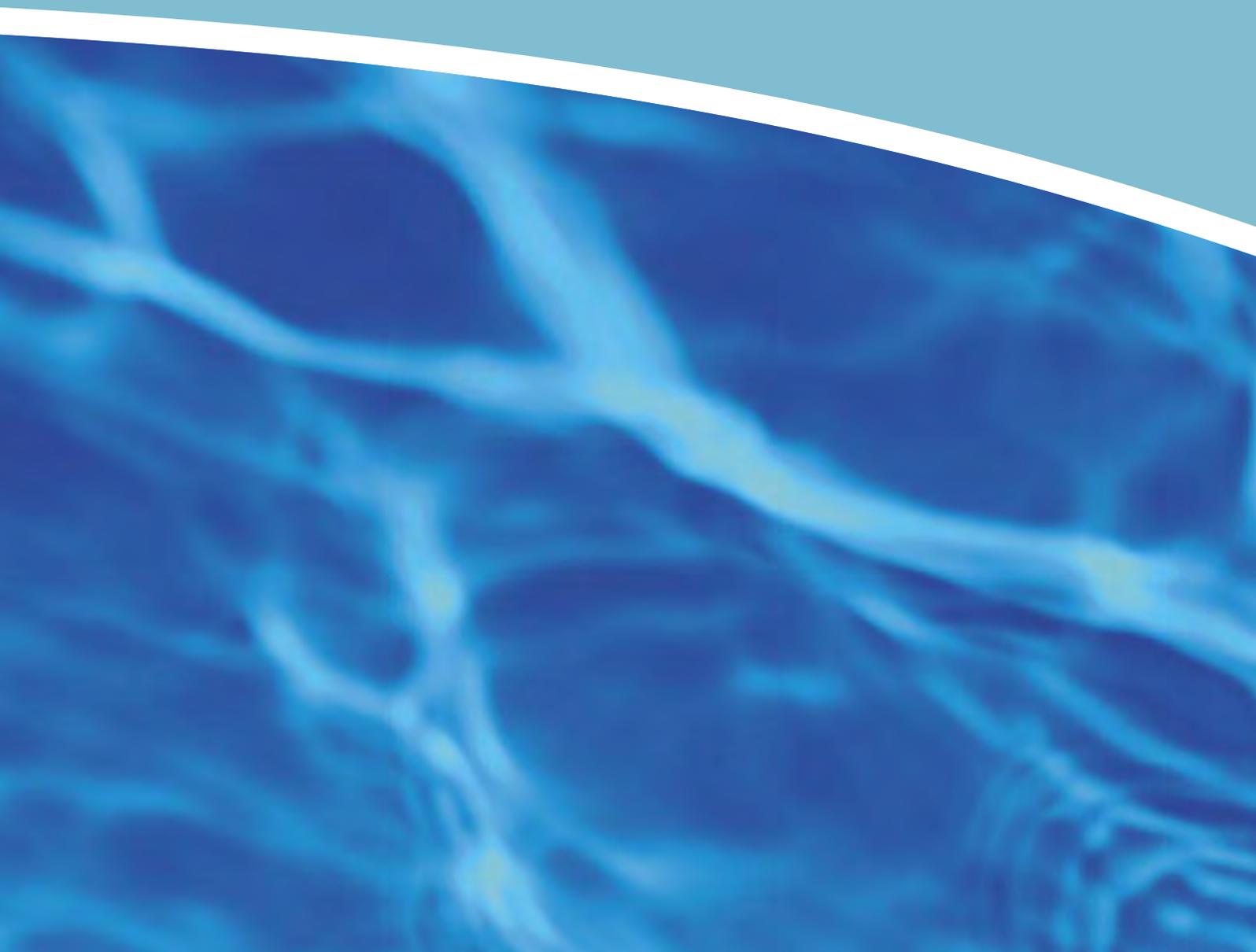


Annual report 2009-10

Water today, water tomorrow



www.ofwat.gov.uk

HC104 £14.75



Water Services Regulation Authority (Ofwat)

Annual report 2009-10

For the period 1 April 2009 to 31 March 2010

Presented to Parliament pursuant to section 192B of the Water Industry Act 1991 (as amended by section 38 of the Water Act 2003)

Ordered by the House of Commons to be printed on 14 July 2010

HC104 London: The Stationery Office £14.75

© Crown copyright 2010

The text in this document (excluding the Royal Arms and other departmental or agency logos) may be reproduced free of charge in any format or medium providing it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Where we have identified any third party copyright material you will need to obtain permission from the copyright holders concerned.

ISBN: 9780102965995

Printed in the UK for The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
ID 2366097 07/10

Printed on paper containing 75% recycled fibre content minimum.

About this report

This report sets out the work we carried out in 2009-10 to deliver our strategy.

Our duties are laid out in the Water Industry Act 1991 as amended. We are directly accountable to Parliament and the National Assembly for Wales.

Further information about our work is available on our website at www.ofwat.gov.uk.



Contents

Chairman's foreword	4
Chief Executive's report	5
Our strategy	6
Our Board	7
Facts and figures: price limits for 2010-15	8
Ensuring a fair deal for customers	10
Keeping companies accountable	14
Making monopolies improve	18
Harnessing market forces	22
Contributing to sustainable development	26
Delivering better regulation	30
Appendices	35

Chairman's foreword



At the end of the 2009-10 reporting year we published 'Ofwat's strategy – delivering sustainable water'. This is our refreshed long-term strategy for regulating the water and sewerage sectors in England and Wales.

At the heart of our strategy is our desire to protect consumers, both today and for the long term. Collectively, the water and sewerage sectors have achieved much since privatisation in 1989. Services are better, more reliable and more efficient. Our natural environment is also cleaner. But we now face new challenges, including climate change and rapid population growth, which

threaten the progress we have made – unless we anticipate those challenges and prepare for them.

A key part of our work this year was to set limits on the prices the appointed, regional monopoly companies can charge their customers for 2010-15. While keeping bills broadly flat, we have allowed the companies to invest in significant improvements to services and the environment over the next five years. This will allow them to deliver benefits to customers and the environment today – and begin to invest in the services we will receive many years from now.

But we need to go further.

The challenges facing the sectors will make delivering water and sewerage services an increasingly difficult and uncertain job. The companies will need to plan, innovate and deliver services in new and more sustainable ways. And that means the regulatory environment we provide needs to change as well.

This is why we have launched a new programme of work comprising a number of inter-linked strategic projects. The programme aims to review fundamentally why, and how, we regulate.

The theme that runs through all of our projects is revealing – and using in decision-making – the true value of the resources and services we all consume. If we are to ensure our water security, and protect the natural environment we enjoy, we need to plan, manage and use water, sewerage and drainage services more responsibly.

Our review will operate within the overall framework provided by the Coalition Government for England and the Welsh Assembly Government for Wales. Working together with other stakeholders, we can find the solutions to the challenges the sectors face.

Finally, I am grateful for the dedication of all of my colleagues on the Ofwat Board, and for the support and expertise of all of the Ofwat team during the year.

Philip Fletcher
Chairman

Chief Executive's report

The year 2009-10 has been an important one for the water and sewerage sectors. Inevitably, the year was dominated by Ofwat's periodic review of prices. In July, we published our draft decisions on prices for customers for 2010 to 2015. The feedback and opinions we received from a wide range of stakeholders helped us to arrive at our final decisions in November. Those decisions set a clear and stable outcome for customers and the sectors for the next five years, and 21 of the 22 companies accepted them. One company appealed to the Competition Commission.

Over that time, customers' bills will remain broadly flat – a good result when customers are facing much financial uncertainty in the wider economy. But flat bills are not at the expense of investment – more than £22 billion will go towards real improvements to services for customers and the environment. Our decisions mean the companies can plan for the services they need to deliver over the long term by, for example, investing in renewable energy, promoting water efficiency and developing catchment management schemes.

