

A n n u a l R e p o r t 2 0 0 3 - 0 4
OF THE DIRECTOR GENERAL OF WATER SERVICES



Annual Report 2003-04

OF THE DIRECTOR GENERAL OF WATER SERVICES

For the period 1 April 2003 to 31 March 2004



Presented to Parliament in pursuance of section 193 of the Water Industry Act 1991 and to the Welsh Assembly Government.

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To

RT. HON. MARGARET BECKETT, MP

The Secretary of State for Environment, Food and Rural Affairs

and

RT. HON. RHODRI MORGAN, AM

First Minister, Welsh Assembly Government

Dear Secretary of State and First Minister

I am pleased to present my report on Ofwat's work for the year ending 31 March 2004.

We are committed to taking a transparent approach in exercising our functions. This report is one expression of our accountability.

The focus of our work this year has been the price review for the period 2005-10. After intensive preparatory work, which included your principal guidance to me, the water companies are now submitting their final business plans. Our challenge in the year ahead is to set limits that enable well-managed companies to finance their functions and encourage them to perform well, but to impose no greater burden on the customers of these monopoly companies than is necessary.

During the year, the Water Act 2003 passed through Parliament and received Royal Assent. We offered advice during its preparation and on its progress through both Houses. We shall now work with your officials on its implementation. In particular, we are taking a leading role in the development of the regime for price competition in the water sector. We shall also co-operate in the establishment of a new Consumer Council for Water, wholly independent of Ofwat, which will succeed WaterVoice from October 2005, and of the new structure for Ofwat under a Water Services Regulation Authority from April 2006.

Our work of monitoring the companies' performance and responding to proposals for companies' corporate and financial restructuring continues. Protecting the interests of customers remains central to our role, working closely with WaterVoice.

A handwritten signature in cursive script that reads 'Philip Fletcher'.

Philip Fletcher

Director General of Water Services

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Our vision

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



Our mission

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



How we do it

By:

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

Director's review

This year has been a period of intensive preparation for setting price limits for the water and sewerage companies for 2005-10. We have carried out research and refined the options. Draft company plans have been subjected to analysis, and to constructive dialogue with the companies and other stakeholders. During the year, the new Water Act has also passed through Parliament and received Royal Assent. Amongst other important reforms, it will make changes to Ofwat's constitution and functions, and establish a new framework for competition.

Our approach

We remain committed to the Better Regulation Task Force principles of accountability, transparency, proportionality, consistency and targeting.

Our primary *accountability* is to Parliament. We have, for example, given oral evidence five times in the year to four different Parliamentary Committees on subjects ranging from regulatory accountability to the price review, and to the very unpleasant consequences of sewer flooding in customers' homes.

We are also accountable in a wider sense to all of our various stakeholders.

Although by law our decisions are made independently of others, all of our key issues are subject to appropriate prior consultation, including the key regulatory decision on company price limits.

If those decisions are to command general assent, they must be approached in a way that is *transparent* and *consistent*. Thus, for the price review we have released our new financial model to companies and others, to clarify the processes underlying price setting. We have set out our approach to the review and kept stakeholders informed of developments.



To help ensure that our approach is *targeted* on those issues of most concern to customers, we have conducted market research with Government, the quality and environmental regulators, the industry and representatives of customers and environmental groups into customer attitudes to prices. The findings showed generally high levels of satisfaction with current services and gave indications of the willingness of customers to pay for the proposals in their local companies' business plans. We also ensure that our limited resources focus on necessary regulation – and avoid getting drawn into details more appropriate to management.

We have also sought to be *proportionate*, concentrating our action where it will have most effect. For example, we have set our own leakage targets only where these are necessary as part of a programme to return to economic levels of leakage.

Setting price limits

Our primary statutory duty obliges us to set price limits that would allow efficient companies to finance the functions they are required to carry out. At the same time, for the customers of monopoly companies, prices should be no higher than they have to be. Key inputs to the price review in the past year have been the submission of the companies' draft business plans, the confirmation of our approach to incentives, and the ministerial guidance on the programme of capital investment which the companies are expected to carry out (for the most part to meet the UK's statutory obligations in international law). The guidance was later than had been expected, and has required some adjustment to the timetable for the final stages of the review.

Final business plans are now being submitted by the end of April. They will be thoroughly scrutinised and I shall publish draft price limits on 5 August and final limits on 2 December 2004. The final decisions will take account of

representations made and of any final guidance which the Secretary of State and Welsh Assembly Government may give to me.

In the light of the information already available before the final business plans, it is clear that price limits for most companies will need to rise, in some cases significantly. Increases will be needed to take account of additional pressures to maintain day-to-day services in the face of significant extra costs, including tax changes; to ensure that the companies' infrastructure remains fit for purpose; and to finance the new investment programmes that Ministers have indicated are needed to improve the environment and water quality. Offsetting savings from efficiency gains will not be as significant as at the last review. Many of the easier gains have already been made. To sustain potentially very large investment programmes, the companies must continue to be able to raise the appropriate finance. In setting appropriate price limits, I shall need to take account of the assessments of risk by investors and lenders.

Currently, average prices for water customers are still lower in real terms than they were in 1999. The prospect of significant real term increases from 2005 raises issues about the affordability of bills, especially for less well-off customers in those regions where company bills are highest. While we cannot set price limits by reference to what customers can afford, we welcome the Government's commitment to review aspects of affordability and will take a full part in that work.

Water Act 2003

We offered technical advice on relevant issues during the preparation of the legislation and the passage of the Water Act through Parliament, both to Government and to Members who sought our views.

During the year, we have begun preparations to implement the new competition provisions in the Act and we have participated with the Department for Environment, Food and Rural Affairs (Defra) and the Welsh Assembly Government in the initial studies for the new independent Consumer Council for Water, which will succeed WaterVoice from October 2005. We also stand ready for the implementation of the Water Services Regulation Authority, which will become statutorily responsible for our work from April 2006.

Regulatory monitoring and comparative competition

The essence of Ofwat's approach to its task is to provide incentives – carrots and sticks – to companies to enhance their performance, become more efficient, and provide good services and good value for money for customers. The 22 water companies, ten of which are also responsible for sewerage services, provide worthwhile comparators which strengthen the basis of regulation. We have developed further our comparisons with other countries, and report on relative performance in England and Wales against water services in Scotland, Australia, the Netherlands and the USA. In general, companies here are performing as well as, and in some cases better than, their international counterparts.

Company structures

It is not for Ofwat to manage companies or to establish their structures and financing provision. However, we respond to company proposals in the interests of customers. We have, with Defra, commissioned research into trends in ownership and financing, especially following the trend to highly geared structures.

On mergers, we have seen continuing developments in ownership within the sector. We have commissioned research on the impact of mergers between water companies; research which indicated that bigger does not always mean better.

Conclusion

This has been a demanding year for staff in Ofwat and WaterVoice, and the most challenging time is still to come as the price review is completed and organisational changes are made. I am very grateful for the work of the staff of both Ofwat and WaterVoice, and to WaterVoice Chairmen and members, who give their time voluntarily to representing customers.



Philip Fletcher
Director General of Water Services

Price setting



Price setting was the central focus of our work this year.

In December 2004 we shall set price limits for the water and sewerage companies for the five years from 2005-10. The price limit is the percentage price change above the rate of inflation that a company is allowed to charge its customers each year.

Our aims in this review

We aim to set price limits that provide best value for customers now and in the future. We intend to:

- enable well-managed companies to finance the delivery of services in line with relevant standards and requirements; and
- provide incentives for companies to improve efficiency and service delivery.

1 'Setting water and sewerage price limits for 2005-10: Framework and approach', March 2003.

2 'Setting water and sewerage price limits – A joint statement', 12 August 2003. Issued with Defra, Welsh Assembly Government, the Environment Agency, English Nature, the Drinking Water Inspectorate, the Countryside Council for Wales.

We recognise that there are many upward pressures on customers' bills at this review. We are committed to setting price limits that are high enough to enable companies to finance and run their businesses, but no higher than they need to be for customers.

Managing the review process

We are making steady progress in line with the framework we set out last year¹. We organised the review in four phases:

- Phase 1 – framework and issues,
- Phase 2 – assessing the draft business plans and market research,
- Phase 3 – decisions and determinations,
- Phase 4 – implementation.

This year we have completed phases 1 and 2.

Figure 1 sets out the timetable for the review.

In August, we issued a joint statement with other regulators and Government². This statement outlined the next stages of the review and explained to stakeholders and the public how to get involved in deciding the scale and scope of the quality enhancement programme. It set out some key questions. We received 158 responses; 33 from organisations and 125 from individuals. The responses are available on our website. Most of those who responded supported further environmental improvements. Many accepted that this would increase bills.

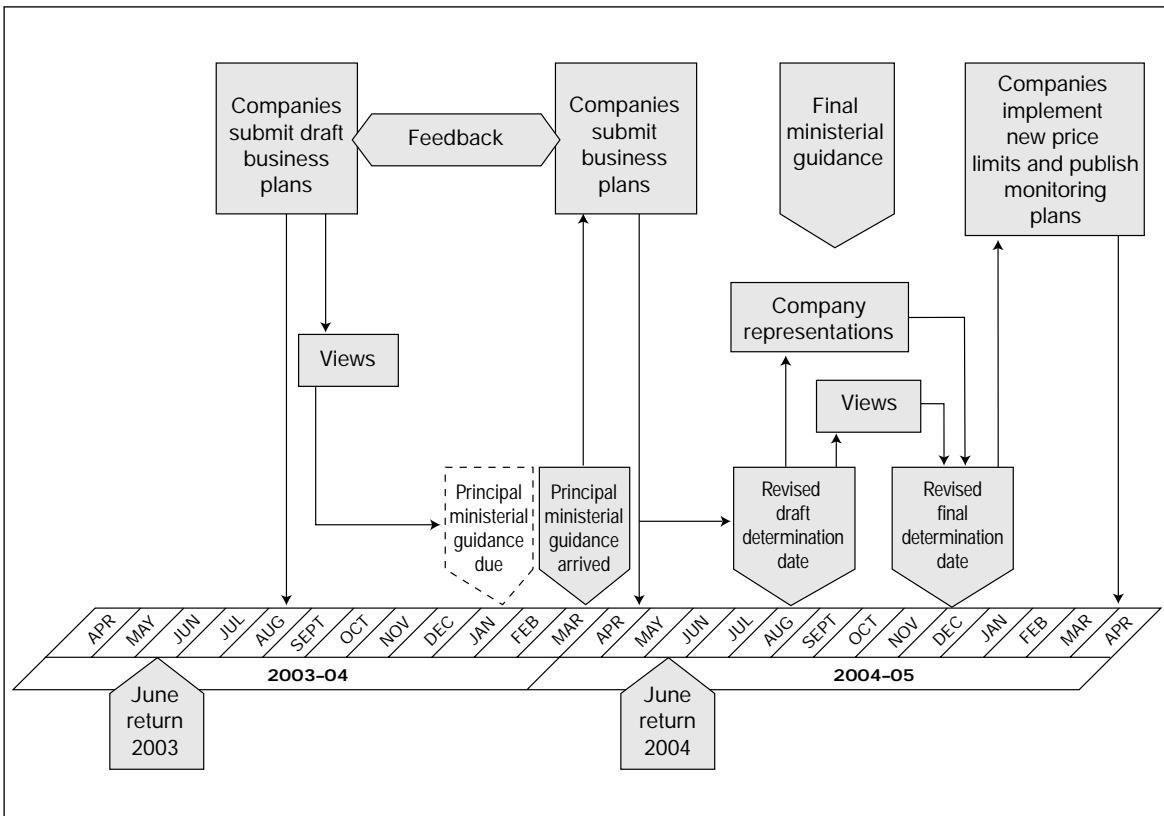


Figure 1: Timetable for the 2004 price review

The draft business plans

The companies submitted their draft business plans in August 2003. The plans aimed to show the potential consequences of the key issues that remain to be resolved in the price review.

Each plan set out the company's own preferred strategy and one (or for the larger companies, two) reference plans.

Each company also published a summary. This set out the company's objectives for the period 2005-10, the quality and service improvements it planned to make and the implications for customers' bills and for price limits. These summaries helped all stakeholders to understand the issues the companies face and informed the public debate that followed.

To help companies draft their plans, we issued an update of our financial model, and guidance on the assumptions companies should use in their reference plans about the scale of the quality

programme and other variables such as efficiency, and the cost of financing investment.

We published a summary of all of the companies' draft business plans in October 2003, setting out the key issues arising from our preliminary analysis of the plans. It was clear that there were hard choices to be made – and potentially significant bill increases if the proposed ambitious investment programmes were confirmed³.

