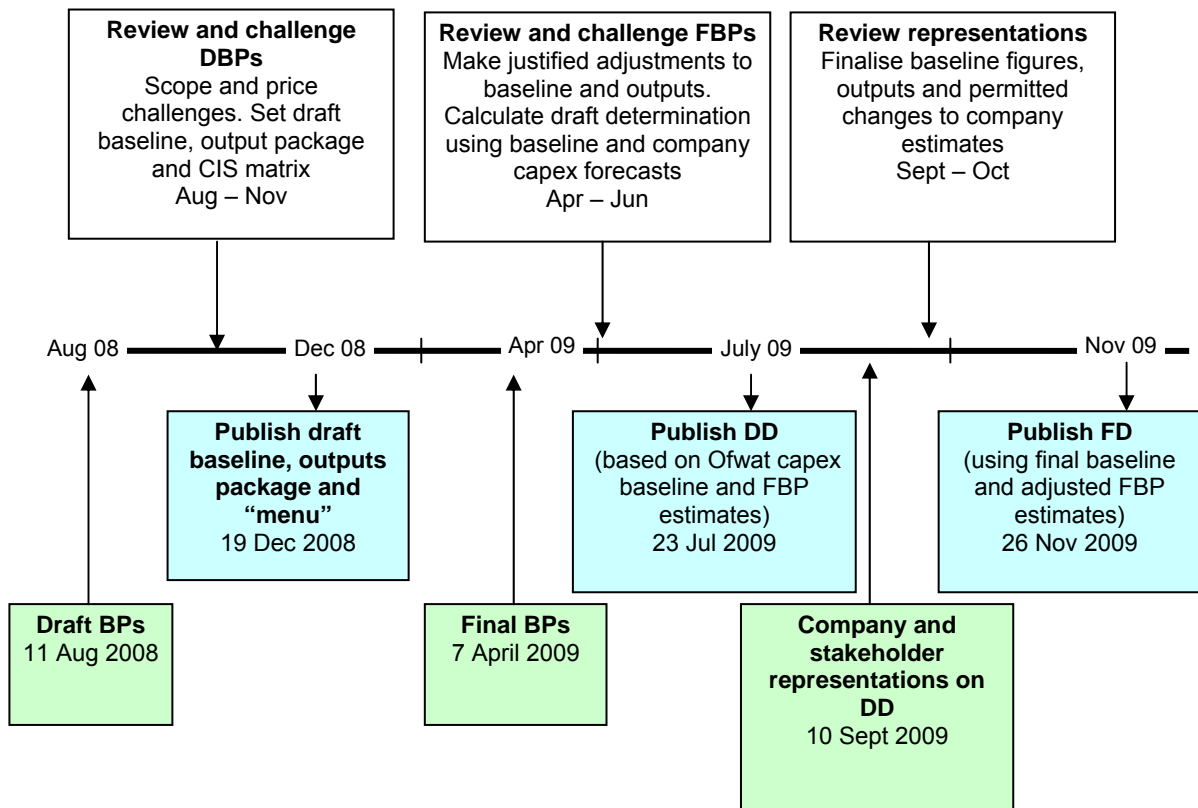
4.2 Capital estimating scorecard

We asked companies to set out their approach to estimating capital projects they have done. They have completed a scorecard assessment which exposes the level of robustness in their 20 largest schemes by value in each sub-service. The scorecard reflects the key areas that influence the overall robustness of an estimate (for example, the scope, cost and risk certainty and robustness of their estimating processes). The companies have submitted their assessments and we will use them to improve our understanding of the robustness of the costs submitted in the draft business plans. Across the water and sewerage sectors the overall robustness of the top 20 schemes ranges between 40% and 80%. This means there is a significant spread in the companies' confidence in their capital costs.

4.3 Capital expenditure incentive scheme (CIS)

The draft business plans provide us with the information we need to develop the CIS baseline, which is essentially our view of the necessary capital investment programme. As shown in figure 7 below, we will issue the draft baseline to companies and publish a summary of our views based on draft business plans in December 2008.

Figure 7 The capex incentive scheme process



5. Financial assumptions for setting price limits

Assumptions on financial matters are an important element of the price review process and the judgements made in this area will have significant impacts on bills. In our [methodology paper](#) we set out how we wanted companies to approach this area in their draft business plans. We are pleased that companies have largely followed our guidance.