During the year, we also saw increased interest in the sectors, including from new entrants. We approved six new appointments

and variations – where a new water company replaces another in a given area. Each case involved clearly identifying benefits for customers. We also continued our work on promoting choice for non-household water customers, developing the systems and processes that will allow them to change their water supplier in the future.

And, following the end of the price review, we launched our major new work programme to deliver our long-term vision of sustainable water, which we set out in our strategy. Through that programme we are looking at how we can better reveal the true value of water to enable the sectors to make better, more sustainable decisions. For example, we are exploring how abstraction and water trading can contribute to this. We are also reviewing how we should set price limits for monopoly companies in a way that incentivises sustainable outcomes. And we are looking at how the structure of the charges customers pay can contribute to long-term outcomes.

Delivering our strategy and our work programme depends on the continued engagement and co-operation of a wide and varied group of stakeholders. During the year, many of those stakeholders began working with us, and I



would like to put on record my thanks to them. We want to build on this collaboration over the coming year so that together we can achieve the best outcomes for customers and the environment.

I would like to finish with thanks to my colleagues. Their hard work and continuing dedication has been, and will be, instrumental in helping to secure sustainable water and sewerages services now and for the long term.

Regina Finn
Chief Executive

Our strategy – a summary

<p>This is our long-term aspiration.</p>	<p>Vision</p> <p>A sustainable water cycle in which we are able to meet our needs for water and sewerage services while enabling future generations to meet their own needs ('Sustainable water').</p>
<p>Our mission and goals set out how we will contribute towards delivering our vision.</p>	<p>Our mission and goals</p> <p>To ensure customers continue to receive safe, reliable, efficient and affordable water and sewerage services that promote positive social, economic and environmental impacts today, tomorrow and over the long term ('Water today, water tomorrow').</p> <ul style="list-style-type: none"> • Ensuring a fair deal for customers • Keeping companies accountable • Making monopolies improve • Harnessing market forces • Contributing to sustainable development • Delivering better regulation
<p>Our values describe how our organisation, and individuals in it, will behave in delivering all aspects of our work.</p>	<p>Responsibility</p> <p>We have values that underpin our vision, mission and goals. We will operate to the highest standards of public office and conduct our business in a responsible and ethical way.</p> <ul style="list-style-type: none"> • Excellence • Leadership • Respect • Integrity
<p>Our vision, mission and goals provide the basis of our annual priorities, which we set out in our forward programme each year.</p> <p>These annual priorities form the basis of our senior management team's objectives. These in turn cascade down the organisation to the objectives of all Ofwat staff.</p> <p>This ensures actions required to deliver our strategy are allocated and aligned with individual responsibilities.</p>	<p>Delivery</p> 
<p>Our annual report and resource accounts show what we have delivered each year and report on progress in delivering our strategy.</p>	<p>Progress and accountability</p> <p>We review how well we have done in delivering our work programme and achieving our goals, mission and vision in our annual report each year. We also report on the efficiency and effectiveness of our organisation in our annual resource accounts. Both documents are laid before Parliament.</p>

Our Board



From left: Keith Mason (Director of Finance and Networks), Philip Fletcher (Chairman), Penny Boys, Gillian Owen, Regina Finn (Chief Executive), Jane May, Mike Brooker, Cathryn Ross (Director of Markets and Economics), Peter Bucks

Non-Executive Directors: Penny Boys, Gillian Owen, Jane May, Mike Brooker, Peter Bucks

Facts and figures: price limits for 2010-15

One of our main pieces of work this year was the 2009 price review (PR09) – the culmination of more than two years of work by us, the companies and stakeholders. In November 2009, we set limits on the prices that the water companies in England and Wales can charge their customers from 1 April 2010 to 31 March 2015.

The task



The companies

22 companies

55 million consumers

668,000 km of water mains and sewers

45,000 assets including reservoirs, treatment works and pumping stations

£9.7 billion annual turnover

The process

30-month process

More than 6,500 consumers surveyed

More than 60 strategic direction statements, draft and final business plans reviewed

200 formal meetings with the companies

8 key organisations working together

The main benefits by 2015

Investment

£22 billion to be invested by 2015

Customers' bills

-£3 average reduction in customers' bills

Maintaining and improving services

The companies will save 100 billion litres of water by increasing water efficiency, reducing leakage and increasing metering

That is a lot of water – enough to supply the cities of Liverpool, Bristol and Brighton for more than a year.



50% of all households (compared with 35% today) to have a meter – the fairest way to charge



10,000 km of water mains will be improved or replaced



6,300 properties will benefit from investment to address sewer flooding problems

Environmental benefits



140 water treatment works to be improved



550 sewage treatment works to be improved



3,000 km of rivers maintained or improved to meet EU environmental standards



55 wetlands and bathing waters to have improved water quality

Climate change

10 million

The number of people who will benefit from investment to help guard them against the risks of extreme circumstances, such as flooding, affecting supplies

90,000 homes

The extra amount the companies will invest in renewables will generate the equivalent electricity to supply this many homes. It will also reduce the companies' running costs by an estimated £8.8 million a year

Efficiency

£1 billion

The total amount we expect the companies to save in efficiencies by 2015

£110

On average, the amount we have saved every customer since privatisation by challenging the companies to be more efficient

Delivering the price review

During the price review, we carried out an unprecedented level of communication and joint working with our stakeholders. That is one reason why our price limits are good for customers and the environment now and over the longer term.

Mark Hann
Head of PR09 and Service and Performance team

Ensuring a fair deal for customers

What we did this year

During 2009-10, we set price limits for the companies we regulate for each year between 2010 and 2015. We challenged their final business plans, consulted on our draft decisions in July and published our final price limits in November 2009. As a result:

- average household bills across England and Wales will remain broadly flat over the next five years, decreasing by £3 (before inflation) to £340 by 2015;
- the companies will invest £22 billion in maintaining and improving services to consumers over the next five years;
- almost ten million people will benefit from investment to guard against them being without water during extreme events like flooding; and
- the companies will address sewer flooding problems for more than 6,300 properties.

We dealt with more than 2,300 disputes and complaints during the year, and obtained rebates or compensation for customers in

excess of £500,000. We also secured capital investment of more than £20 million to address problems that customers experienced.

We responded to, and worked closely with, the independent review of charging for household water and sewerage services led by Anna Walker. As part of this work, we provided evidence and analysis to the review team. We are taking a lead role in ensuring that the case for increased metering is evaluated comprehensively, together with the consequences that some customers could face without effective social safeguards.

We worked closely with the Consumer Council for Water and other key stakeholders during the year. This included the joint consumer research carried out as part of the price review.

We worked closely with the Department for Environment, Food and Rural Affairs (Defra) and other stakeholders on developing the new Flood and Water Management Act. One of the changes in the law that we strongly supported was widening

the definition of those who can be held responsible for bill payment. When implemented, this will help reduce the burden of non-payment of bills that all customers share.

On EU environmental policy, we argued that legislation should take into account both carbon emissions and quality standards. Currently, European legislation does not consider properly the benefits of reducing carbon. The European Commission is now reassessing the impact of carbon on EU water policy with a view to developing legislation that is more effective. This will help protect customers and the environment.

A new EU proposal on consumer rights could reduce protection for water customers as it would impinge upon the ability of regulators to use their statutory powers to protect consumers. We are working with our UK and European stakeholders to persuade the EU to develop legislation that is more flexible and recognises the role that legislators pay. This will ensure that the current levels of service that consumers receive are maintained.