The draft business plans provided the basis for four strands of work through the autumn and remainder of the financial year:

- understanding customers' priorities,
- feedback to companies,
- advice to Ministers and Ministers' guidance,
- preparing for final business plans.

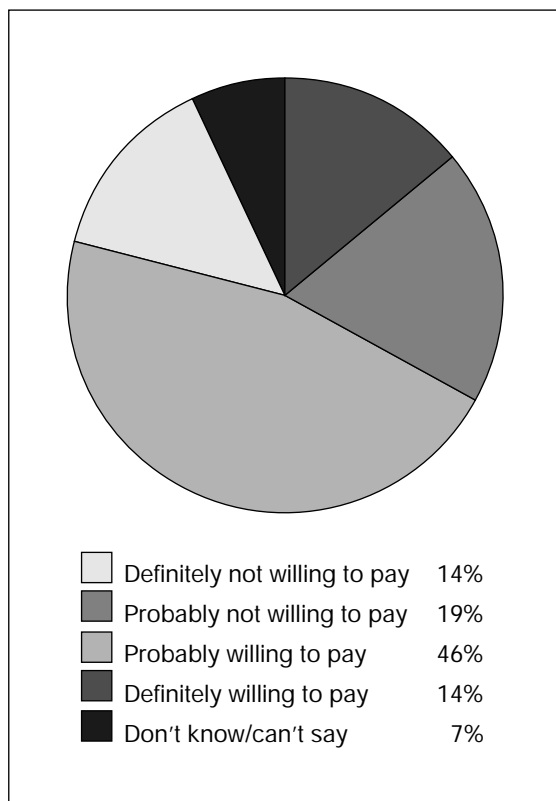
³ 'Setting water and sewerage price limits for 2005-10: Overview of companies' draft business plans', October 2003.

Understanding customers' priorities

We use market research to help us to understand customers' views. With eight other major stakeholders⁴, we conducted the second joint market research survey⁵ for the price review. In December 2003, we published the results of the survey of 6,000 customers⁶. We asked customers' views about the services they receive now, and about proposals in their local water company's business plan for the next five years, including the impact on their bills.

Satisfaction with current services was generally high. Nationally, customers confirmed the importance of maintaining current levels of service. They also wanted to see some improvements. Given the costs of plans, they gave most support to drinking water quality and supply aspects, followed by maintaining

Figure 2: Percentage of bill-paying customers willing to pay for the company's own preferred plan



water and sewerage systems. They gave less support to environmental improvements and customer service. Most customers stated that they were definitely, or probably, willing to pay the price increases associated with the plans, but a significant proportion were not. One in ten customers said that they could not afford the price increases. Willingness to pay went down as costs rose.

Feedback to companies

Preparing the draft business plans was a considerable task for the companies. During the autumn we provided each company with detailed written feedback on its draft plan, and we met company representatives to discuss issues arising.

Advice to Ministers and Ministers' guidance

Government Ministers and the Welsh Assembly Government each provide guidance on the scope and timescale for new water quality and environmental improvements. Following their initial guidance⁷, the environmental and water quality regulators established the detailed programmes that companies would, or might have to, deliver⁸. These lists informed the companies' work on their draft business plans.

Like WaterVoice and the environmental regulators, we offered advice to Ministers on the implications for customers of quality improvements.

In December 2003, we wrote an open letter to Ministers⁹, setting out our concerns about the potential price increases. The letter was informed by scrutiny of the companies' draft business plans, the results of the latest market research, the environmental regulators' publication 'A good deal for water' and the Drinking Water Inspectorate's (DWI's) plans for improvement to drinking water. We set out as an illustration the effect on

4 Defra, Welsh Assembly Government, the Environment Agency, English Nature, the Drinking Water Inspectorate, WaterVoice, Water UK, Wildlife & Countryside Link.

5 The first research survey: 'The 2004 periodic review: research into customers' views', November 2002.

6 'Customer research 2003: periodic review - national report' (MVA, WRC), December 2003.

7 'Initial guidance from the Secretary of State to the Director General of Water Services: 2004 periodic review of water price limits', Defra, January 2003 & 'Initial guidance from the Welsh Assembly Government to the Director General of Water Services on the 2004 periodic review of water price limits', Welsh Assembly Government, March 2003.

8 The Environment Agency with English Nature & Countryside Council for Wales, produced 'Environmental Drivers for the 2004 periodic review' v3 (RD 15/03, 15 April 2003). The companies made proposals to the DWI on the work they thought they needed to do to improve drinking water quality. The DWI considered these and confirmed the programme to be included.

9 'Advice to inform the principal guidance on scale and timing of further quality enhancement', December 2003.

price limits of constraining capital investment to around £15 billion (roughly comparable to capital spending between 2000 and 2005).

In March, nearly six weeks later than had been expected, Ministers issued their principal guidance on the quality programmes that the companies would need to deliver¹⁰. The scale of the programmes envisaged lies between the smaller and the larger reference assumptions in the draft business plans and above the level sought by the companies in their preferred strategies. The Environment Agency and the DWI have since clarified the implications of the guidance on which schemes are required.

The delay to principal guidance from Ministers has affected the rest of the review timetable. Following discussion with the companies, we have agreed revised submission dates for the final business plans. Publication dates for the draft and final determinations have been deferred to 5 August and 2 December 2004 respectively.

Early start

Previous reviews had been characterised by severe troughs in capital investment profiles. For the current review, we introduced an early start initiative to reduce (though it will not eliminate) those troughs. This initiative defined some of the outputs that the companies would deliver in the early part of the new price review period. We told companies the capital expenditure we would include for these outputs in December 2003. This initiative was supported by all parties.

Preparing for final business plans

The final business plan is the key document from each company for the price review. It sets out the company's preferred strategy for 2005-10, and in the longer term. We met with each company to discuss the key issues in its business plan while the plan was being prepared.

In preparing for the final business plans, which would be submitted by the end of April 2004, we carried out further work on:

- future efficiencies;
- incentives;
- cost of capital;
- linking prices to service; and
- possible licence modifications needed.

Future efficiencies

Understanding the scope for future efficiency is an important part of price setting. In the last year, we have commissioned and published (on our website) further work from Europe Economics¹¹, London Economics¹², and Stone & Webster¹³.

In addition, companies' draft business plans contained important information on how the industry sees the potential for future efficiency.

Incentives

Regulatory incentives have to simulate the pressures and rewards found in a normal competitive market. Such incentives need to evolve to meet the changing environment. We consulted on our approach to rewarding future outperformance and handling underperformance against regulatory expectations¹⁴. We published our conclusions in March 2004¹⁵.

¹⁰ 'Principal guidance from the Secretary of State to the Director General of Water Services – 2004 periodic review of water price limits', March 2004 & 'Guidance from the Welsh Assembly Government to the Director General of Water Services on the 2004 periodic review of water price limits', Welsh Assembly Government, March 2004.

¹¹ 'PR04: Scope for efficiency improvement – uncertainties and measurement issues', (Europe Economics), November 2003.

¹² 'PR04: Scope for efficiency improvement – final report to Ofwat' (London Economics, Black & Veatch Consulting, Prof. Maurice F Shulter), December 2003.

¹³ 'Investigation into evidence for economies of scale in the water and sewerage industry in England and Wales' (Stone & Webster), January 2004.

¹⁴ MD 187, 24 June 2003.

¹⁵ MD 191, 26 March 2004.

Cost of capital

We commissioned Cambridge Economic Policy Associates and Europe Economics to advise us on the cost of capital and related issues. We set out guidance for the companies in March 2004¹⁶. We have said that we believe there is no strong case for setting the basic cost of capital at a lower level than at the last review.

Linking prices to service

Our annual assessment of performance leads to price adjustments at a price review. This gives companies the incentive to maintain service to customers by linking prices to service delivery. We assess how each company's service levels compare with the rest. During the year, we consulted on proposals to update our overall performance assessment (OPA)¹⁷. Some of the proposals take account of changing legislation, such as satisfactory disposal of sewage sludge. Others update measures to reflect improvements to service monitoring, such as the development of a qualitative customer survey about telephone call handling. Stakeholders broadly accepted these proposals. In March, we published our conclusions and set out our methodology for the OPA for 2004-05 to 2008-09¹⁸.

Possible licence modifications needed

In March, we consulted on modifications to companies' licences associated with the price review¹⁹. We shall publish our response to the consultation with the draft determinations.

Monitoring plan information requirements

Each company will publish a monitoring plan in March 2005, or later if it seeks a redetermination of its price limits at the Competition Commission. This plan will set out for customers the service that will

be delivered within the new price limits. This will enable WaterVoice and others to assess the companies' performance. We are currently considering responses to our consultation²⁰ on the information requirements for these plans. We will issue our conclusions in the autumn of 2004.

Price changes between reviews

Ofwat can reassess price limits between reviews if a company's costs or revenues change materially in specific areas. This is an interim determination. Either Ofwat or a company can initiate an interim change subject to strict criteria.

We wrote to the companies in May 2003²¹, setting out our approach to interim determination applications for the year. Subsequently Anglian Water Services, Northumbrian Water and United Utilities Water submitted applications. We also received applications from Northumbrian Water and Bournemouth & West Hampshire Water under the substantial effect or 'shipwreck' condition of their licence of appointment.

We scrutinised the applications and published draft conclusions in November (and in January for Bournemouth & West Hampshire). In the light of these, Anglian Water decided to withdraw its application and its price limits for 2004-05 remain unchanged. We discussed the applications with the respective WaterVoice committees and, after careful consideration, announced new price limits for Northumbrian Water and United Utilities Water in December, and for Bournemouth & West Hampshire Water in February.

Both Northumbrian Water and Bournemouth & West Hampshire Water demonstrated that their businesses

16 MD 190, 19 March 2004.

17 'Updating the overall performance assessment (OPA) – A consultation', December 2003.

18 'Updating the overall performance assessment (OPA) – Conclusions and methodology for 2004-05 onwards', March 2004.

19 MD 189, 3 March 2004.

20 RD 40/03, 17 December 2003.

21 MD 186, 1 May 2003.

suffered substantial adverse effects, which were beyond management control. They had received less income than was forecast from metered customers and as a result of large businesses closing. These new price limits were the first given under the substantial effect clause.

We are consulting on changes to the calculation of the materiality threshold both for conventional and substantial effect determinations, to ensure that the balance and risk between companies and customers remains appropriate²².

Mid Kent Water and Sutton & East Surrey Water agreed to adjust prices for 2005-10 to return benefits to customers that have accrued in 2000-05. This removed the need for an interim determination in 2003-04 to recover these amounts.

22 MD 189, 3 March 2004.

Protecting customers



Working closely with WaterVoice

WaterVoice, through its ten statutory regional committees and the WaterVoice Council, represents the interests of customers. Although currently maintained by Ofwat, WaterVoice speaks as an independent body dealing with consumer issues regionally, nationally and in Europe.

We work closely with WaterVoice under a memorandum of understanding. We value their input on behalf of customers on a wide range of regulatory and consumer issues.

WaterVoice's views were particularly influential in:

- assessing the quality of service to customers, based on sample audits and other assessments;
- providing a customer perspective on the price review;
- providing options to enhance existing levels of service;
- bringing to our attention customer service issues that may require us to exercise our power; and
- monitoring implementation of regulations to protect vulnerable groups.

23 PR04: Customer research, December 2003.

24 'Paying for water', (Accent Marketing & Research), September 2003.

25 'An investigation into costs of sewer flooding alleviation schemes', November 2003.

This year we have carried out customer research with WaterVoice and others on:

- customers' priorities and willingness to pay for companies' planned work programmes over the next five years²³;
- customer debt²⁴ and;
- sewer flooding²⁵.

As a result of the Water Act 2003, WaterVoice will become fully independent of Ofwat. Defra is leading a team involving WaterVoice, Ofwat and the Welsh Assembly Government to manage a smooth transition to the new organisation.

Complaints and disputes

WaterVoice deals with most complaints. Ofwat settles and reviews some complaints and disputes.

Ofwat dealt with 391 formal and 115 informal complaints and disputes in 2003-04. We obtained compensation and rebates amounting to £151,000.

We held complaint workshops in May and October for WaterVoice members and staff.

We received four complaints that WaterVoice had been unable to resolve with the companies. Nine complaints had been carried forward from the last year.

We dealt with 11 complaints and supported WaterVoice's recommendations in ten. The companies accepted our recommendations and we obtained compensation totalling £42,612. In one case, we were unable to support WaterVoice. Two cases are ongoing.