5.1 Reflecting capital expenditure in price limits

Customers pay for capital expenditure over the lifetime of the assets they finance. Bills to customers include:

- a current cost depreciation charge (CCD) for above-ground assets, such as treatment works; and
- an infrastructure renewals charge (IRC) for underground assets, such as pipes, which form part of either the water or sewerage networks.

Together these are referred to as 'capital charges'. In addition, price limits must provide for a return on the capital invested by efficient companies.

5.1.1 Current cost depreciation

At industry level, companies project in their draft business plans CCD of £14 billion for the five years 2010-15, compared with £10.3 billion allowed in price limits for 2005-10. Part of the increase in the CCD reflects an assumption of an increase in maintenance activity for above-ground assets. This would increase bills by 3.5%.

5.1.2 MEA revaluations

For this review, we require all companies to carry out a full asset revaluation (on a modern equivalent asset (MEA) basis). Each company should then calculate its projected CCD on base assets on this revaluation.

Nearly all companies have completed a revaluation in their draft business plans. Some companies have said that they will complete a revaluation in time for the final business plan. The revaluation data appears to show an increase in the net MEA value of 5.5% to £37.2 billion for non-infrastructure assets.

5.1.3 Infrastructure renewals charge (IRC)

Our requirement for each company to adopt infrastructure renewals accounting means that the infrastructure network is treated as a single asset system to be maintained in perpetuity. Instead of a depreciation charge, the IRC represents the annualised costs of maintaining the system at its current level of operations. A company's accounting policy for infrastructure renewals should be consistent with the regulatory accounting guidelines (RAGs). The level of IRC should be broadly constant, in real terms, over the medium to long term, assuming that the network systems are in a steady state regarding operational capacity. We expect the IRC and the expenditure to maintain and replace the network (IRE) to be equal. In any given year, the balance sheet reflects the difference between the two as an accrual or prepayment.

5.1.4 Infrastructure renewal expenditure

In March 2008, we [confirmed](#) that we would retain a 15-year period of average forecast IRE in order to calculate the IRC. Where a company has demonstrated a medium- to long-term view of IRE (in its calculations of IRC) in its regulatory accounts, we will calculate the IRC as the average of expenditure for the period from 2010-25. Where a company has not done this, we will continue to use the five years back and ten years forward calculation (2005-20) for PR09. Seven companies have submitted plans with IRC based on the forward-looking view, that is, using 2010-25. There has been some variation in the time span that other companies have used, with some assuming a period of less than 15 years.

The IRC has a considerably higher impact on bills at industry level than the CCD. We allowed £3.3 billion for IRC for the period 2005-10, while companies' draft business plans for 2010-15 include proposals for £5.6 billion. This is an increase of nearly 70% and is equivalent to a 9.2% increase in bills.

5.1.5 Prepayment and accruals

For PR09, each company must demonstrate why we should recognise in price limits IRE incurred over and above our assumptions for the current price-setting period (2005-09), through an increase in the IRC over a ten-year period (2010-20). This should include:

- an updated long-term infrastructure maintenance plan reflecting the need for additional IRE over and above the level we assumed in price limits in 2004;
- evidence in the June return of increased spending on infrastructure renewals. We expect this to reflect a sustained, long-term increase, not a one-off peak in expenditure; and
- evidence of an increase in the IRC in the regulatory accounts, indicating a step change in the required level of capital maintenance expenditure. A static IRC would signal that the prepayment is a short-term position that the company expects to reverse in the future.

Three companies have said that they have spent more on infrastructure renewals over 2005-10 and are requesting a prepayment windout in their plans.

5.2 Cost of capital and financeability

Each company was required to include its view of its cost of capital in its business plan. The majority of companies relied heavily on NERA's advice to Water UK on the cost of capital¹ and submitted figures towards the high end of the NERA range. Companies explained that their views on the cost of capital and financeability are tentative because of conditions in the capital markets and will be revisited in the final business plan submissions.

¹ 'Cost of Capital for PR09; Final Report for Water UK', NERA, 2008.