What we said

“ People can shop around for the best deal on many things, but not water. Our job is to do this for them”

Our final decisions on price limits for 2010-15

Other work this year included:

- checking that the companies were properly re-enrolling customers on the Watersure tariff for low-income metered customers. We required one company to improve its procedures and provide payments averaging £90 to 30 customers;
- publishing customer leaflets on surface water drainage charges, water resale and dealing with complaints;
- working with the Welsh Assembly Government, the Wales PR09 Forum and other stakeholders to support the continued protection for Welsh consumers within the context of a devolved administration;
- responding to the Consumer Council for Water’s consultation on its work programme for 2010-11 and beyond; and
- setting up a customer research framework contract which we, the Consumer Council for Water and other public bodies can use, and working with CCWater on their customer research.



We are working with our UK and European stakeholders to persuade the EU to develop consumer rights legislation that is more flexible



A snapshot of the year

Ensuring a fair deal for customers... on sewer flooding

One of the worst service failures a customer can experience is flooding of their home from a public sewer.

The companies are legally required to ensure they drain their area effectively. We expect them to identify those properties that are at risk of flooding and take action to address that risk. We will investigate complaints from customers where repeated flooding suggests that a company needs to take action.

One such case involved the flooding of two basement properties in York, where residents had experienced five events of flooding of their homes in four years.

Following our intervention, Yorkshire Water investigated options for mitigating the risk and impact of flooding. It provided non-return valves in

the sewer and door protection, while developing a longer-term solution to remove the risk of flooding.

The company considered a number of options for a capital works scheme to alleviate the risk of flooding and decided to carry out one that cost approximately £650,000. It completed the scheme in 2009, removing the risk of flooding for these customers.

Pauline Amor
Head of Enquiries and Complaints



Keeping companies accountable

What we did this year



Following consultation, we published our approach to enforcement in July 2009.

We aim to secure compliance and change behaviour, so that consumers' interests are protected. The action that we take will depend on the nature, seriousness and impact of any contravention.

In July, we also consulted on our revised statement of policy on financial penalties. This will help guide our decisions when we impose any penalties on the companies. Since 2005, we have imposed eight penalties. We will take strong action where necessary, but our focus is for the companies to take responsibility where problems arise and put things right for their customers.

Properties in the Penketh area of Warrington have experienced sewer flooding problems since 2004. In September 2008, United Utilities provided a legal

undertaking in which it agreed to take action to reduce the risk of sewer flooding for specified properties by specific dates. The company failed to meet the terms of the first element of its undertaking, and in 2009 we placed an order on the company to remove all affected customers in the Penketh area from its 'at risk' registers by August 2011.

This is the first time that we have used such an enforcement order. The company is making progress and is on track to meet the terms of the undertaking.

In taking forward enforcement action at United Utilities, our focus was on pursuing an approach that secured appropriate systems and processes for the future and help for customers whose properties faced the risk of sewer flooding.

During the year, South West Water made us aware that it had identified specific failings in its systems and processes for

What we said

“ We now need to make sure the companies deliver on their promises. If they do not, we will take action”

Our announcement during 2009-10 of companies' charges for 2010-11 – the first year that our new price limits apply

dealing with email complaints and appointments. As a result, the company misreported information to us.

The company:

- carried out a thorough investigation;
- compensated customers directly affected; and
- volunteered an undertaking to put right its systems and to make additional redress to its customers. This includes funding for schemes to deal with sewer flooding and odour problems.

We welcome the constructive approach the company has taken – companies should be accountable to their customers. We are seeking to incentivise the companies to take full responsibility for complying with their obligations to customers.

We consider that the actions that South West Water took in this case demonstrate this.

All of the companies met their 2008-09 leakage targets, which we reviewed during 2009-10, despite some of the most difficult operating conditions for more than a decade. Thames Water made significant progress with its mains replacement programme. This includes the extra work it has carried out at shareholders' expense as part of its legal undertaking. We will confirm that the company has met the requirements of this in 2010-11.

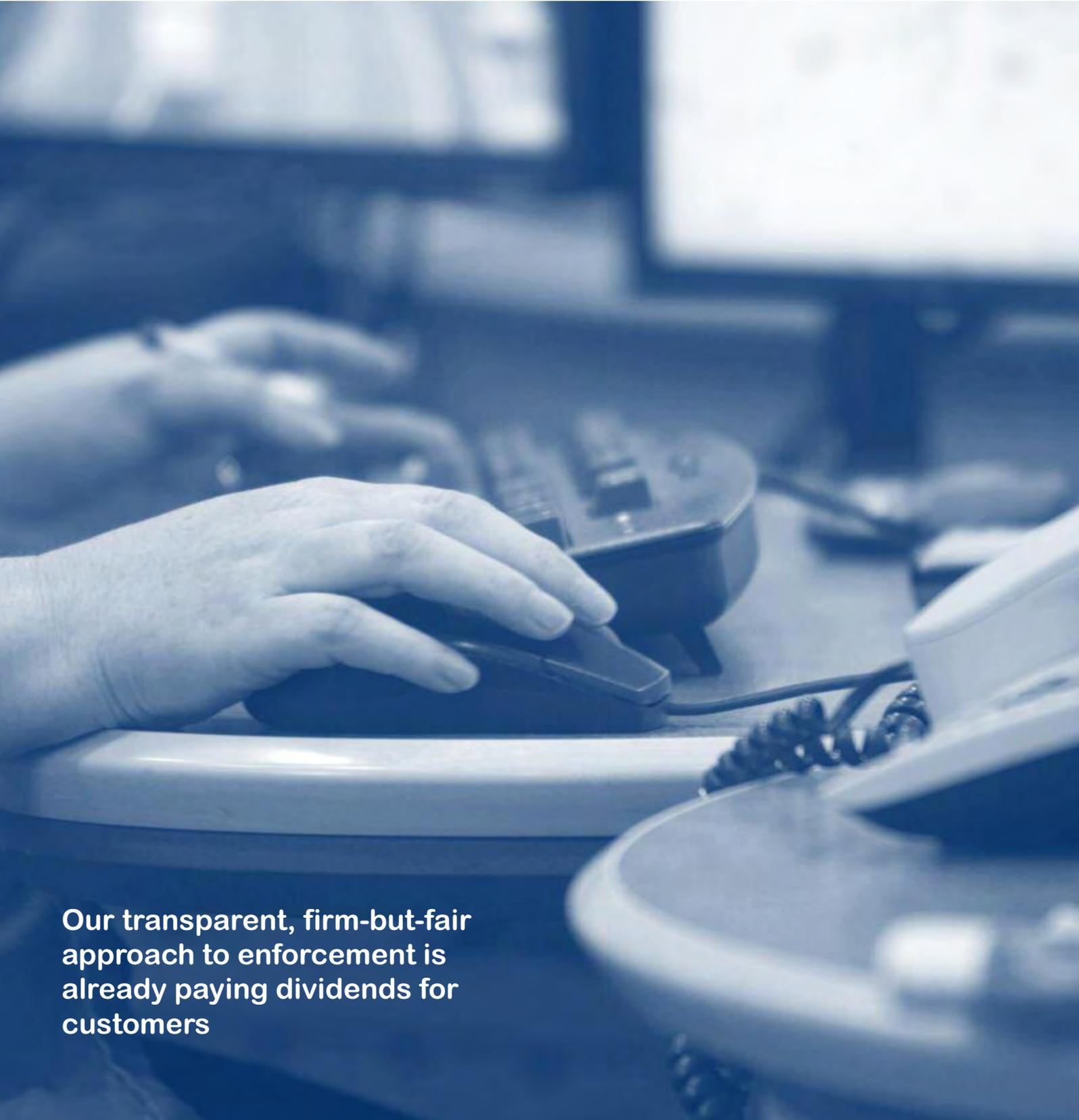
During the year, we also consulted on the principles that we will use in deciding whether to open or continue investigations under the Competition Act 1998. We have powers under this Act to investigate businesses suspected of anti-competitive agreements or the abuse of a dominant market position. We can impose tough

penalties on those that have contravened the Act. We will use our published principles to help us decide whether and what enforcement action we should take if there are any breaches of the legislation.