We dealt with 66 complaints from customers who were not satisfied with WaterVoice's investigations. We upheld three of these complaints and partly upheld eight. We obtained compensation or rebate for the complainant from the company in 15 cases. Five cases are ongoing. We did not uphold the remaining cases. We are satisfied that there is no evidence of significant shortcomings by WaterVoice in its complaint handling.

Connection charge disputes

Companies are entitled to recover the reasonable costs of making connections to water mains. Disputes may be referred to the Director for determination.

Of the five disputes closed, all were settled in favour of the customer. We required companies to make refunds to customers ranging from 3% to 31% of the original charge (an average refund of 13%).

Of the 30 cases we referred to the companies to review their charges informally, 11 resulted in refunds to the customer.

Sewer appeals

If a company refuses to adopt a customer's sewer as public, the customer may appeal to the Director.

We dealt with 21 appeals and 36 enquiries during the year.

Trade effluent appeals

Traders can appeal to the Director if a company refuses permission to discharge effluent into a public sewer.

Six cases were brought forward from last year and we have received 10 new cases. One was resolved formally and seven informally or withdrawn. The remaining eight are also likely to be resolved without the need for a hearing.

Complaints about pipe laying in streets

We received 15 complaints, none of which required formal arbitration.

Complaints about pipe laying in private land

One case was resolved formally with an award of £2,000. We resolved 67 cases informally, usually by the company agreeing additional compensation, or doing further reinstatement work.

Guaranteed Standards Scheme (GSS) disputes

Customers are entitled to guaranteed standards of service, as laid down by Government. If a company fails to meet any of the guaranteed standards, customers can claim a compensation payment. We monitor the scheme and recommend changes.

We settled two disputes under the GSS, one in favour of the customer. We resolved a further eight cases informally.

New powers to determine disputes

The Water Act 2003 gives the Director powers to determine a new range of disputes. These include the terms and financial conditions of water, sewer and lateral drain requisitions²⁶, the terms and financial conditions of self-lay agreements and refusals by water companies to adopt self laid pipes supplying water for domestic purposes²⁷. Following the consultation, we will be issuing guidance.

²⁶ 'Consultation paper on the financial arrangements for self-lay and requisitioning agreements', December 2003.

²⁷ 'Process for handling disputes and appeals: Requisitioning of water mains and public sewers', December 2003.

Sewer flooding

During the year, we agreed with companies substantial work to address sewer flooding problems in the next three years. We have also worked with companies to understand their longer term plans.

We commissioned studies into the costs and economic benefits of alleviating sewer flooding²⁸.

The House of Lords gave their judgement on the sewer flooding case, *Marcic v Thames Water*²⁹. This case concerned a claim by a customer for damages from a sewerage company caused to his property by repeated external sewer flooding. The Lords unanimously dismissed the appeal and concluded that customers suffering from sewer flooding do not have a cause of action under the common law of nuisance or under the Human Rights Act 1998. The Lords acknowledged that the regulatory system established by Parliament is the appropriate route for dealing with such issues as it allows the Director to balance the interests of flooded customers against those of customers generally as all customers would have to pay to solve the flooding problem. We and WaterVoice have reviewed our arrangements for handling sewer flooding complaints in the light of the *Marcic* judgement.

We welcome the National Audit Office (NAO) study into sewer flooding³⁰. We will carefully consider the conclusions of the Public Accounts Committee whose report has yet to be published.

We held a seminar on compensation, insurance and ways to reduce the impact of sewer flooding. We invited representatives from WaterVoice, the companies, Defra and the insurance industry. We discussed issues including: the customer perspective of a flooding incident, and the balance between insurance, the Guaranteed Standards Scheme and other compensation payments to those flooded. We also shared good practice in reducing the

damage caused when flooding occurs and ways to avoid flooding within properties. We will continue to work on these issues with the industry and expect to hold a further seminar later this year and to address the issues in setting price limits.

Social issues

Services to disabled or elderly customers

Companies have procedures to ensure that support is available to customers with additional needs.

In June 2003 we published the findings and recommendations of WaterVoice's review of our guidelines on services for disabled or elderly customers. These set out the essential elements that companies are expected to adhere to in order to meet these customers' needs.

The review found that most companies were following the guidelines, but that take-up varied significantly. It recommended work to increase awareness of the availability of special services, and to encourage stronger links with care and advice agencies to encourage take-up. We published revised guidelines following consultation³¹.

Affordability

Various stakeholders have raised concerns about the affordability of water for households, particularly in light of potential price increases.

The Environment, Food and Rural Affairs Committee, in its report on water pricing³², recommended that the Government should review how poorer households are helped with their bills. An inter-governmental steering group was established, lead by Defra. We are contributing to the review.

28 'An investigation into costs of sewer flooding alleviation schemes', November 2003.

29 *Marcic v Thames Water Utilities Ltd*, 4 December 2003 [2003], UKHL66.

30 'Out of sight, not out of mind – Ofwat and the public sewer network in England and Wales' (NAO), January 2004.

31 RD 23/03, June 2003.

32 'House of Commons Environment, Food and Rural Affairs Committee Water Pricing – First Report of Session 2003-2004', HC121 (2003-04), December 2003.

Payment options

Access to suitable payment arrangements is important, particularly for low-income customers. Our monitoring shows that all companies continue to offer a wide range of payment methods, frequencies and payment locations.

A number of companies proposed to introduce, or increase, charges for 'payment related' activities. These include charges for dishonoured cheques or cancellation of direct debit agreements. We compared the level of charges between companies, and encouraged those with higher charges to reduce them.

We continued to work with the companies and the Department for Work and Pensions (DWP) to ensure adequate promotion of 'Water Direct', whereby customers in debt and on benefit may have their water bills paid direct by DWP to the company. Improvements in the operation of this scheme have resulted, for example, in the introduction of a standard application form, and a revised Joint Statement of Intent, which sets out how the scheme operates between the water companies and the DWP.

Customers in debt

Following the abolition of disconnections for domestic customers, the companies had to review their debt recovery procedures, to make sure that they could collect debt from customers efficiently.

WaterVoice audits companies' procedures to see whether they are consistent with our debt recovery guidelines³³. We hosted a debt audit workshop for WaterVoice to help committees to audit cases consistently.

We collect and publish company information about the number of commercial water disconnections and the total level of debt recovery actions relating to domestic customers.

Levels of outstanding revenue and the cost of debt recovery continue to rise.

Debt levels and associated recovery costs in 2002-03 were higher than for 1998-99, the last full year before the ban on disconnection. We are working with the industry to improve information quality and understanding about water debt.

We attended Water UK debt focus groups, to discuss debt issues with industry representatives. We have also joined the project steering group for Water UK research into the socio-economic characteristics of customers in debt.

Research on debt

In September 2003, we published national qualitative research with WaterVoice and Water UK, exploring customers' views on paying for water and debt. The research combined face-to-face interviews and focus groups³⁴. The bill for water was as important to customers as those for gas and electricity, after the top priorities of rent or mortgage and Council Tax. Customers with water debt often had multiple debts and continually juggled bills. Frequent, effective communication was found to be key in encouraging prompt, regular payments. WaterVoice is working with the companies to follow up the findings.

Water ingress to gas mains

We worked with stakeholders to develop a memorandum of understanding, setting out roles and responsibilities when water accidentally enters gas pipes. The memorandum sets out how water companies and Transco will work together to help customers by removing the water and restoring gas services quickly and safely.

Approving charges schemes

Within the overall price limits, each company decides its own individual

³³ 'Dealing with customers in debt – guidelines', October 2002.

³⁴ Research carried out by Accent Marketing and Research: 'Paying for water', September 2003.

charges and publishes these in an annual charges scheme. To ensure that customers are protected, we check and approve each scheme before it is published. Companies submit drafts of their charges schemes, together with their principal statements, which set out their charges in detail. We scrutinise these to ensure that charges:

- comply with price limits;
- reflect costs; and
- are consistent with guidance from the Secretary of State.

We consulted the WaterVoice committees on companies' charging proposals. We subsequently approved companies' 2004-05 charges schemes in February 2004.

Full details of our approach to charges schemes, together with information on charges and tariffs, are set out in our tariffs report³⁵.

Reviewing company charges

Our main role in tariff policy is to ensure that companies comply with licence conditions. Companies must show neither undue preference nor discrimination in their charges.

The measured/unmeasured household differential

We reviewed the measured/unmeasured household tariff differential. This differential compares the average unmeasured bill with the amount an average unmeasured customer would pay if they were metered. We use this comparison to check whether the balance between measured and unmeasured charges is fair. This year we have reviewed how to calculate the differential. We consulted on proposals, and published our decisions in January³⁶. The changes take effect in 2005-06. They will result in a fairer balance, taking account of company-specific circumstances.

35 'Tariff structure and charges report', May 2003.

36 RD 02/04, 21 January 2004.

37 RD 31/03, 27 August 2003.

38 RD 35/03, 1 October 2003.

39 MD 189, 2 March 2004.

Non-household policy issues

Companies are developing new standby, interruptible and subscribed demand tariffs for business customers. In February 2003, we consulted on our policy. We took account of comments and published our conclusions in August 2003³⁷.

We introduced changes, including a new check of standby charges, and we agreed to consider proposals for short-term interruptible tariffs.

We hold regular meetings with business customers. We value opportunities to listen to their views, and to update them on relevant policy developments.

Charging for surface water drainage

Companies adopt a variety of approaches to charging for surface water drainage. We reviewed those approaches and concluded³⁸ that, for non-household customers, charges based on the site area of premises are preferable because they are cost-reflective and give the strongest incentive to customers to reduce costs. We urged the companies to consider this approach.

Licence condition B

We consulted on two proposed modifications to licence condition B which concern charges. Licence condition B operates in such a way that companies are able to increase charges to other customers when they introduce new, below-average charges that add to the number of chargeable supplies. One of the modifications was to remove a loophole, which would allow companies to secure, in effect, a bigger price limit as a result of this. The other modification was to ensure that large user charges are treated consistently in companies' annual principal statements and in the June return³⁹.

Vulnerable groups

Under government regulations, metered customers receiving specified benefits, and who use a lot of water due to having large families or certain medical conditions, can opt for a capped tariff. Although we have continued to ensure that companies advertise the availability of this tariff, uptake remains low.

The regulations changed in April 2003. We checked companies' charges schemes to ensure that their literature reflected the introduction of the new qualifying benefits.

We responded⁴⁰ to Defra's consultation paper 'Reductions for vulnerable groups', which proposed to extend the assistance available to vulnerable customers. We supported a number of the proposals. We await Defra's conclusions.

Water Resale Order

The Water Resale Order 2001 protects customers who pay someone else – such as their landlord – for their water and sewerage services rather than the company direct. This year, we formally dealt with over 100 queries from resellers and purchasers about how charges should be set.

At our request, the Water Act 2003 included new provisions allowing us to specify the information that resellers should provide to customers explaining their bills. We will also be able to require payment of interest on excess charges.

⁴⁰ 'Ofwat response to Defra consultation on the reductions for vulnerable groups', May 2003.

Safeguarding quality and service



Comparative competition

We use comparative competition to impose on the monopoly companies a proxy for pressures that would exist in a free market for water and sewerage services. There is a sufficient number of companies to enable us to promote effective comparative competition between them. We also compare our companies with a number of companies from overseas.

We monitor company progress in delivering the outputs and efficiencies we expect from them. We compare their performance and set challenging goals. We encourage them to outperform our expectations.

Together with the environmental and water quality regulators, the Environment Agency and the DWI, we have developed many comparative tools covering nearly all aspects of the monopoly businesses. These tools range from simple comparative measures (of reporting compliance with quality requirements; of service; and of average bills), through consolidated indicators (such as our overall performance assessment), to complex statistical models.

All of the tools we use rely on good quality and comparable information from each company. We achieve a high

standard of information through our substantial information requirements, and through scrutiny by reporters and auditors.

We have well established reporting procedures. We collect the information we need annually from the companies through:

- the principal statement, which details their charges for the forthcoming year;
- the annual charges scheme;
- the June return; and
- regulatory accounts.

In 2004-05, we plan to review our annual information requirements to ensure that our data collection is optimal and does not place an unnecessary burden on companies.

In its June return, each company sets out the achievements in its regulated activity: on service to customers, spending and performance.

The Agency and the DWI also give us an annual report on the companies' progress in delivering required enhancements. We publish our analysis of the data in our annual performance reports. We also release the data used for the analysis,

thus enabling others to review, repeat and challenge both our analysis and findings. We make the majority of information in the June return available to the public. Up to 2003, we have produced a CD ROM as well as placing the return in the Library. This year we also ran a successful pilot project to put key June return public data on the web. From 2004, the whole public domain June return will be accessible through our website.