Table 8 Companies' views on the cost of capital

Company	Company view of cost of capital	
	Vanilla ²	Fully post-tax
Water and sewerage companies		
Anglian	5.4	4.8
Dŵr Cymru	5.3	4.7
Northumbrian	5.3	4.7
Severn Trent	5.7	4.9
South West	5.2	4.6
Southern	5.5	4.8
Thames	5.5	4.8
United Utilities	5.3	4.7
Wessex ¹	5.3	
Yorkshire	5.5	4.8
Water only companies		
Bournemouth & West Hampshire	5.9	5.2
Bristol Water	6.5	5.7
Cambridge	6.1	5.4
Cholderton ³		
Dee Valley	6.4	5.7
Folkestone & Dover	6.2	5.6
Portsmouth	6.0	5.3
South East	5.9	5.2
South Staffordshire	6.2	5.4
Sutton & East Surrey	6.0	5.5
Tendring Hundred	6.5	5.5
Three Valleys	5.5	4.9

Notes:

1. Wessex modelled a return of 5.3% in its draft business plan but did not propose a view on the cost of capital at this stage, due to uncertainties in the capital markets. Hence the fully post-tax cost of capital is not stated.
2. The vanilla is the weighted average cost of capital calculated on the basis of pre-tax debt and post-tax equity. This is used to calculate the revenue requirement in our financial model, because we model a notional capital structure and take a company-specific approach to tax.
3. Cholderton has not (because of its size) submitted a business plan that has a comparable cost of capital assumption.

5.2.1 Gearing

Each company used a notional gearing assumption of 60% (net debt:RCV) to determine its proposed cost of capital, regardless of whether this represented its capital structure.

5.2.2 Debt and equity

Most water and sewerage companies propose a real cost of debt in the range of 3.5% to 3.9%. Only Severn Trent proposed a cost of debt above this range, using the PR04 figure (4.3%). Proposals for the cost of equity are in the range of 7.65% to

7.9%, with several companies proposing a higher cost of equity than that set at PR04 (7.7%). Company assumptions on the cost of debt and the cost of equity result in a fully post-tax cost of capital in the range of 4.6% to 4.9% for water and sewerage companies (table 8). This is below our assumption of 5.1% at PR04.

5.2.3 Small company premium

All the water only companies include a small company cost of capital premium in their proposals, which increases the range of the post-tax cost of capital for water only companies to between 5.2% and 5.7%. The premiums that the water only companies propose reflect the companies' assumptions of higher direct and indirect equity trading costs and higher debt costs, largely based on a similar evidential approach to that provided by companies at PR04.

5.2.4 Financeability

Three companies (Severn Trent, Sutton and East Surrey and Cambridge) include an assumption of specific revenue uplifts to address financeability issues. No company has assumed any new issuance of index-linked debt to address financeability constraints. However, some companies have assumed equity formation either through an equity injection or retained earnings. While citing caution due to market conditions, all companies state their draft business plans are financeable.

5.2.5 Next steps

We have appointed Europe Economics to advise us on the cost of capital and related issues for this review. With Europe Economics, we will continue to review market evidence, to assist our judgement on the cost of capital and related issues. We will maintain our consistent and transparent approach to setting the cost of capital, which is critical to investors. We will not comment on a range or a point estimate for the cost of capital until we publish our draft determinations in July 2009. However, our current expectation is that the cost of capital we will use to set price limits will be lower than that set in 2004. This view is founded in current market evidence on the cost of debt and interest rates, arising from changes in the companies' debt portfolios since 2004.

5.3 Taxation

Companies project that tax costs will rise in the early years of 2010-15 because of the recent changes in tax legislation, principally the abolition of industrial buildings allowances. Towards the end of the period, taxation falls as the impact of tax allowances on the large capital programme work through. In 2014-15, tax charges are expected to be lower than 2009-10.

Our analysis of recent June returns has highlighted some instances where companies were surrendering tax losses to group companies and not receiving full payment. This could mean that the tax losses are not available to reduce future price limits. However, in their draft business plans all companies confirmed that they received full payment for losses surrendered.

5.4 Revenues

At the industry level, changes in revenue have a negative impact on the average bill in 2009-10 because population and housing growth is increasing the size of the customer base, generating more revenue. We expected companies to base the revenue projections in their business plans on the information in their water resource plans and long-term sewerage plans. We are scrutinising companies' assumptions.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water and sewerage sectors in England and Wales provide customers with a good quality and efficient service at a fair price.



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

Photographs © Getty Images/Shine Pictures
Printed on Revive Silk 75, a carbon-neutral
paper containing 75% minimum de-inked
post-consumer waste paper
October 2008

ISBN 1-904655-47-5

© Crown Copyright 2008