Within the bounds specified the onus is on each company to provide reliable, accurate and complete data. And to support this, we published each company's annual returns soon after submission to us in June 2009. We plan to do this every year.

Other work this year included:

- checking and approving the companies' charges for 2010-11; and
- launching a new project looking at how we monitor compliance and how this can be achieved more efficiently in future (see [appendix 5](#) on page 39).



Our transparent, firm-but-fair approach to enforcement is already paying dividends for customers

A snapshot of the year

Keeping companies accountable... with a firm-but-fair enforcement policy

In all that they do, we consider that the companies should be accountable to their customers. We are seeking to incentivise them to take full responsibility for complying with their obligations to customers – particularly when things go wrong.

The case at South West Water was a good example. The company identified specific problems with its systems. This meant that some customers had received a level of service that was less than they were entitled to.

South West Water contacted us to tell us about the problems they had identified, and carried out a thorough investigation. The company has worked hard to identify and compensate customers that were directly disadvantaged. It is fixing its systems and, as a further step, has volunteered to spend its own money to provide improvements to its services for all customers.

We welcome the approach that South West Water took. It is a positive example of how our transparent,

firm-but-fair approach to enforcement can pay dividends for customers. We want to encourage the right sort of behaviour from the companies. Our regulatory compliance project, which we began during the year, is about developing this further and encouraging all companies to do the right thing.

Ingrid Olsen
Head of Enforcement Policy



Making monopolies improve

What we did this year

We need to make sure the companies continue to improve. That is why we challenged them hard when we set price limits for 2010-15. For example, we are demanding that they make efficiency savings of about £1 billion by 2015.

At the same time, our price limits allow each company to earn a return on their capital and enable them to raise finance on reasonable terms. They borrow money to pay for investment and then recover this through customers' bills over the long term. We consider our price limits will help an efficient company to deliver the right outcomes at the right time, and represent value for money for customers.

We met with more than 70 investors and analysts individually to discuss our approach to regulating the sectors.

Maintaining the confidence of investors is important in ensuring that the companies can raise money to invest in services for customers.

We consulted on and published procedures for companies seeking financial adjustments relating to changes to their investment programmes between 2010 and 2015. This gives the companies and investors greater regulatory certainty. It also helps to ensure that they are able to finance their functions.

Following two years' work, we consulted on and published our final approach for using the service incentive mechanism (SIM). From April 2010, we will use the SIM to encourage the companies to improve the quality of service that consumers experience. We have developed the SIM in close consultation with our stakeholders. Our stakeholders have highlighted this work as an example of good practice in stakeholder engagement.

Accounting separation will inform our work on market reform. It is also a key part of our future price limits project. Following a review of company responses to the

accounting separation consultation that we published in March 2009, we:

- published our conclusions;
- updated and published accounting separation reporting requirements;
- published accompanying auditor procedures and reporters guidance; and
- published an impact assessment.

The companies are now required to report their costs against nine separately identified parts of their business ('business units'). The information this should reveal will provide all stakeholders with greater transparency of costs for different parts of water and sewerage service delivery.

It should also enable us to challenge and regulate the companies more effectively. Requiring them to prepare separate accounts will help

What we said

“ Our decisions allow efficient, well-run companies to invest in the right place at the right time for the right price”

Our final decisions on price limits for 2010-15

them and others gain a better understanding of the costs and of different activities within each business unit. This could lead to the companies identifying potential new areas of efficiency savings.

As part of our approach to implementing accounting separation, we have continued to engage with the sectors. We have also held meetings with all those companies that were not part of the original pilot group. They all submitted the first set of accounting separation returns in June 2010.

Other work this year included:

- continuing to publish comparisons of the companies' performance in our annual industry reports and to require improvements where performance was inadequate.



**We think the SIM will encourage
the companies to reduce the
causes of complaints**

A snapshot of the year

Making monopolies improve... the consumer experience

During the year, we concluded our consultation and confirmed that we would introduce a new mechanism to encourage the companies to improve the quality of service that consumers experience.

The service incentive mechanism (SIM) gives the companies an incentive to get things right first time and provide high-quality service for their customers. It replaces the overall performance assessment (OPA) that we have used since 1996.

The SIM works by measuring the number of complaints each company receives and (by asking customers who have contacted their company) the quality of the response the customer receives. We rate the companies on their performance, and reward or penalise them when we next set their price limits.

We think that the SIM will help the companies to focus on reducing the number of complaints they

receive by improving their services overall. It will also deal effectively with those customers who do make complaints.

The SIM came into effect on 1 April 2010. We will publish the first year's results in 2011.

Sue Cox
Head of Consumer Policy



Harnessing market forces

What we did this year



We responded to, and worked closely with, the independent review of competition and innovation in the water markets led by Professor Martin Cave (the 'Cave review'). We also responded to the previous Government's consultation on the recommendations of the Cave review. We think that introducing and developing markets within the sectors will play a key part in ensuring they respond effectively to new challenges like climate change.

During the year, we granted six new appointments and variations. These give companies the opportunity to provide water and sewerage services, sewerage only or water only services to a specific area in place of the former service provider. When we assess applications, we make sure customers will be no worse off than if the former provider was still supplying them. New appointments and variations can benefit customers in different ways. For example:

- in four cases, the new appointee offered customers a discount on the charges they paid to the existing provider; and
- in five cases, the new appointees provide a multi-utility service, supplying water, sewerage, gas and electricity – helping to reduce costs to developers and improving the service they receive.

In addition, applications for new appointments also challenge the existing provider to improve the services it offers. This may benefit its remaining customers, as well as developers.

We consulted on the principles and process we will use to assess new appointments and variations. We considered our own experience and feedback from both participants and other stakeholders involved in this work. We hope to streamline the process for granting new appointments and variations, to make it easier for companies to apply.

What we said

“Ofwat has now granted 22 new appointments and variations – 11 in the past two years. This demonstrates our commitment to introducing competition into the water and sewerage sectors where it benefits customers”

Our announcement of a new appointment in July 2009

We also granted a retail water supply licence to Scottish Water Business Stream Ltd. This will enable the company to purchase a wholesale supply of water and serve its customers in England and Wales.

We have now granted water supply licences to seven companies. However, since launching this work in 2005, only one customer has changed supplier. As well as working with the Government to reform water supply licensing, we have been considering ways to improve the existing rules and processes to help encourage more companies to change supplier.

As well as changing our guidance on access pricing, we have also been working with stakeholders to develop a common operational code and common contract. We have also consulted on our revised processes for transferring customers between supplier.

During the year, we consulted on our principles for bulk supply

agreements. This is the supply of water, sewerage or water and sewerage services to one company from another. We want to encourage more bulk supplies. This is because they promote competition and can also help to ensure that water resources are used efficiently. Our principles give us a clear basis on which to make decisions on individual agreements. They also provide transparency for those companies that want to agree bulk supplies.

With other key stakeholders, we took part in a Market Reform Financing Forum during the year, which will meet every quarter. Its purpose is to exchange information to maintain the necessary confidence and support of debt providers and capital markets, while regulatory and other changes to the sectors are being considered. Principal members of the forum are Defra, Welsh Assembly Government, HM Treasury, and the Shareholder Executive. It also includes representatives from Water UK and the companies.

We have also continued to support the Environment Agency in our joint project to reduce the barriers to abstraction trading and promote sustainable abstraction.

Other work this year included:

- providing advice to the Government on the threshold for legal separation of the companies' retail businesses;
- considering the practical arrangements for the way that an expanded retail services market will operate, including systems used to switch customers;
- publishing some evidence of the potential benefits of upstream markets; and
- making a draft decision on the price and terms of a bulk supply of water between Dŵr Cymru and Albion Water.



A retail market would create new opportunities for existing companies to expand their customer bases and increase their revenues

A snapshot of the year

Harnessing market forces... by assembling the evidence

We are working with stakeholders to establish a marketplace where different water and sewerage retailers compete to provide 'retail services' to non-household customers.