We published our five main annual reports, so that customers, WaterVoice and other interested parties can see how the companies are performing. They include details of regulatory action.

'Tariff structure and charges 2003-04', May 2003.

'Financial performance and expenditure of the water companies in England and Wales 2002-03', August 2003.

'Levels of service for the water industry in England and Wales 2002-03' September 2003.

'Security of supply, leakage and the efficient use of water 2002-03', October 2003.

'Water and sewerage service unit costs and relative efficiency 2002-03', January 2004.

Monitoring operating and capital maintenance expenditure and efficiency

We believe that the efficiency regime continues to give companies the incentive to drive down costs and improve efficiency. We monitor the companies' operating and capital maintenance expenditure and publish the results⁴¹. This work shows that the industry continues to slightly outperform our expectations for reducing operational costs.

We have reviewed the capital maintenance econometric models, in association with a small group from the industry and our external academic econometric advisor. We shared the revised models with the companies and we shall use them in association with the standard unit costs (cost base) to set efficiency targets for the price review.

Companies submitted their standard unit costs for review and comparison in March 2003. We analysed these costs to derive potential improvements in efficiency for the poorer performing companies – in both capital maintenance and capital enhancements⁴². We aimed to help the companies understand how the cost base works and compare their unit costs with those of other companies. Companies also had the opportunity to resubmit their standard unit costs with their draft business plans for review and feedback.

We have continued our work on understanding how the performance and efficiency of companies in England and Wales compare with those of water and wastewater service providers around the world. Our annual report on this confirms that customers here receive a level of service that compares well with the best elsewhere in the world⁴³.

Reporters and auditors

Independent professionals called reporters scrutinise and comment on company regulatory information. They give us confidence in the consistency and reliability of the information.

The auditors examine companies' regulatory accounts, and comment in the same way as with statutory accounts. They work with the reporters in scrutinising the financial aspects of companies' business plans.

The reporters worked on information in three main areas this year:

41 'Water and sewerage service unit costs and relative efficiency 2002-03', January 2004.

42 RD 22/03, 4 June 2003.

43 'International comparison of water and sewerage service 2001-02 report', March 2004.

Performance monitoring information:

- 2003 June returns,
- sewerage service econometric information,
- 2004-05 principal statement of charges schemes.

Regulatory information company-specific actions:

- Thames Water's progress against its leakage action plan,
- Severn Trent's water balance and leakage levels,
- Southern Water's work to meet the Urban Waste Water Treatment Directive.

Information in preparation for the periodic review:

- company-specific special factors claims,
- draft business plans – we put one page summaries of the reporters' reports on our website and in our library.

Reporters also commented on information supporting interim determination applications.

We continued to monitor and develop reporters' performance. Babtie Group, a firm of consulting civil engineers with wide experience in the water industry, reviewed the reporters' processes for the draft business plans, and published their conclusions⁴⁴.

We consulted companies, and current and prospective reporters, about the process for the round of reporter appointments starting in late 2004. We held reporters' and auditors' joint workshops in April and December 2003⁴⁵.

44 'External review of the reporters' audit of water company draft business plans – summer 2003' (Babtie), January 2004.

45 RD 21/03, 16 May 2003 and RD 04/04, 26 January 2004.

46 'Levels of service for the water industry in England & Wales 2002-03 report', September 2003.

47 RD 03/04, 22 January 2004.

We assessed the reporters' and auditors' performance in 2003, shared our findings with the companies and made awards to the top performers:

June return 2003: Roger Sawdon of W S Atkins (South West Water) and Keith Hall of Strategic Management Consultants (South East Water)

Draft business plan: Chris Turner of Halcrow Management Sciences (United Utilities Water); Nigel Kent of Montgomery Watson Harza (Dee Valley Water); and PricewaterhouseCoopers (Anglian Water and Bournemouth & West Hampshire Water).

Monitoring environmental and drinking water quality

Companies are continuing the programmes of drinking water quality improvements to treatment works and the distribution system. The DWI tells us each year how the companies are performing in meeting the required standards. We make that information available, alongside the information in companies' June returns. Companies are generally on course with expected improvements. In some cases, those expectations have been revised. For example, the DWI will review the extent of the lead pipe replacement needed after the success of treatment methods to reduce lead levels has been assessed.

The Environment Agency gave us its annual report on company progress in June. We have reviewed company progress in delivering the substantial environmental improvement programme set down by Ministers in April 2000. With the Agency, we held joint environmental performance meetings with all ten water and sewerage companies in September 2003. We reviewed and reported on their current performance⁴⁶ in meeting their responsibilities towards the environment, and on their progress in delivering new requirements⁴⁷.

Companies now have less than a year before they should have completed the National Environment Programme for 2000-05. We asked companies to tell us if they envisaged completing this work on time. We published a joint report with the Agency⁴⁸, setting down the company responses that they were generally on course. We will follow this up in our joint environmental performance meetings later this year.

Water Framework Directive

The regulations transposing this Directive into legislation in England came into force in January 2004. This will have significant impacts on all water providers and users.

We are working with Defra and the Agency to provide the information and analysis required by the Directive. We are part of the group looking at the implementation of the Directive. We are also members of the Economics Steering Group and the Economic Advisory Stakeholders Group. With our experience, we are contributing to projects on how water services are paid for, and the cost-effectiveness of measures to address the environmental objectives of the Directive. In February 2003 and March 2004, we participated in EU Commission conferences on the economic analysis required to implement it.

Control of odour

We responded to Defra and the Welsh Assembly Government consultations on odour control from sewage treatment works in March⁴⁹ and June⁵⁰ 2003 respectively. Following the recent clarification of the law on statutory nuisance and odour from sewage treatment works (*LB Hounslow v Thames Water*), we are participating in a Defra-led industry group overseeing the drafting of a code of practice that will provide advice and guidance on resolving odour from sewage treatment works.

The Government is considering further what action may need to be taken in respect of other nuisances such as mosquitoes.

We also responded to the following Defra consultation papers.

- New designations under the Fresh Water Fish Directive (in September 2003).
- Existing private sewers (in October 2003). We consider that the top priority is to ensure that problems associated with private drains and sewers are not exacerbated. We are not, however, convinced of the case for a widescale transfer of responsibilities for private sewers either to sewerage undertakers or local authorities and we want to see further research on the implications and costs of such a transfer.

Maintaining security of supply

The ability to maintain water supplies is essential. The extended dry weather in 2003 was a significant test for companies. Companies made some use of drought orders and permits, but avoided restrictions for customers, largely due to leakage reductions since 1995.

But there is no room for complacency. This year, we worked with the Agency to audit companies' draft plans for long-term security of supply. We participated in a joint project with the Agency and companies to model shared water resources for the South East of England. We also reported on companies' progress in improving security of supply to customers, in particular Thames Water's work in London.

48 'Delivering the National Environment Programme' (Ofwat/Environment Agency), January 2004.

49 'Ofwat's response to Defra consultation on proposals for the statutory control of odour and other nuisance from sewage treatment works', March 2003.

50 'Ofwat's response to Welsh Assembly Government consultation on proposals for the statutory control of odour and other nuisance from sewage treatment works', June 2003.

Ensuring serviceability to customers

Each year we monitor and report on water companies' service to customers and we assess their ability to continue to provide those services in the future⁵¹. Where we assess a company's serviceability as marginal or deteriorating, we expect the company to demonstrate its plans to restore stable serviceability for its customers. Overall, industry-wide assessments were stable this year, except for sewerage non-infrastructure, which was marginal.

Monitoring leakage and efficient use

Leakage

Most companies have leakage at an economic level now and we will set prices on the basis that this continues for the period from 2005. When assessing the need for further leakage reductions, companies will take account of the social and environmental costs of leakage as well as customers' needs for water.

We have continued our annual monitoring of all companies' leakage levels. We remain concerned about leakage at Thames Water and the company is following a detailed action plan to reverse the trend of rising leakage. Severn Trent Water was also subject to an investigation in 2003. This concluded that, while leakage had risen slightly in recent years, the underlying level of leakage was significantly higher than previously thought. We have set leakage targets to recover from the recent increase.

We have continued to approve companies' codes of practice on leakage from customers' pipes.

Efficient use of water

Companies have a duty to promote the efficient use of water by customers. We continue to monitor their work in this area. We began joint work with the Environment Agency to review the current regulatory arrangements for water demand management. We fed back to companies the results of our work with WaterVoice to gain a more customer-focused view of companies' efforts in this area.

We also assessed companies' plans to promote efficient use of water, including extending water metering, as part of our work on their draft business plans.

⁵¹ 'Financial performance and expenditure of the water companies in England and Wales, 2002-03 report', August 2003.

Companies' finance and mergers



Each company's management is free to choose its own capital structure. But we must ensure that customers continue to be protected and that the companies remain capable of financing their present and prospective capital programmes readily and at reasonable costs.

The Water Industry Act 1991 requires the Director to act in a way that he judges will enable efficient companies to carry out their functions properly and finance them, in particular by securing that they are able to earn reasonable returns on the capital they employ given the risks they face.

The City plays a critical role in enabling the companies to finance their functions. We held three City briefings during the year (two in London and one in Edinburgh). These briefings provide the opportunity to explain our approach to regulation, to inform City contacts about developments in the industry and to hear their views and concerns. We also regularly meet with investors in the industry.

Financial restructuring

Changes in levels of gearing

A highly geared company is one which raises a high proportion of capital through debt (borrowing) rather than through equity (shares).

The level of gearing in the water sector has increased substantially since the 1999 review. We believe that it is for the companies to manage their own capital structures. We welcome innovation directed at improving efficiency and effectiveness. However, whilst higher ratios of debt to equity may reduce the cost of finance in the short term – an important aim in an incentive-based regime – it might reduce the financial flexibility of companies in the future. We must ensure that customers are protected from undue risk and that companies remain capable of financing their present and future capital programmes. Any increase in financial risk should be a matter for shareholders and lenders, not customers.

Where companies propose to outsource the majority of their operations, we expect them to ensure that they do not compromise safety and quality.

Study into trends in ownership and financing

We published a joint study with Defra this year, which examined recent trends in the pattern of ownership and financing of water and sewerage companies and their ability to meet the Government's objectives for this sector⁵².

The report found no evidence so far that highly geared structures affected water and sewerage companies' ability to deliver their objectives. Such structures did not seem to make them more averse to taking major investment decisions, although they were yet to be tested under adverse market conditions. The report welcomed the current diversity of structure in the industry. We see benefit in shareholder equity and aim to maintain a framework where both the traditional equity model and more highly leveraged structures can co-exist.

Refinancing activity

There have been a number of specific transactions this year.

In 2002, Dee Valley Water plc completed a capital restructuring that raised its gearing to around 80% of its regulatory capital value. We consulted on modifications to the company's licence in March 2003. These were incorporated into Dee Valley Water's licence in November 2003.

On 23 May 2003 Northumbrian Water Group plc (formerly Aquavit plc) announced that it had completed the purchase of 75% of the share capital of the parent company of Northumbrian Water. The former owner of Northumbrian Water, Suez, retained the remaining 25%. We consulted on the change of ownership in June 2003. We published a position paper in August 2003 and in November 2003 consulted on proposed amendments to Northumbrian Water's licence that will further strengthen ring fencing of the appointed business. The acquisition resulted in a sharp downgrade

in the corporate credit rating of Northumbrian Water and the bonds issued by the company. We are continuing to monitor the company's progress against a number of options that might improve its credit rating and financial position. We will conclude whether any further regulatory action is required in June 2004.

In July 2003 United Utilities Water announced its intention to launch a rights issue. We commented that we see virtue in shareholder equity as a cushion against external events and as a spur to greater efficiency.

In February 2004 Bristol Water plc finalised new financing arrangements that will increase the level of debt of the appointed business. We proposed modifications to Bristol Water's licence that would bring its licence into line with other water companies with restructured finances. These licence modifications have now been made.

Mergers

Our objective is to ensure that a company's ownership structure maintains incentives for improved efficiency and performance.

We have long argued that the loss of independent companies through mergers permanently harms the whole comparative regime. Mergers also reduce the number of independent management teams aiming to improve returns to investors and push back the efficiency frontiers.

However, we do not and cannot block mergers. We recognise that mergers and changes in ownership can be a powerful stimulus for improved performance, particularly in poorly performing companies.

⁵² 'Structure of the water industry in England: does it remain fit for purpose?' (Defra/Ofwat), November 2003.

Any merger benefits need to be assessed against the detriment to the industry as a whole, not simply in relation to the customers who are directly involved. A merger could bring benefits that outweigh losing a comparator. Innovative and highly efficient management could benefit all consumers in the long run if the overall efficiency of the industry is thereby improved.