In general, these are the activities that involve a direct interaction with customers. Examples include billing and meter reading activities, which account for about a tenth of a customer's bill. This project is developing the details around how this marketplace could operate.

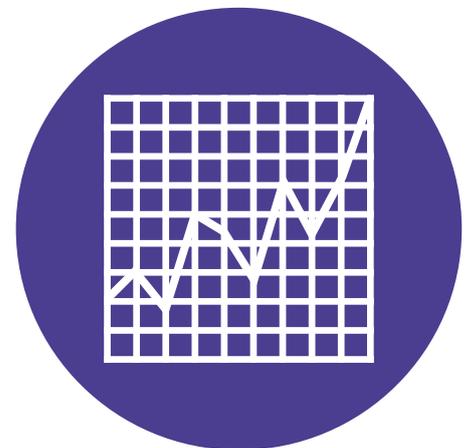
For non-household customers, a retail market would mean being able to choose their water and sewerage service supplier and secure a package that best meets the needs of their business. A retail market would also create new opportunities for existing companies to expand their customer bases and increase their revenues.

Over the past year, we have provided evidence to the Cave review and responded to its interim and final reports. We also produced some advice for the UK and Welsh Assembly Government on the retail

separation proposals and whether there should be an exemption threshold for smaller companies.

We look forward to the UK and Welsh Assembly Government's decisions on whether to take forward the Cave review's recommendations. Following this, we hope to consult on more detailed proposals for a retail market.

Andrew Beaver
Head of Competition Framework



Contributing to sustainable development

What we did this year



The price limits we set during the year mean that over the next five years the companies will:

- maintain or improve more than 3,000 km of rivers to meet EU environmental standards;
- improve water quality in more than 55 wetlands and bathing waters;
- carry out more than 100 schemes to work with farmers and landowners to help control pollution and reduce costs through better use of land and preventing pollution of drinking water sources;
- save more than 100 billion litres a year by meeting water efficiency targets, reducing leakage, and increasing metering. This is enough water to supply the cities of Liverpool, Bristol and Brighton for more than a year; and
- generate enough renewable electricity to power the equivalent of about 90,000 homes – enough for all the homes in Portsmouth. This will

help reduce carbon emissions and keep water bills down.

Our price limits also included a revenue correction mechanism. This is designed to share the benefits and risks of recovering more or less revenue than we assumed when we set price limits between the companies and their customers. It also provides a financial incentive for the companies to encourage consumers to use water wisely.

We also responded to the Environment Agency's consultation on draft River Basin Management Plans, which were approved by the Secretary of State for Environment, Food and Rural Affairs and Welsh Ministers in December 2009. Our response helped to inform their decisions (and we hope those in the future) on the measures necessary to protect and improve water quality in rivers, lakes, estuaries and coastal waters, as required by the European Water Framework Directive.

In February, we brought together the companies, regulators and scientists for the first time to

What we said

“We face huge challenges in the coming decades. We need incentives in place to help companies make efficient decisions about water and reduce their impact on our environment”

Our joint statement with the World Wildlife Fund UK (WWF) on reforming the water abstraction regime

discuss adaptation to climate change in a three-day workshop hosted at the Met Office. The aim of the workshop was to provide a clear understanding of the underpinning science and explore key issues facing the sectors. It was well received by participants and our stakeholders.

We introduced significant improvements to carbon accounting in response to changes in Defra’s overall methodology. This keeps the sectors in line with best practice and is more transparent. Ultimately, this should lead to a greater appreciation of where and how carbon emissions within the sectors can be reduced.

During the year, we continued to engage with stakeholders on a number of key issues.

- We submitted written evidence to the Environmental Audit Committee inquiry on climate change adaptation.
- We worked with the Cabinet Office on the delivery of its critical infrastructure resilience programme. This aims to

protect critical water infrastructure from natural hazards.

- We contributed to the Royal Commission on Environmental Pollution study on the UK’s institutional capacity to adapt to climate change. The Commission’s final report provides useful guidance to the sectors.
- We played an active role in a new forum on climate change and water resources, set up by the Environment Agency and the Met Office, which aims to take a strategic approach to the long-term issues of future supply/demand balance.

In addition, we responded to the Welsh Assembly Government’s consultation on its ‘Climate change strategy programme of action’ and to Defra’s consultation on ‘Adaptation reporting power in the Climate Change Act 2008’. We are helping the sectors to understand the statutory climate change adaptation reports that Defra requires under the Climate Change Act. We have invited both Dŵr Cymru and Dee Valley Water

to report voluntarily to give complete coverage of the companies we regulate. The reports provide them with an excellent opportunity to identify the key issues and whether they are responding effectively to protect current and future consumers.

Other work this year included:

- issuing a joint statement with WWF-UK, supporting effective measures to achieve sustainable abstraction;
- responding to Defra’s consultation on the Marine Strategy Framework Directive and on updating the 2005 Detergents Regulations;
- responding to Natural England’s consultation on marine conservation; and
- continuing to support the implementation of the Water Framework Directive by participating in stakeholder and implementation meetings.

For the first time, we included more than 100 catchment management schemes and investigations in price limits



A snapshot of the year

Contributing to sustainable development... and a cleaner environment

The focus of our work for much of the year was our analysis of the companies' proposals to deliver improved environmental and drinking water quality, as part of the 2009 price review.

Our final decisions on price limits included £4.5 billion of investment in maintaining and improving the environment and drinking water quality over the period 2010-15. The companies will improve some 140 water treatment works and 550 sewage treatment works and maintain or improve more than 3,000 km of rivers to meet EU environmental standards.

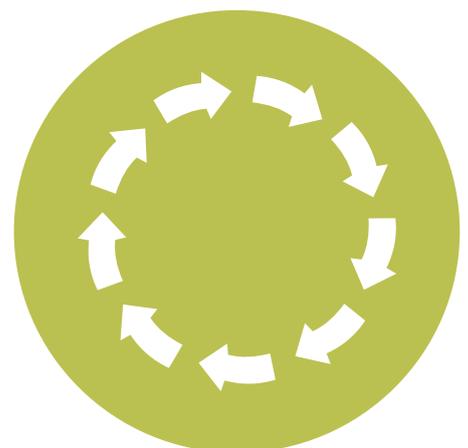
For the first time, we included more than 100 catchment management schemes and investigations. These should help identify and deliver more sustainable, lower-carbon solutions to improving drinking water and environmental quality standards than traditional end-of-pipe treatment solutions – and at a lower cost to the customer. We are now working with the companies and other regulators to identify and promote best practice in this area.

Our price review work has given us a good deal of data and information, especially through the cost-benefit analysis accompanying company proposals and our work with the Environment Agency on

implementing the Water Framework Directive. We will use this to ensure that all stakeholders are informed about the implications for the companies and their customers as policies are developed to meet the huge challenges that the sectors face in the coming years.

In this way, we will contribute to ensuring water is delivered both sustainably and at the lowest cost to customers not just over the next five years, but for future generations as well.

Noel Wheatley
Head of Environment and Water Quality



Delivering better regulation

What we did this year

We worked closely with our stakeholders and consulted extensively on both the process and decisions for setting price limits. We listened carefully to representations, took account of the most up-to-date information, and we made final decisions that are balanced and robust. We have also had regard to the principles of best regulatory practice throughout the decision-making process.

We paid particular regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases that need action.

We also published our refreshed strategy for regulating the sectors over the long term. We launched it at an event in March 2010 that was attended by more than 100 of our stakeholders.

After completing the price review, we began a new programme of work to consider options for setting price limits in the future alongside other projects on market reform, metering and charging, and regulatory

compliance. This included setting up an external advisory panel of experts to challenge and develop our thinking.

During the year, we published the first in a series of focus reports that highlight work we are doing on a particular issue. They aim to encourage wider debate and discussion among our stakeholders in order to help us collectively find the right long-term, sustainable solutions for the sectors. The published reports are listed below.