We remain unconvinced by arguments for mergers in terms of economies of scale. The recent Stone & Webster report, which we commissioned in the light of the recommendations of the Competition Commission report on Vivendi's bid for Southern Water, in relation to comparative competition, did not provide evidence of such economies⁵³. We look for remedies sufficient to outweigh the permanent harm of a merger to the comparative regime. If no sufficient remedies can be found then the proposed merger should not go ahead.

Any decision on a merger between UK water companies remains for the Competition Commission, not Ofwat. In the event of a proposed merger between water companies, we will:

- look with an open mind at individual propositions; and
- submit evidence to the Commission, including an assessment of the impact of the merger on the comparative regime and any benefits it may bring.

If other mergers lead to a change of ownership for a water company, we will publicly consult on any regulatory issues arising and provide advice to the Director General of Fair Trading (DGFT) if required.

Changes of ownership for Southern Water plc

The proposed acquisition of First Aqua Holdings Limited, owners of Southern Water plc, by Vivendi Water UK was referred to the Competition Commission in May 2002 and we reported last year on its outcome.

Subsequently, in June 2003, we consulted on licence modifications for Southern Water which were incorporated into the Southern Water licence in November 2003.

The majority stake in Southern Water was acquired by Southern Water Investments Limited. Initially all the shares in Southern Water Investments Limited were held by the Royal Bank of Scotland (RBS). In February 2004, RBS syndicated some of this stake to Perry Capital Ltd and D E Shaw.

Change of ownership for South East Water plc

On 1 October 2003, Macquarie Bank Limited announced that it had acquired all of the equity of South East Water plc and its affiliated businesses from French group Bouygues. We consulted on the acquisition and its impacts in November 2003. We invited views on a number of changes to South East Water's licence designed to strengthen the ring fence around the regulated business. We will be formally consulting on these changes shortly.

Enterprise Act

Later in 2004, the merger regime for the industry will be subject to the provisions of the Enterprise Act 2002. The Act maintains the mandatory reference to the Competition Commission of qualifying mergers between two or more companies but changes the threshold for qualification to one based on turnover rather than assets. Any merger between water

⁵³ 'Investigation into evidence for economies of scale in the water and sewerage industry in England and Wales', (Stone & Webster) January 2004.

companies will continue to qualify for an automatic reference to the Competition Commission. The Commission must consider the effect of the merger on our ability to make comparisons between water companies. In line with the changes to the general merger regime, Ministers will be removed from decisions on mergers, except in special cases.

Keeping costs transparent

Maintaining transparency of water companies' costs ensures that the financial ring fence around the Appointee is effective and protects water customers from inflated bills. All costs declared by the companies must be incurred in the proper performance of delivering water and sewerage services.

Transfer pricing

Water companies are required to prevent cross-subsidy by keeping their regulated and unregulated businesses separate; and by trading at arm's length with associates. We monitor the companies to ensure that cross-subsidy does not take place and that companies are complying with our guidance on transfer pricing (Regulatory Accounting Guideline 5.03).

This year we reviewed in detail trading arrangements at Anglian Water Services, Northumbrian Water, Severn Trent Water, Thames Water Utilities, United Utilities Water, Mid Kent Water and Three Valleys Water. The companies are working to address the issues we identified.

We also work to ensure that greater levels of integration between the water company and associates in some groups do not compromise the ability of the water company to discharge its functions in each case.

We work with other regulators (principally Ofgem) to ensure that costs to water customers can be separately identified from other group costs.

Regulatory accounts

We require companies to publish annual regulatory accounts in accordance with our Regulatory Accounting Guidelines (RAGs) 1 to 4. Following consultation we issued revised RAGs in January 2003. As part of our conclusions we said we would work with the industry and others to consider whether to develop proposals for companies to provide additional cost information at a disaggregated level.

We have delayed this piece of work until after the 2004 price review. This will enable us to take into account the changes arising from the Water Act.

We published our annual update to regulatory capital values for the period to 2005 in March 2004⁵⁴.

54 RD 05/04, 11 March 2004.

Price competition



Water supply licensing and the Water Act 2003

The new Water Act (see Chapter 6) brings in specific legislation for competition.

- From autumn 2005, customers who are likely to consume at least 50 megalitres of water a year will be able to purchase water from either their existing water undertaker or from a water supply licensee. We estimate that this competition will be open to around 2,300 customers, spending £200 million on water each year.
- Companies will be able to apply for either a 'retail' licence, which entitles the holder to purchase water from a water undertaker (called a wholesale supply) and to retail it to eligible customers; or a 'combined' licence, which authorises the holder to introduce water into a water undertaker's supply system and retail it to eligible customers (common carriage). This will become available during summer 2005.

Undertakers will have a duty to provide access to their supply systems, and to provide wholesale supplies, on reasonable terms. As part of this, we will issue guidance on price and non-price terms for access, and will expect undertakers to have price and non-price terms for access ready by summer 2005.

To enable the basic legislative framework to operate, the Water Act 2003 provides for the making of secondary legislation and statutory guidance. Ofwat, Defra and the Welsh Assembly Government will develop this secondary legislation, and we are working together to produce both the required statutory and non-statutory guidance.

Setting up new advisory groups

This is an ambitious project requiring all stakeholders in the industry to work together to ensure that an effective regime is delivered on schedule. To achieve this, we have established:

- a sponsor group with representatives from all industry stakeholders, to oversee the project and ensure its successful delivery by autumn 2005;
- two advisory groups, with representatives from all industry stakeholders, to assist Ofwat, Defra and the Welsh Assembly Government, as appropriate, as they prepare the relevant secondary legislation and guidance; and
- a regulators' group involving Defra, Ofwat, the DWI, the Environment Agency and Welsh Assembly Government, to co-ordinate the various activities of each organisation.

Initial work on new licences

Under the new regime, water undertakers will continue to operate according to their instruments of appointment, although there will be some modifications to existing conditions of appointment to reflect the competition provisions in the Act. Licensees will have a water supply licence, which will be of a different construction to water undertakers' instruments of appointment. These licences will have standard terms and conditions governing how licensees operate, together with specific individual conditions where appropriate.

In February 2004, we consulted on modifications to water undertakers' existing conditions of appointment and conditions of water supply licences. We expect to consult on the formal text of the licences in early 2005.

Self-lay

Self-lay is the mechanism by which developers or their contractors can install new water mains and service pipes instead of asking the water undertaker to do the work.

The Water Act introduces a statutory framework for self-lay. In December 2003, we published a consultation on the financial arrangements for self-lay and requisitioning agreements⁵⁵. This set out the financial arrangements that should underlie water undertakers' self-lay policies and procedures for implementing the Act.

We held a workshop in January 2004 for stakeholders to discuss the proposals. We will take account of comments in the final guidance, which we will publish in May 2004.

Working with self-lay groups

We have continued to work with our industry self-lay advisory group (SLG). The SLG has supported us in preparing to implement the Water Act framework, by

commenting on the draft consultation paper and considering the issues raised. The SLG has also produced national levels of service for water undertakers to follow when handling self-lay applications. We carried out this work in conjunction with UK Water Industry Research, which is producing a guide on the adoption of self-laid water mains.

Insets

An inset appointment allows one company to replace another as the statutory undertaker for a specific area.

We continue to work with applicants on a variety of inset proposals. The inset regime will exist in parallel with the water supply licensing regime. The existing large user inset threshold in England will be lowered to 50 megalitres a year, in line with the water supply licensing eligibility threshold.

Enterprise Act 2002

The Enterprise Act reformed competition law and consumer law enforcement in the UK. It came into force in 2003. The Act gives us new concurrent powers with the Office of Fair Trading (OFT) to refer market investigations to the Competition Commission. We also have the power to apply to the courts for orders disqualifying directors of companies who have breached competition law.

Competition Act 1998

The Competition Act prohibits anti-competitive behaviour and abuses by companies with dominant positions in markets. When we receive a complaint, we decide whether we have powers to consider it under the Competition Act 1998 or the Water Industry Act 1991 and, if necessary, which powers are most appropriate. The Water Act 2003 introduces a framework into the Water

⁵⁵ 'Consultation on the financial arrangements for self-lay and requisitioning agreements', December 2003.

Industry Act 1991 for licensing new entrants.

In April, we published our annual report on the complaints that we have handled this year and policy developments⁵⁶. We continue to improve the process for dealing with complaints by learning from our experiences and those of other competition authorities, including the Competition Appeal Tribunal.

Modernising EC competition law

Regulation 1/2003 of the Council of the European Union comes into force on 1 May 2004. This modernises EC competition law. It enables national competition authorities (the OFT and concurrent regulators, including Ofwat) to apply EC competition law⁵⁷.

The Regulation requires us to apply EC competition law when applying national competition law where there is a potential effect on trade between Member States. We are working with the OFT and other concurrent regulators to ensure the effective and appropriate implementation of the Regulation.

56 Complaints considered under the Competition Act 1998, April 2004.

57 Articles 81 and 82, EC Treaty.

The Water Act 2003



In November, the Water Act 2003 received Royal Assent. We offered technical advice to Defra in its preparation and passage through Parliament.

The Water Act 2003 introduces important changes including:

- a regulatory authority, with a Board structure, in place of the Director General of Water Services;
- water-specific legislation for competition;
- tougher penalties for companies that breach their licence conditions;
- an independent Consumer Council for Water; and
- changes to abstraction licensing.

A steering group is working on the establishment of the new independent Consumer Council for Water. The group, chaired by Defra, and involving WaterVoice and Ofwat, is now taking forward the work required to get the organisation up and running in October 2005.

The Water Services Regulation Authority will replace the Director General in April 2006 and will not overlap with the price review. This will allow the current price review process to be fully completed.

The Act will give the Authority a duty to further the consumer objective wherever appropriate by promoting effective competition. The Act includes provisions to increase opportunities for competition in the supply of water services (see Chapter 5). We have worked with Defra to consider when each section of the Act will be implemented.

The Act allows us to impose fines of up to 10% of annual turnover on companies. However, we do not expect to impose fines of this level, except in a case of extreme failure. In February 2004, we consulted on the criteria we intend to use in deciding whether to impose a fine upon a company⁵⁸. The consultation also sought views on the factors that should influence decisions on the levels of such fines. The consultation closes at the end of May 2004.

The Act also requires the Authority to publish a code of practice setting out how it will discharge its functions. Following consultation, we issued a code of practice governing the way we discharge our functions⁵⁹. Once the new Authority is set up, we expect to update this.

58 'A consultation paper on application of powers under section 22A of the Water Industry Act 1991 to impose financial penalties', February 2004.

59 RD 33/03, 11 September 2003.

Communications



Good communication with stakeholders is essential to effective regulation.

Stakeholders rightly expect to be kept informed. We work to become more open, to provide information about what we do and to take account of the views of others when we make decisions. Informed stakeholders make better contributions to the debate, ensuring that our decisions are based on sound evidence. And, by adopting a 'no surprises' approach, we aim to minimise regulatory risk.

Our redesigned website helps us to deliver our commitment to good communications.

Our staff have contributed to over 70 conferences, workshops and other events this year. We have also held more than 20 events ourselves, including our annual stakeholder conference.

Ofwat continues to attract interest from abroad and, during the year, we have received visitors at our offices in Birmingham from countries including China, Uganda, Malaysia and Jamaica.

Publications

We produce our reports in hard copy as well as in electronic form in response to our readers' demands. To help keep costs down and speed up production, we produce most reports in black and white. We aim to place all of our reports on our website early on the day of publication.

We have conducted 15 consultation exercises this year. We are currently revising our code of practice to take account of the latest government guidelines. Eight of our consultations had a 12-week response period.

This year we produced the following documents:

86	Publications
7	Leaflets and information notes
67	Press notices and information bulletins
2	Price review newsletters
43	MD/RD letters

We aim to meet our commitments under the Welsh Language Scheme. This year we produced two documents in Welsh. We did not receive any requests for documents to be translated.

Customer charter

We aim to provide a high quality and effective service. Table 1 sets out our performance against our key targets in

our customer charter⁶⁰. We always work to achieve our goals and this year we have met most of our charter standards. Where we have not done so, we aim to improve.