- 'A drain on society – what can be done about water debt?' examines the issue of consumer debt in the sectors – and what can be done about it.
- 'Putting water consumers first – how can we challenge monopoly companies to improve?' explains the service incentive mechanism and the benefits it will bring to consumers.
- 'Harnessing upstream markets – what's to play for?' examines the benefits that can result from opening upstream water markets.

- 'Climate change – good practice from the 2009 price review' provides an opportunity for the companies to learn from each other by sharing examples of good work and from this promote more effective solutions in the future.

To deliver our new strategy and projects effectively, and make the most efficient use of resources, we reorganised our structure. We also adopted different ways of working, including programme and project management. In addition, we continued to deliver our ongoing commitment to continuous improvement and development of our staff by:

- setting up training in project management and PRINCE2 to enable colleagues to deliver our strategic aims and goals;
- offering the Institute of Leadership and Management (ILM) certificate in First Line Management (level 3) for new and aspiring line managers;
- organising a course with the University of Warwick to provide staff working on competition issues with a good

What we said

“Delivering sustainable water is not about Ofwat telling you how things should be. In order to meet the challenges these sectors face, we all need to work together to find the solutions”

The launch of ‘Delivering sustainable water – Ofwat’s strategy’

understanding of competition economics and UK and EC law; and

- gaining reaccreditation for Investors in People.

We continued to reduce our own environmental impact by:

- promoting a public transport discount scheme for employees;
- recycling paper and other products;
- reducing the number of printed documents we produce in favour of on-demand printing and web-based publishing;
- enabling home and remote working; and
- investing in energy efficient information technology.

We also developed a new procurement strategy to improve competition and innovation for the goods and services we procure from third parties. This included creating a new procurement area on our website to communicate more effectively with current and potential suppliers.

During the year, we continued to develop our high-quality, in-house design and printing service. We have produced a range of documents over the past year, including information leaflets, reports and consultations. This was particularly beneficial during key stages of the price review as it allowed us to produce information to extremely tight deadlines.

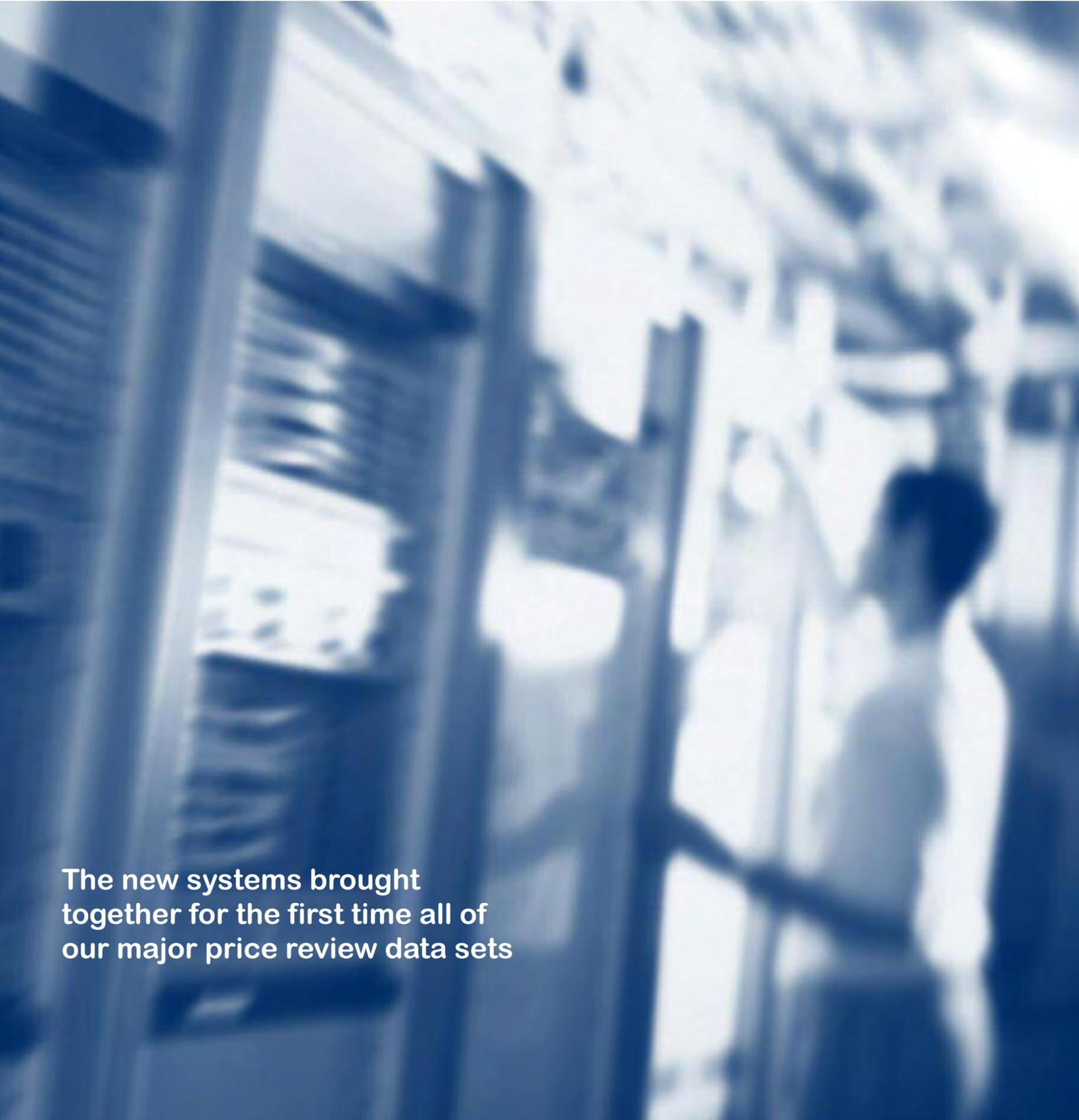
Customers and our other stakeholders need to have confidence that the decisions we make are sound, balanced and fair. Our biggest job this year was making sure people understood our decisions on investment and bills over the next five years. As well as making sure consumer-friendly material was easily available on our website, we focused on gaining extensive regional media coverage.

We generated about 450 regional news items. And by doing dozens of interviews, we made sure people could hear about our decisions from a real voice rather than through dry statements. We also organised extensive briefings with a range of audiences with different interests – from city

investors, MPs and Assembly Members to environmental groups.

Other work this year included:

- continuing to develop our contingency plan and off-site contingency facilities;
- voluntarily disclosing the expenses that our Chairman, Non-Executive Directors and senior managers claimed in 2009-10;
- installing a new phone system to provide increased reliability and functionality to staff and improved service to key stakeholders; and
- appointing a panel to provide us with additional legal support when required, on an efficient and cost-effective basis.



The new systems brought together for the first time all of our major price review data sets

A snapshot of the year

Delivering better regulation... through information technology

The 2009 price review was underpinned by a set of new open source IT systems that enabled efficient data capture and financial modelling. The internally developed 'Reservoir' systems tackled issues of data duplication, data integrity and transparency while delivering complex data collection and modelling tools.

We listened to the companies' feedback after the 2004 price review. This included a need for us to reduce the burden of data input on users. The new systems brought together for the first time all of our major price review data sets. The June return, draft and final business plans, the cost base and the financial model were all integrated within Reservoir to reduce the total data-inputting burden on water companies, re-use data efficiently throughout the system and guarantee a greater level of data integrity throughout all of the systems.

These systems were delivered freely to water companies in England and Wales using open source

technology and standards – a strategy endorsed by the previous Government's Transformational Government Open Source Action Plan.

Carl Poulton
Head of Information Management





Appendix 1: How we performed during 2009-10

In our 'Forward programme for 2009-10 to 2011-12', we set out a number of specific actions for the 2009-10 financial year. The section headings relate to our old strategy, 'Ofwat's strategy – taking a forward look', which we published in April 2008. The table below shows our performance.