Table 1: Performance against our standards ^(1, 2)

	Performance standards	Achievement against standard
Replying to written enquiries	Reply within 10 working days (unless the item is particularly complicated). Our target is 95%.	Achieved
Replying to phone enquiries	Reply within 2 working days (by phone). Our target is 97%. Reply within 10 working days (in writing). Our target is 95%.	Achieved Achieved
Returning your messages	If you ask us to, we will return calls left on our answering machines within one hour of re-opening.	Achieved
Requests under the Code of Practice on Access of Government Information	We will reply within 20 working days.	No requests
Requests under the Environment Information Regulations	We will reply within 40 working days.	Achieved
Complaints handled by the Director and disputes and appeals	We will respond to enquiries within 10 working days. Our target is 80%.	Achieved
	We will decide formal disputes or appeals within 90 working days. Our target is 80%.	Not achieved ³
Internal review procedure	We will tell you about the outcome within 20 working days.	Not achieved ⁴
Complaining to Ofwat about the WaterVoice committees	We will tell you within 10 working days whether we will investigate the matter. We aim to deal with 80% of complaints within 40 working days.	Achieved

1. WaterVoice reports on its performance against charter standards in its own Annual Report.
2. Complaints involving competition matters are excluded from our customer charter. These complaints tend to be very complicated so they are not covered by our standard complaint procedure.
3. 74% of complaints within the Director's jurisdiction were settled within 90 days.
4. Cases we consider under the internal review procedure are sometimes long and complicated and involve a number of different parties. The 12 cases reviewed this year took from two to six months to complete. Three are ongoing. None of these cases was taken up by the Parliamentary Commissioner. We are currently reviewing this standard as it is not achievable.

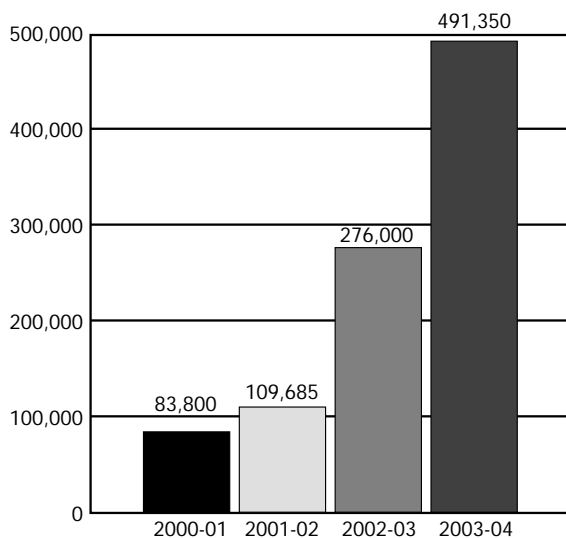
60 'Customer Charter: Our standards of service', July 2003.

Our website

We continue to develop our website as our main communication tool. This is particularly important in the price review when there is increased demand for web information.

Our website has seen a huge increase in the number of hits again this year.

Figure 3: Number of website hits



Our subscription service now holds around 500 email addresses. Users are notified by email when new information is placed on the web.

The website is also very useful for Aquarius 3 users, as they can download upgrades, fixes and documentation relating to the software.

The redesigned website was voted 'Website of the month' in Public Service Magazine in July 2003.

Working with Parliament

We have appeared five times before parliamentary committees this year, as well as contributing a memorandum of written evidence to the Environment, Food and Rural Affairs (EFRA) Committee's inquiry into Sites of Special Scientific Interest. Our first appearance

was before the House of Lords Constitution Committee's inquiry into 'The accountability of regulators', on 11 June 2003. Later the same day we also appeared before the EFRA Committee to answer questions about issues covered in our Annual Report for 2002-03.

The price review prompted inquiries by two committees. We welcomed the timely inquiry by the EFRA Committee into 'Water pricing' following submission by the companies of their draft business plans. We gave evidence to the EFRA Committee in October 2003. It issued its findings in December 2003 and the Government's response was published in March 2004. The Environmental Audit Committee announced its inquiry into 'Water: The periodic review 2004 and the environmental programme' in February 2004. We appeared before the Committee in March 2004.

During the year, the NAO investigated the sewerage network in England and Wales, culminating in its report 'Out of sight, not out of mind – Ofwat and the public sewer network in England and Wales'. We answered questions from the Public Accounts Committee, arising from this report, in March 2004.

We also gave evidence to and appeared before the London Assembly's Public Services Committee as part of its inquiry into London's water supply.

Library and information services

The library acts as the public enquiry unit and as our publication sales and distribution point. This year we answered 9,636 telephone enquiries and issued 5,795 publications.

We received no requests for information under the Open Government Code of Practice on Access to Government Information and one under the Environmental Information Regulations.

The library houses and maintains the Director's Register. This is a collection of documents, specified by section 195 of the Water Industry Act 1991, which includes water company licences, undertakings and determinations. It is freely available for consultation by the public, with a small charge made for copies of extracts. Determinations made by the Director under the Water Industry Act 1991 are also available for inspection.

The 2003 June returns were published on CD ROM and will be published on our website for the first time in April 2004. We updated the Special Agreements Register and the price review section on the website. We continue to update the Information Asset Register. This is a list of the Government's information sources and contains records of mainly unpublished information. It is co-ordinated by the Cabinet Office and can be accessed through departmental websites and Inforoute on the Cabinet Office website.

We answered 1,091 written enquiries of which 1,078 were by email. Email enquiries increased by 10% over 2002-03. Thirty-seven outside visitors used the library, fewer than in 2002-03, probably as a result of more information being available electronically and also being near the end of the price review cycle.

Ofwat's public enquiry unit can be contacted via email at enquiries@ofwat.gsi.gov.uk

responsibilities under the Act. We were grateful to Maurice Frankel, Director, Campaign for Freedom of Information, for speaking at a lunchtime seminar as part of our training programme.

Freedom of Information Act 2000

We aim to make public as much information as we can, subject to confidentiality requirements. However, we recognise that the Act, which takes effect in January 2005, places us under an even greater obligation to disclose information.

We reviewed our publication scheme during the year. We are raising the awareness of Ofwat staff about their

Resources



Staff recruitment & development

We recruit on merit through fair and open competition. This ensures opportunities for employment regardless of race, sex, physical disability, religion, or marital status. Recruitment activities are subject to external audit by the Civil Service Commissioners to ensure that we comply with our recruitment code.

During the year we undertook 40 recruitments.

Level	Number appointed	Proportion of women (%)	Proportion from ethnic minorities (%)
Head of team/function	3	0	0
Middle management	25	44	8
Clerical and secretarial	20	85	15
TOTAL	48	58	10

Everyone was recruited through open competition, except three, who were short-term contract appointments.

Ofwat has a total staff of 251 (full-time equivalent, as at 31 March 2004) of whom:

- 60% are women,
- 14% are from ethnic minority groups (this reflects the profile of the West Midlands),

- 7 are members of the Senior Civil Service (6 men and 1 woman),
- 7% are employed on fixed term and casual contracts,
- 12% work part-time,
- 18% work in WaterVoice offices.

Staff turnover at the year end was 12%.

Training and development continues to be a key activity. We encourage staff to undertake training necessary for their work, and to develop skills to their full potential. The main focus of training this year has been on the price review.

Senior staff changes, remuneration and non-pay benefits

Tony Smith joined us in May 2003 as Director of Competition and Consumer Affairs Division and Huw Brooker became Head of Legal Services from April 2003.

The salary of the Director is £140,037.

Salaries for members of the Senior Civil Service (as at 31 March 2004, £)

90,000 – 94,999	1
85,000 – 89,999	1
80,000 – 84,999	1
75,000 – 79,999	1
70,000 – 74,999	1
60,000 – 64,999	2

Non-pay benefits

Annual leave and paternity leave were increased as part of our 2003 pay review. All staff were issued with a total reward statement, informing them of the total value of their employment package.

Legislation

New legislation on sexual orientation and religious observance was introduced in December 2003. We updated our policies on equal opportunities and harassment.

IIP reaccreditation

Following a full assessment, we maintained our recognition as an Investor in People. This demonstrates our ongoing commitment to developing staff to improve business performance and facilitate career progression.

Race equality scheme

Under our race equality scheme, we monitor staff by ethnic group to ensure that they do not receive less favourable treatment because of their race or ethnic background. During the year, no ethnic staff were involved in disciplinary procedures and no grievance cases were due to race or ethnic background. No diversity issues were mentioned by staff during exit interviews. Details of the scheme are available on our website.

Staff training attendance, April 2003–March 2004 by ethnic breakdown

Ethnic group	No of days training	%
White	751	87.9
Other ethnic groups	104	12.1
Total number of days	855	100

This broadly reflects the profile of ethnic minority staff in Ofwat.

WaterAid

During the last ten years the money staff have raised for WaterAid, through activities such as recycling, sponsored rock climbs and quizzes, has helped several thousand families access safe drinking water and sanitation.

We have sponsored WaterAid projects in Ghana, India, Nepal and Ethiopia; the latter will help manage safe water supplies for over 10,000 people. This year our sponsored project will help communities in the sand islands of the rivers of Bangladesh.

WaterAid's Fiona Blake visited us in February to explain their work in Africa.

WaterVoice recruitment, training and development

The Director has statutory responsibility for appointing WaterVoice chairmen and members. These appointments are outside the remit of the Commissioner for Public Appointments, but the Director is committed to complying with the Commissioner's code of practice. An independent assessor is involved in all new appointments.

WaterVoice Chairmen and members

In August 2003, the appointments of three chairmen were extended to achieve a uniform expiry date of 31 March 2005 for the appointments of all ten chairmen in preparation for the expected start of the Consumer Council for Water.

Membership of the ten WaterVoice committees is normally reviewed annually. However, this year appointments due to expire were extended to 31 March 2005. Of the 33 members concerned, 28 agreed to stay on until then. Two members declined re-appointment and three members retired.

Table 2: WaterVoice Chairmen as at 31 March 2004

Committee	Chairman	First appointed	Current appointment started	Appointment ends	Monthly time (days) commitment	Remuneration £
Central	James Perowne	01.8.02	01.8.02	31.3.05	8	20,531
Eastern	Catherine Harvey	1.4.01	1.4.01	31.3.05	8	20,531
North West	Maurice Terry	26.2.97	26.2.01	31.3.05	12*	30,796
Northumbria	Andrea Cook	1.4.01	1.4.01	31.3.05	8	20,531
Southern	Richard Sturt	1.10.01	1.10.01	31.3.05	8	20,531
South West	Noel Olsen	1.4.01	1.4.01	31.3.05	8	20,531
Thames	Herman Scopes	19.4.97	1.4.01	31.3.05	8	20,531
Wales	John Ford	26.2.01	26.2.01	31.3.05	8	20,531
Wessex	Sheila Reiter	1.8.95	1.4.01	31.3.05	8	20,531
Yorkshire	Mohammed Ajeeb	26.2.01	26.2.01	31.3.05	8	20,531

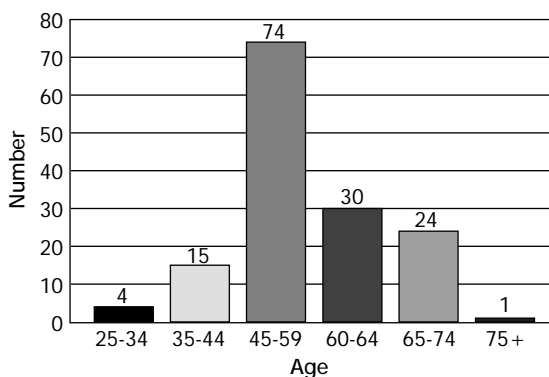
* Includes four days as WaterVoice Council Chairman.

We are discussing with chairmen and members possibilities for the extension of their current appointments to the new start date for the Consumer Council for Water of October 2005.

At 31 March 2004, the total membership was 148 (including the 10 chairmen). There were 55 (37%) women and 12 (8%) from ethnic minority groups. This compares with the national averages for public bodies appointments for 2002-03⁶¹ (the most recent data available) of 35.7% women and 4.7% ethnic minorities.

The age profile for chairmen and members is shown in Figure 4.

Figure 4: Age profile of WaterVoice chairmen and members



Names and biographical details of chairmen and members are published in the WaterVoice Annual Report 'Representing water customers' and are on the WaterVoice website www.watervoice.org.uk.

Training

New WaterVoice committee members were invited to attend the following training courses:

- Background to the water industry;
- Understanding water company accounts and the K factor; and
- Stronger voice (on being an effective consumer representative).

Honours

WaterVoice members give their time voluntarily. Piers Feilden, a member of WaterVoice Wessex, received the MBE in the Queen's Birthday Honours List. Brenda Finnigan, a member of WaterVoice Central, received the MBE in the Queen's New Year Honours List. Since the committees were established, 13 members have been awarded MBEs for services to water customers.

61 'Public Bodies 2003' (Cabinet Office), July 2003.

Setting up the Consumer Council for Water

The Water Act 2003 includes legislation to set up an independent Consumer Council for Water. We supported Defra as it began planning the new organisation. The Director of Operations and his staff have worked closely with staff representatives to provide advice to those staff from WaterVoice who will transfer to the Consumer Council.