Section	Comments
Keeping consumers at the heart of what we do	<p>We completed or continued with most of our work as planned. However, during the year some of our planned work was changed or delayed.</p> <p>We have delivered a new service incentive mechanism to encourage the companies to deliver better services to consumers. This replaces the overall performance assessment. We will review the need to consider changes to the guaranteed standards scheme and any changes to company licences as we consider our future approach to price setting and regulatory compliance.</p>
Keeping companies accountable	<p>We completed or continued with most of our work as planned.</p> <p>We proposed to develop a strategic framework to keep the companies accountable. We also proposed to carry out proactive checks on company performance. These pieces of work are now part of our regulatory compliance project, which we started towards the end of the reporting year.</p>
Enforcing compliance in a reasonable and transparent way	We completed or continued our work as planned.
Introducing competition progressively where it benefits consumers	We completed or continued our work as planned.
Regulating effectively where competition will not protect consumers	<p>We completed or continued with most of our work as planned.</p> <p>We proposed consulting on options for regulating large projects effectively. We will no longer carry out this work. This is because clauses relating to the infrastructure service provider were included within the Flood and Water Management Act 2010.</p> <p>We also proposed publishing a revised protocol to govern the way in which reporters are contracted, utilised, reviewed, assessed and their contracts ended. This is now part of our regulatory compliance project.</p>
Taking a long-term view of sustainability	We completed or continued our work as planned.
Shaping the regulatory agenda at a national and EU level	<p>We completed or continued with most of our work as planned.</p> <p>We proposed carrying out a survey of our key stakeholders to understand their perceptions of us. Instead, we are considering stakeholder engagement as part of our overall approach to implementing our refreshed strategy.</p>

Appendix 2: Having regard to the social and environmental guidance from Government

Under the Water Industry Act 1991 (as amended), the Secretary of State for Environment, Food and Rural Affairs and Welsh Ministers have powers to issue separate social and environmental guidance to the Water Services Regulation Authority (Ofwat). We are required to have regard to both sets of guidance when discharging our statutory functions.

The Secretary of State published his final, statutory social and environmental guidance to us on 22 September 2008. Welsh Ministers published their guidance on 9 March 2009.

The Secretary of State and Welsh Ministers have made it a requirement that we demonstrate in our annual report each year how we have contributed to delivering the policies set out in their respective sets of guidance. The tables below show how we met this requirement in 2009-10.

Guidance from the Secretary of State for Environment, Food and Rural Affairs

Policy area	Example of contribution
Sustainable development	'Delivering sustainable water – Ofwat's strategy' (March 2010)
Future water	'Future water and sewerage charges 2010-15: final determinations' (November 2009)
Social policies	
Fairness and affordability	'Future water and sewerage charges 2010-15: final determinations'
Competition	'Ofwat's response to the Cave review's final report on competition and innovation in water markets' (July 2009)
Better regulation	See appendix 5
Environmental policies	
(Climate change) mitigation	'Future water and sewerage charges 2010-15: final determinations'
(Climate change) adaptation	'Future water and sewerage charges 2010-15: final determinations'
Supply/demand balance	'Future water and sewerage charges 2010-15: final determinations'
Surface water flooding	'Future water and sewerage charges 2010-15: final determinations' Sustainable drainage project, see www.ofwat.gov.uk/future
Resilience	'Future water and sewerage charges 2010-15: final determinations'
Water quality	'Future water and sewerage charges 2010-15: final determinations'

Guidance from Welsh Ministers

Policy area	Example of contribution
Sustainable development	'Delivering sustainable water – Ofwat's strategy'
Long-term viewpoint	'Future water and sewerage charges 2010-15: final determinations'
Corporate social responsibility	'Future water and sewerage charges 2010-15: final determinations'
Company reporting (better regulation)	See appendix 5
Community engagement and consultation	'Future water and sewerage charges 2010-15: final determinations'
Economic development	'Future water and sewerage charges 2010-15: final determinations'
Wider social responsibilities	'Future water and sewerage charges 2010-15: final determinations'
Water affordability	'Future water and sewerage charges 2010-15: final determinations'
Metering and charging	'Future water and sewerage charges 2010-15: final determinations'
Charging	'Customer charges 2010-11'
Competition	'Future water and sewerage charges 2010-15: final determinations'
Environmental policies	'Future water and sewerage charges 2010-15: final determinations'
Environment strategy	'Future water and sewerage charges 2010-15: final determinations'
Climate change	'Future water and sewerage charges 2010-15: final determinations'
Emission reduction and preserving carbon stores	'Future water and sewerage charges 2010-15: final determinations'
Adapting to impacts of climate change	'Future water and sewerage charges 2010-15: final determinations'
Supply/demand balance	'Future water and sewerage charges 2010-15: final determinations'
Water efficiency	'Future water and sewerage charges 2010-15: final determinations'
Leakage	'Future water and sewerage charges 2010-15: final determinations'
Floods and resilience	'Future water and sewerage charges 2010-15: final determinations'
Surface water flooding and the new approaches programme for flood and coastal risk management in Wales	'Future water and sewerage charges 2010-15: final determinations' Sustainable drainage project, see www.ofwat.gov.uk/future
Resilience to natural hazards	'PR09/12, Asset resilience to flood hazards: development of an analytical framework' (June 2008)
Maintaining and improving standards of water quality	'Future water and sewerage charges 2010-15: final determinations'
Water company partnerships working with land managers	'Future water and sewerage charges 2010-15: final determinations'



Appendix 3: List of impact assessments carried out during 2009-10

Date of publication	Document	Stage
18 December 2009	Implementing accounting separation – impact assessment	Draft
7 August 2009	Service incentive mechanism – a consultation on moving forward from the overall performance assessment	Draft

Appendix 4: Review of Board effectiveness

The Board carried out its annual review of its own effectiveness in fulfilling its functions. It made use of the standard questionnaire prepared by the National Audit Office for Boards of public bodies, which was completed by Board members and observers, and of collective and individual discussions between the Chairman and Board members.

Provisionally, the Board decided that it might be appropriate to commission an external stakeholder review during 2010-11, subject to any relevant decisions from the newly-elected Government.

Appendix 5: Progress in reducing regulatory burdens

The UK Government introduced the Regulatory Enforcement and Sanctions Act 2008 for the purpose of delivering better regulation. The Act placed a duty on us to:

- review the regulatory burdens we impose;
- reduce any that are unnecessary and unjustifiable; and
- report on our progress each year.

When we report on progress, we have to set out what we have done in the past 12 months, and what we will do in the coming year, to review our functions in line with the duties set out above. We also have to set out the reasons for maintaining any burdens.

Our forward programme sets out what we intend to do over the coming 12 months. Our report on what we have done in the past year is set out below.

Report on progress

During the year, we carried out a number of individual actions to reduce the regulatory burden. For example, we reduced the data burden by using new IT systems (see [page 33](#)) and streamlined the process for new appointments and variations (see [page 22](#)). In addition, in March 2009, we set out in our strategy our intention to review how we monitor compliance and enforce that the companies deliver appropriate service standards and their other regulatory and legal obligations.

Through our regulatory compliance project, we aim to create a risk-based framework that protects consumers' interests by:

- developing incentives to encourage the companies to take full responsibility for complying with their obligations to customers and the environment;
- looking to reduce the regulatory burden;
- strengthening the reliability of company reporting;
- targeting examination of contractual, compliance or performance concerns about companies; and
- establishing the principles we use to carry out investigations into company compliance.

This project will consider all of the information that we collect from the companies to monitor compliance and consider how this can be achieved more efficiently in the future. Completing the price review offers us a valuable opportunity to consider the companies' accountability to their customers at the beginning of a new price limit period.

We started the project in March 2010. We look forward to working with stakeholders to make sure that we meet the aims of this project.

Appendix 6: Performance against our stated levels of service

Improving performance

Every year, we respond to thousands of general public enquiries for information. We also investigate hundreds of disputes between customers and their water companies. Our customer charter sets out our targets for responding to customers in a timely way.

We have continued to receive an increased number of complaints and disputes in 2009-10.

To help improve our performance, we have worked with our internal auditors to develop our processes. We have also made organisational changes to bring all our casework together. This will provide greater scope to work flexibly and prioritise our work.

General enquiries

In 2009-10, we dealt with 8,000 phone enquiries. We also replied to more than 800 written enquiries.

Performance standard for general enquiries

Standard

Achieved

95% of written enquiries to be dealt with within ten working days

93%¹

1. See 'Review of levels of service' on page 41.

Disputes and complaints

The Consumer Council for Water (CCWater) represents consumers in the water and sewerage sectors. It deals with most complaints from consumers about the service their water or sewerage company provides, which the company itself cannot resolve. We support CCWater's complaint handling role by providing advice on individual cases and by contributing to workshops.

Disputes and complaints we are responsible for

- complaints about regulatory policy;
- allegations of breach of duty by a company;
- water supply and sewer connection charges;
- requisitioning of water mains, sewers and lateral drains;
- adoption and financial arrangements in respect of self-laid mains;
- sewer appeals;
- refusals by companies to install an optional meter;

- guaranteed standards scheme payments (GSS);
- trade effluent appeals; and
- pipe-laying in streets and across private land.

We dealt with 2,317 disputes and complaints in 2009-10, obtaining rebates or compensation in excess of £500,000. We have also succeeded in getting the companies to carry out capital works to resolve problems, which exceeded £20 million in value.

The time taken to resolve complaints depends on the nature and complexity of individual cases, but we aim to deliver our performance standards. Performance against these standards is shown in the table below.

Performance standards for disputes and complaints

Standard	Achieved
80% of non-investigated complaints to be dealt with within ten working days	90%
65% of investigated complaints to be resolved within three months (65 working days)	58% ²
80% of investigated complaints to be resolved within six months (130 working days)	76% ²

2. See 'Review of levels of service' below.

Review of levels of service

The complaints and disputes that we receive for investigation are becoming increasingly complex, requiring expert technical and legal advice. And this takes more time. This is why, together with the increased number of complaints and disputes, we did not meet our targets on dealing with general enquiries and on dealing with investigated complaints.

We have reviewed our performance in light of the changes we have made and the nature of the complaints and disputes we receive.

From 1 April 2010, we will report our performance against revised standards:

- respond to at least 95% of written enquiries within ten working days;
- respond to at least 80% of non-investigated complaints within ten working days; and
- provide an initial response to at least 95% of investigated complaints within ten working days.

We will also report our performance on resolving complaints and disputes that we investigate.

Appendix 7: Summary of our 2009-10 expenditure

On average, we cost each of the 23.5 million customers in England and Wales 75p a year. Without us, customers' bills would be about £110 more than they are now.

During the year, we continued to demonstrate our value for money to customers. As part of the price review, we secured a reduction in the annual average bill of £31 by 2015, compared with what the companies had asked for. At the same time, we approved more than £22 billion of capital investment to be delivered over the next five years – for the benefit of both consumers and the environment.

Our expenditure is also the smallest of the other main economic regulators. In 2009-10, our total expenditure amounted to less than 0.2% of the sectors' total turnover.

Estimated income and expenditure 2009-10	£000	£000
Income		
Licence fees recovered	18,108	
Other income (including brought forward licence fees)	4,094	
Licence fees unused to carry forward	(4,999)	
Total income		17,203
Expenditure		
Permanent staff	10,749	
Personnel overheads	851	
Consultancy projects	2,245	
Accommodation	1,113	
Non-cash items, for example depreciation	981	
Other	1,264	
Total expenditure		17,203

Administration costs by activity group	2009-10 estimated outturn £000
Regulatory monitoring and action	7,600
Policy and Communications	2,112
Corporate Services: programme management, finance, human resources, facilities management, information technology, legal services and procurement	7,491
Total expenditure	17,203

Appendix 8: Resource management 2009-10

Staff recruitment during 2009-10 (by gender and ethnic group)

Level	Number appointed	Proportion of women (%)	Proportion from ethnic minorities (%)
Head of team/function	1	100	0
Middle management	18	55	17
Clerical and secretarial	12	50	33
Total	31	55	23

Employed staff information (as at 31 March 2010)

Full-time equivalent staff (as at 31 March 2009)	226
Proportion of women (%)	51.8
Proportion from ethnic minorities (%)	19.5
Proportion disabled (%)	2.2
Members of the Senior Civil Service	7
Number of fixed-term and casual contracts	10
Number of staff working part-time	42
Staff turnover (%)	8.9

Salaries for members of the Senior Civil Service (as at 31 March 2010)

£100,000 – £145,000	4
£90,000 – £99,999	2
£75,000 – £89,999	1

Staff training attendance 2000-10 (by ethnic group)

Ethnic group	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)
White	1,036	93
Other ethnic groups	83	7
Total number of training days	1,119	100

Consultancy and professional services expenditure summary 2009-10 (company contracts costing more than £50,000 excluding VAT)

Project	Supplier
Supply of software licences under a Microsoft Enterprise Agreement	Trustmarque Solutions
Refurbishment works package for 18th floor, and potential remedial works on floors 17, 19 and 20 at Centre City Tower	City Office Interiors Ltd
Advice on costs of legal separation of retail water businesses	Ernst & Young LLP
Desk study into regulatory tools	Europe Economics
Project Voice: supply and installation of a new phone system (hardware and software)	Azzurri Communications
Interim Change Manager	Interim Performers
Future market support arrangements for the water and sewerage sectors – options review	Kema Ltd
Review of licence conditions	Wragge & Co
Web hosting services (fully managed hosting of Ofwat's website)	Attenda Ltd
Training course on utility regulation	Oxera Ltd
Thames Tideway scheme: engineering advice	Mott MacDonald
SunSystem and Vision Upgrade, new purchase order and travel and subsistence modules, plus maintenance of the software	Sapphire Systems PLC
Future price limits – risk and incentives: options appraisal	Europe Economics
Form of control and regulated/unregulated business – sub-projects: options appraisal	Frontier Economics Ltd
Review of companies' capital maintenance plans (common framework assessment)	Mott MacDonald
Interim Director of External Affairs	Sand Resources

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 consumers with a good quality and efficient service at a fair price.



Published by TSO (The Stationery Office) and available from:

Online

www.tsoshop.co.uk

Mail, telephone, fax and email

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/general enquiries: 0870 600 5522

Order through the Parliamentary Hotline Lo-Call: 0845 7 023474

Fax orders: 0870 600 5533

Email: customer.services@tso.co.uk

Textphone: 0870 240 3701

The Parliamentary Bookshop

12 Bridge Street, Parliament Square, London SW1A 2JX

Telephone orders/general enquiries: 020 7219 3890

Fax orders: 020 7219 3866

Email: bookshop@parliament.uk

Internet: www.bookshop.parliament.uk

TSO@Blackwell and other Accredited Agents

Customers can also order publications from

TSO Ireland

16 Arthur Street, Belfast BT1 4GD

Telephone: 028 9023 8451

Fax: 028 9023 5401



Ofwat

Centre City Tower

7 Hill Street

Birmingham B5 4UA

Phone: 0121 644 7500

Fax: 0121 644 7699

Website: www.ofwat.gov.uk

Email: enquiries@ofwat.gsi.gov.uk

Photographs © Environment Agency/Getty Images/Highways Agency/iStockphoto/Shine Pix/Transport for London

Printed on Revive Silk 75, a carbon-neutral paper containing 75% minimum de-inked post-consumer waste paper

July 2010

© Crown copyright 2010