IT development

The focus of IT development has been to provide systems to support the price review. We have developed the financial model, Aquarius 3, along with information capture systems for the draft and final business plans, for use by Ofwat and the water companies.

IT services

Secure email transmission

We have introduced a cost-effective, secure email transmission facility between stakeholders and ourselves through the Government Secure Intranet (GSI) using the PKZip protocol.

Dealing with viruses

All of the computer systems were successfully defended against all virus attacks this year.

Wide area network (WAN)

We have signed the order for a WAN between the WaterVoice offices and Ofwat to be implemented from April. WaterVoice offices will be connected by telephone line to the same network as Ofwat. This will improve our internal communications.

Operating system

Along with nine other public sector organisations we evaluated the use of the Linux business software to support the diverse range of applications we operate. This pilot is coordinated by the Office of Government Commerce and the Office of the E-Envoy to measure the effectiveness of this software against proprietary software solutions.

Office services

Safeguarding the office environment

Our priority remains the provision of a healthy, safe and secure workplace for all staff. This year, we have introduced new risk assessment policies, held awareness sessions on fire safety and security, and installed air conditioning/humidification systems. Contingency and business continuity plans have been reviewed.

Finance

Financial information provided in this Annual Report is an estimate and is subject to external audit by the NAO. We prepare the accounts in accordance with HM Treasury Resource Accounting requirements.

We expect to achieve a small underspend of 1.5% against a budget of £14.0 million. The price review was the main cost pressure on expenditure. We continued to operate well within the licence fee ceiling. Our expenditure plans are scrutinised by Parliament and HM Treasury. Our income from companies was £12.6 million (2001-02: £11.9 million, 2002-03: £11.9 million). The estimated total expenditure was £13.8 million (2001-02: £10.9 million, 2002-03: £11.8 million). The income and expenditure is summarised in Table 3.

Table 3: Estimated income and expenditure 2003-04

	£000s	£000s
Income		
Licence fees applied from previous years' underspends	1,037	
Licence fees recovered	12,600	
Other income	164	
Total income		13,801
Expenditure		
Permanent staff	8,336	
Agency and secondees	200	
Personnel overheads	767	
Consultancy projects	1,160	
Accommodation	1,519	
Non-cash costs (eg depreciation)	456	
Other	1,363	
Total expenditure		13,801

We will carry forward an estimated £1.3 million of the previous years' licence fees to offset against future fees charged to the companies.

Table 4: Administration costs – by activity group

	2002-03 outturn	2003-04 estimated outturn
	£000s	£000s
Regulatory action	6,417	7,901
External relations and legal services	1,138	1,084
Finance, human resources, office services and operations	1,353	1,537
Direct costs of WaterVoice and consumer representation	2,376	2,611
IT services and information management	541	668
Total	11,825	13,801

Resource accounts

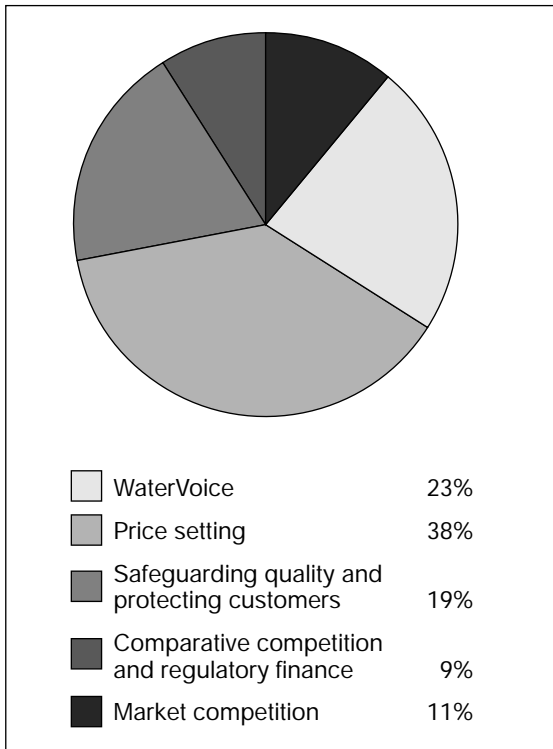
We published our resource accounts for 2002-03 in October 2003 (HC1120). The accounts received an unqualified audit certificate from the Comptroller and Auditor General. We plan to publish the accounts for 2003-04 by October 2004. The resource accounts are prepared in accordance with the Government Resources and Accounts Act 2000 and directions issued by HM Treasury. We are

working with our external auditors, NAO, to achieve a faster close and audit of our accounts.

Resource allocation

Our expenditure is apportioned to the outputs planned in our annual forward programme. During the year, we reallocated finance to unplanned work including Competition Act cases and

Figure 5: Resource allocation



interim determinations. A summary of resource allocation against our main outputs is shown in Figure 5.

Audit

Our financial and risk management systems and reports are scrutinised by the Audit Committee. Members of the committee are John Baker (Chairman and non-executive advisory director, NEAD), and Roger Munson (NEAD). NAO, Internal

Audit (KPMG), the Director General and senior finance staff attend the committee. The Audit Committee met three times during the year.

Publishing forward work programmes

We published our draft forward programme on 31 October 2003 and final programme on 31 March 2004. The consultation exercise included a workshop in November 2003 at the NEC in Birmingham. We made changes to the draft as we received more detailed information about the Water Act, Water Framework Directive and Enterprise Act 2002. There were also policy and timetable changes.

Risk management and RIAs

We contributed to the Government-wide developments of risk management, and have further developed our own procedures to strengthen internal control processes. Regulatory impact assessments (RIAs) are policy tools to assess the impact in terms of costs, benefits and risks of any proposed regulatory actions affecting our stakeholders. During the year we applied RIAs to the new regulations arising from the Water Act 2003.

Table 5: Consultancy and professional services expenditure summary 2003-04 (company contracts costing more than £50,000, excluding VAT)

Project	Supplier
The cost base	Babtie Engineering
Review of water company capital maintenance submissions	Mott MacDonald
Scope for future efficiency studies	London Economics
Price review customer research	MVA Ltd
Cost of capital	Europe Economics
Company tax projections	Deloitte & Touche
Aquarius 3 audit	Robson Rhodes
Corporate finance	Deloitte & Touche

Appendices



Appendix 1 – Ofwat’s milestones 2003-04

This table sets out our progress against the key milestones detailed in our forward programme. Generally we achieved our milestones when we said that we would.

Price setting	Date achieved
Release update of financial model (Aquarius 3)	May 2003
Issue draft business plan information capture system	May 2003
Publish initial feedback on cost base submissions	May 2003
Publish updated guidance on the interim determinations process	May 2003
Companies submit June returns 2002-03	June 2003
Companies submit draft business plans	August 2003
Companies publish summaries of draft business plans	September 2003
Publish document that identifies issues emerging from draft business plans	October 2003
Publish results of independent external review of reporters’ work on companies’ business plans	January 2004 ¹
Provide feedback to companies and their reporters on draft business plan submissions	October to December 2003
Respond to requests for interim determinations and issue counter notices where necessary	September to October 2003
Provide companies with details of 2005-06 capital investment programme	December 2003
Publish results of joint customer research	December 2003
Ministers provide final guidance on the required quality programme	March 2004
Safeguarding customers	
Publish ‘Tariff structure and charges’	May 2003
Hold complaints workshops	May 2003 and October 2003
Publish ‘Financial performance and expenditure of the water companies in England and Wales’	August 2003

¹ Originally due to be completed by December 2003. We changed the process and decided to issue a preliminary report, which we did in October 2003, followed by the final report in early January 2004.

Consultation on measured/unmeasured household differential	August 2003
Publish 'Levels of service for the water industry in England and Wales'	September 2003
Publish companies' leakage performance	July 2003
Publish the June return 2003	October 2003
Publish 'Security of supply, leakage and the efficient use of water'	October 2003
Report progress on Thames' security of supply in 'Security of supply, leakage and the efficient use of water'	October 2003
Approve companies' draft charges schemes	February 2004
Publish the results of the Water Resale Order review	March 2004

Comparative competition and companies' finance

Consult on proposed modifications to licence Condition B	February 2004 ²
Publish international comparison report	March 2004 ³
Publish 'Water and sewerage service unit costs and relative efficiency'	January 2004 ⁴
Hold reporters and auditors joint workshop	December 2003
Publish results of assessment of reporters' performance on June returns	December 2003
Publish updated regulatory capital values (RCVs) for 2000-05	March 2004
Hold City briefings	Ongoing
Respond to financial restructuring proposals	As required
Respond to merger proposals	As required

Competition

Second report on Competition Act 1998 casework	April 2003
Consult on the possible industry working groups to help prepare for the implementation of the Water Bill proposals on competition	December 2003 ⁵
Respond to Competition Act 1998 queries	As required
Respond to applications for inset appointments within stated timescales	As required

Proposed legislation

Publish the code of practice on discharge of functions	September 2003
Develop new procedures to implement powers conferred by Enterprise Act 2002	To be developed in 2004

Resources and accountability

Publish our Annual Report	May 2003
Publish our annual accounts	October 2003

2 Originally due to be completed by April 2003. The consultation for these licence modifications was combined with other modifications in respect of the price review. Publication was held back until the substantial effect determinations for Northumbrian Water and Bournemouth & West Hampshire Water were complete in February 2004.

3 Originally due to be completed by October 2003. The work was delayed due to staff changes.

4 Originally due to be completed by December 2003. The slight delay was due to additional validation of data submitted for the econometric modelling and the cost base.

5 Originally due to issue a consultation by September 2003. However, as we were unable to issue any publications until the Water Act 2003 had received Royal Assent, we issued an Information Bulletin in December 2003 and held an industry workshop in January 2004, after Royal Assent.

Appendix 2 – WaterVoice committees

WaterVoice Central

For customers of Severn Trent Water and South Staffordshire Water

First Floor, Chanelle House,
86 New Street, Birmingham B2 4BA

Tel: 0121 644 5252

Fax: 0121 644 5256

Lo-call: 0845 702 3953

e-mail: central@watervoice.org.uk

WaterVoice Eastern

For customers of Anglian Water, Cambridge Water, Essex & Suffolk Water, and Tendring Hundred Water

Ground Floor, Carlyle House, Carlyle Road,
Cambridge CB4 3DN

Tel: 01223 323889

Fax: 01223 323930

Lo-call: 0845 795 9369

e-mail: eastern@watervoice.org.uk

WaterVoice Northumbria

For customers of Northumbrian Water and Hartlepool Water

Eighth Floor, Northgate House,
St Augustine's Way, Darlington DL1 1XA

Tel: 01325 464222

Fax: 01325 369269

Lo-call: 0845 708 9367

e-mail: northumbria@watervoice.org.uk

WaterVoice North West

For customers of United Utilities Water

Suite 902, Ninth Floor, Bridgewater House,
Whitworth Street, Manchester M1 6LT

Tel: 0161 236 6112

Fax: 0161 228 6117

Lo-call: 0845 705 6316

e-mail: northwest@watervoice.org.uk

WaterVoice South West

For customers of South West Water

First Floor, Broadwalk House, Southernhay
West, Exeter EX1 1TS

Tel: 01392 428028

Fax: 01392 428010

Lo-call: 0845 795 9059

e-mail: southwest@watervoice.org.uk

WaterVoice Southern

For customers of Southern Water, Folkestone & Dover Water, Mid Kent Water, Portsmouth Water and South East Water

Fourth Floor (South), High Holborn House,
52/54 High Holborn, London WC1V 6RL

Tel: 020 7831 4790

Fax: 020 7831 7253

Lo-call: 0845 758 1658

e-mail: southern@watervoice.org.uk

WaterVoice Thames

For customers of Thames Water, Three Valleys Water, and Sutton & East Surrey Water

Fourth Floor (South), High Holborn House,
52/54 High Holborn, London WC1V 6RL

Tel: 020 7831 4790

Fax: 020 7831 4850

Lo-call: 0845 758 1658

e-mail: thames@watervoice.org.uk

WaterVoice Wales (DyfrLais Cymru)

For customers of Dŵr Cymru Welsh Water and Dee Valley Water

Room 140, Caradog House,
1-6 St Andrews Place, Cardiff CF10 3BE

Tel: 029 2023 9852

Fax: 029 2023 9847

Lo-call: 0845 707 8267

e-mail: wales@watervoice.org.uk

WaterVoice Wessex

For customers of Wessex Water, Bournemouth & West Hampshire Water, Bristol Water, Cholderton & District Water

2 The Hide Market, West Street,
St Phillips, Bristol BS2 0BH

Tel: 0117 955 7001

Fax: 0117 955 7037

Lo-call: 0845 707 8268

e-mail: wessex@watervoice.org.uk

WaterVoice Yorkshire

For customers of Yorkshire Water

Eighth Floor, Northgate House,
St Augustine's Way, Darlington DL1 1XA

Tel: 01325 469777

Fax: 01325 369269

Lo-call: 0845 708 9368

e-mail: yorkshire@watervoice.org.uk

Appendix 3 – Independent reporters and auditors

Water and sewerage companies	Auditors	Reporters
Anglian Water Services Ltd	PricewaterhouseCoopers	WS Atkins
Dŵr Cymru Cyfyngedig	PricewaterhouseCoopers	Halcrow Management Sciences
Northumbrian Water Ltd	Ernst & Young	Black & Veatch
Severn Trent Water Ltd	PricewaterhouseCoopers	Halcrow Management Sciences
South West Water Ltd	PricewaterhouseCoopers	WS Atkins
Southern Water Services Ltd	PricewaterhouseCoopers	WS Atkins
Thames Water Utilities Ltd	PricewaterhouseCoopers	WS Atkins
United Utilities Water plc	Deloitte & Touche	Halcrow Management Sciences
Wessex Water Services Ltd	KPMG	Halcrow Management Sciences
Yorkshire Water Services Ltd	Ernst & Young	Strategic Management Consultants
Water only companies	Auditors	Reporters
Bournemouth & West Hampshire Water plc	PricewaterhouseCoopers	Halcrow Management Sciences
Bristol Water plc	PricewaterhouseCoopers	WS Atkins
Cambridge Water plc	Deloitte & Touche	Black & Veatch
Dee Valley Water plc	Saffrey Champness	MWH UK Ltd
Cholderton & District Water Company Ltd	B Johnson Esq	*
Folkestone & Dover Water Services Ltd	Ernst & Young	MWH UK Ltd
Mid Kent Water plc	Deloitte & Touche	Monson Engineering Ltd
Portsmouth Water plc	Grant Thornton	Kellogg, Brown & Root Ltd
South East Water plc	PricewaterhouseCoopers	Strategic Management Consultants
South Staffordshire Water plc	Deloitte & Touche	Black & Veatch
Sutton & East Surrey Water plc	KPMG	Kellogg, Brown & Root Ltd
Tendring Hundred Water Services Ltd	Ernst & Young	MWH UK Ltd
Three Valleys Water plc	Ernst & Young	WS Atkins

* Cholderton & District Water Company is an exceptionally small company and does not provide annual return information.

Appendix 4 – The water and sewerage companies

Anglian Water Services Ltd

Henderson House
Lancaster Way
Huntingdon
Cambridgeshire
PE29 6XQ

Telephone: 0800 145145
www.anglianwater.co.uk

Dŵr Cymru Cyfyngedig (Welsh Water)

Pentwyn Road
Nelson
Treharris
Mid Glamorgan
CF46 6LY

Telephone: 01443 452300
www.dwrcymru.co.uk

Northumbrian Water Ltd

Abbey Road
Pity Me
Durham
DH1 5FJ

Telephone: 0870 608 4820
www.nwl.co.uk

Severn Trent Water Ltd

2297 Coventry Road
Sheldon
Birmingham
B26 3PU

Telephone: 0121 722 4000
www.stwater.co.uk

Southern Water Services Ltd

Southern House
Yeoman Road
Worthing
Sussex
BN13 3NX

Telephone: 01903 264444
www.southernwater.co.uk

South West Water Ltd

Peninsula House
Rydon Lane
Exeter
EX2 7HR

Telephone: 01392 446688
www.southwestwater.co.uk

Thames Water Utilities Ltd

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Telephone: 0845 920 0888
www.thameswater.co.uk

United Utilities Water plc

Dawson House
Great Sankey
Warrington
WA5 3LW

Telephone: 01925 234000
www.unitedutilities.com

Wessex Water Services Ltd

Claverton Down Road
Claverton Down
Bath
BA2 7WW

Telephone: 01225 526000
www.wessexwater.co.uk

Yorkshire Water Services Ltd

Western House
Western Way
Halifax Road
Bradford
BD6 2LZ

Telephone: 01274 691111
www.yorkshirewater.com

Appendix 5 – The water only companies

Albion Water Ltd

71 Clarence Road
Teddington
Middlesex
TW11 0BN
Telephone: 0208 977 3055

Folkestone & Dover Water Services Ltd

Cherry Garden Lane
Folkestone
Kent CT19 4QB
Telephone: 01303 298800
www.fdws.co.uk

Tendring Hundred Water Services Ltd

Mill Hill
Manningtree
Essex CO11 2AZ
Telephone: 01206 399200
www.thws.co.uk

Bournemouth & West Hampshire Water plc

George Jessell House
Francis Avenue
Bournemouth BH11 8NB
Telephone: 01202 591111
www.bwhwater.co.uk

Mid Kent Water plc

High Street
Snodland
Kent ME6 5AH
Telephone: 0845 850 6060
www.midkentwater.co.uk

Three Valleys Water plc

PO Box 48
Bishop's Rise
Hatfield
Herts AL10 9HL
Telephone: 01707 268111
www.3valleys.co.uk

Bristol Water plc

PO Box 218
Bridgwater Road
Bristol BS99 7AU
Telephone: 0117 966 5881
www.bristolwater.co.uk

Portsmouth Water plc

PO Box 8
West Street
Havant
Hants PO9 1LG
Telephone: 02392 499 888
www.portsmouthwater.co.uk

Cambridge Water plc

41 Rustat Road
Cambridge CB1 3QS
Telephone: 01223 403000
www.cambridge-water.co.uk

South East Water plc

3 Church Road
Haywards Heath
West Sussex RH16 3NY
Telephone: 01444 448200
www.southeastwater.co.uk

Cholderton & District Water Company Ltd

Estate Office
Cholderton
Salisbury
Wiltshire SP4 0DR
Telephone: 01980 629203

South Staffordshire Water plc

Green Lane
Walsall
West Midlands WS2 7PD
Telephone: 01922 638282
www.south-staffs-water.co.uk

Dee Valley Water plc

Packsaddle
Wrexham Road
Rhostyllen
Wrexham
North Wales LL14 4EH
Telephone: 01978 846946
www.deevalleygroup.com

Sutton & East Surrey Water plc

London Road
Redhill
Surrey RH1 1LJ
Telephone: 01737 772000
www.waterplc.com

Appendix 6 – Ofwat administrative costs

	£000s					
	2000-01 Outturn	2001-02 Outturn	2002-03 Outturn	2003-04 Estimated outturn	2004-05 Plans	2005-06 Plans
Gross administrative costs:						
Staff	5,897	6,407	7,312	8,536	9,307	-
Other	5,021	4,425	4,513	5,265	5,094	-
Total gross administration costs	10,918	10,832	11,825	13,801	14,401	-
Related administrative receipts from licence fees and other minor receipts	(11,554)	(11,563)	(11,825)	(13,801)	(14,401)	-
Total net administration costs	(636)	(731)	-	-	-	-
Departmental expenditure limit (DEL)	(636)	(731)	-	-	-	-

NOTES:

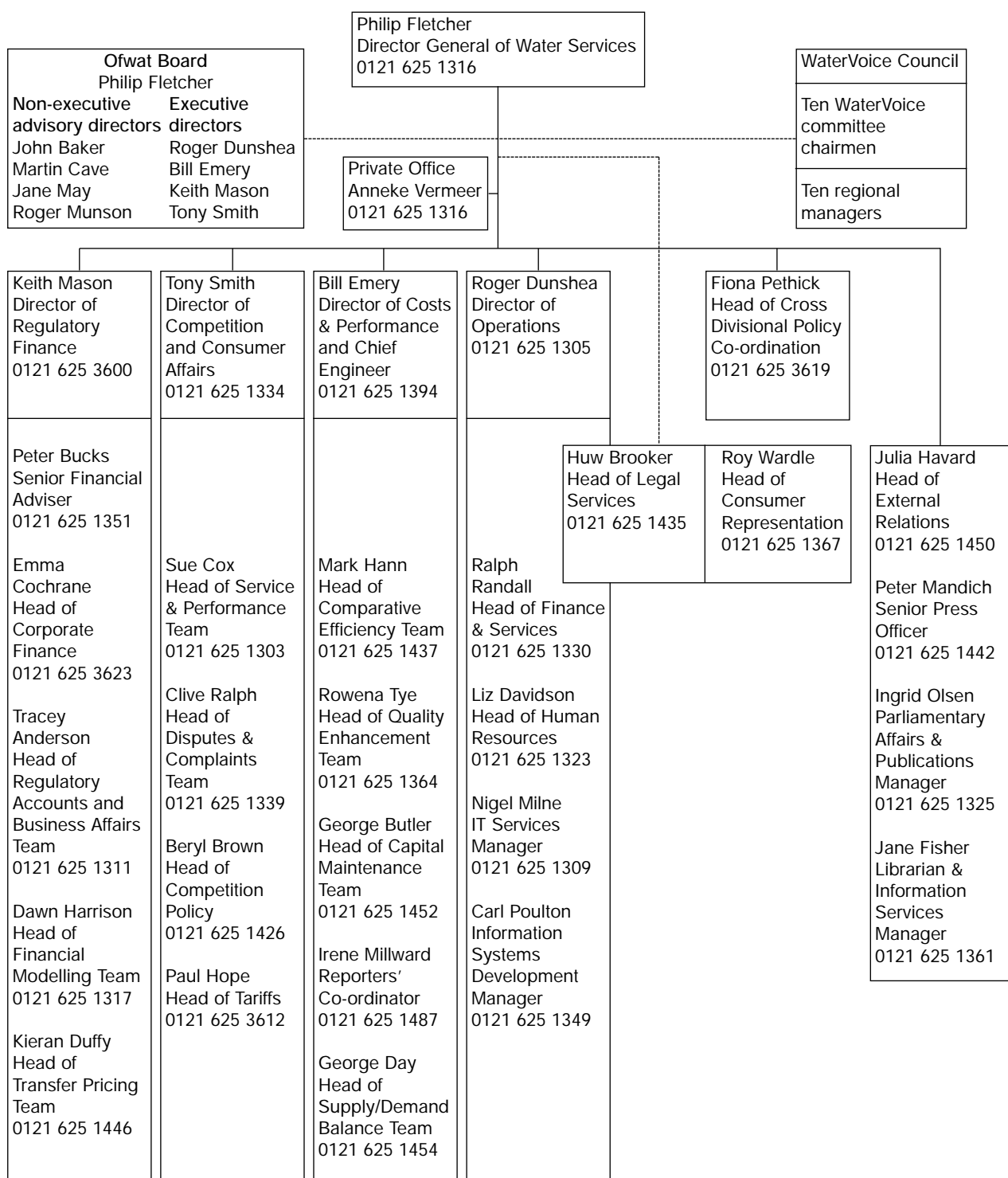
1) This table is included as a requirement stipulated by HM Treasury. Outturn figures are taken from our published Resource Accounts. We operate on the basis that licence fees recovered from the industry should cover our costs. Surpluses of income stated in 'Total net administration costs' refer to the income generated from our publications and monies recovered on behalf of the Competition Commission.

2) 2003-04 gross administration costs are based on estimated outturn and are subject to review by audit.

Appendix 7 – Ofwat staff numbers

	1996-97 Actual	1997-98 Actual	1998-99 Actual	1999-00 Actual	2000-01 Actual	2001-02 Actual	2002-03 Actual	2003-04 Actual	2004-05 Plans
Civil Service full-time equivalents	183	175	176	195	202	210	231.5	243	245
Overtime	1	1	1	1	1	1	0	1	1
Casuals	4	5	7	15	6	7	1.5	7	4
Total	188	181	184	211	209	218	233	251	250

Appendix 8 – Ofwat structure



Email: firstname.lastname@ofwat.gsi.gov.uk

Ofwat's senior management team and non-executive advisory directors*



Back row (from left):

Keith Mason (Director of Regulatory Finance), Huw Brooker (Head of Legal Services), Roger Dunshea (Director of Operations), Roy Wardle (Head of Consumer Representation), Bill Emery (Director of Costs & Performance and Chief Engineer), Julia Havard (Head of External Relations)

Front row (from left):

Roger Munson (non-executive advisory director), Philip Fletcher (Director General of Water Services), Martin Cave (non-executive advisory director), John Baker (non-executive advisory director)

* *Jane May (non-executive advisory director) and Tony Smith (Director of Competition and Consumer Affairs) were unable to be present when this photograph was taken.*

How to contact us:

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