**Water UK 9th Annual City Conference**
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Those of you who have been to City Conferences before may, like me, be thinking that we've seen the industry through a lot of ups and downs.

This is our ninth conference, but self-evidently none of the previous ones has been held in a global economic crisis like the present. Something new seems to happen everyday to undermine confidence. We think we know what's happening and where things are going. But it's becoming clear that we can't take anything for granted.

The past is always an uncertain guide to the future. But this is still the basic dilemma. Do we trust to what we know? Or tear up the map and set out in a different direction?

The 2009 outlook is problematic to say the least: PR09 approaching its critical points. An election clearly visible on the horizon. A global credit freeze. And a recession including deflation that's putting heavy pressure on companies that have to fund essential investment.

All this means the business and financial world turned upside down. Hard-pressed customers. Nervous investors.

However you look at it, coping successfully is going to need some fresh thinking by the industry and regulators – the industry has done a lot of fresh thinking. And we are going to have to make hard choices. This is true even if you agree with me that one way out of business problems is always getting the basics right.

What do I mean by the basics? Here are five which I think are relevant to the industry, regulators, government and stakeholders.

> Focus on the two groups who matter most – customers and investors – and recognising that their interests are inextricably linked.
> Build on success

> Ensure long-term certainty for investment in the two things that matter most – quality and resilience
> Accept that we are a diverse industry
> Encourage innovation where customers will benefit.

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I want to say something about each of these, because they can help the industry add up to a way out of recession into a sustainable future based on the confidence of customers and investors.

But first, to shed light on this happy prospect, let's look at the opposite – the unsustainable way forward. What are the musts-to-avoid in working through and beyond this year from hell?

**First, over-reacting or under-reacting.** Doing nothing, showing no understanding, looks a certain recipe for lower confidence. But then over-reacting could be worse.

Over-reacting could mean a lurch towards short-term thinking on the grounds that people have stopped caring about the longer-term. This would be a betrayal of customers, who always tell us that what they want is quality and reliability. Well, these things can only be achieved through long-term investment – short-termism won't do it.

Over-reacting could also mean going back to the bad old days when the industry was starved of investment for asset maintenance and replacement. Absolutely no one is in favour of taking a holiday from planning for resilience. Let's not go there by default because times are hard.

**My second must-to-avoid is the 'one-size-fits-all' solution.** Everyone is tempted by this. It's a particular risk when the mantra of the times could easily be: "whatever you do, do something".

One-size-fits-all could lead to customers being treated like numbers. It could mean regulators imposing simplistic rules – rules that ignore the diversity of companies that defines our industry and plays a big part in its success. Or it could lead to ministers changing guidance in the face of protests about affordability. None of this would be wise. None of it would contribute to a sustainable future.

**And then there’s a third must-to-avoid – losing sight of the real purpose of regulation.**

Everyone knows that good regulation is all about those five adjectives: transparent, consistent, proportionate, targeted and accountable. This is another way of saying that regulation must always be a means to an end, never an end in itself. The end is to ensure that customers get the right service, at the right price, through the right mix of incentives.

Now the pressure is on, government and regulators might be tempted to forget this. For example, by taking an aggressive attitude to company price proposals. Or emphasising sticks more than carrots. Or putting a disproportionate effort into freeing up markets, when many people are asking if freer markets are always better – and when many people think there is still room to improve the current system.

And whilst I'm on about must-avoids, how about the behaviour of the banks? Companies have spent years painstakingly building excellent working relationships with the banks. Right now, what we don't need is banks holding back on that relationship. What we do need is banks willing to lend to this sector. So, I'm telling banks - if you want a long-term successful working relationship with this sector, make sure that you deliver.

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But that’s enough negatives. Let’s get on to the front foot and look at the priorities that made us successful in the past and are still fit for purpose.

Of course everything has changed. So maybe it’s not so much a case of going back to basics as refreshing the parts of the engine that can carry us out of the downturn in shape to support a reviving economy. We know they work, but perhaps they’ve become less salient in the boom years – and now we’re in recession they run the risk of being overtaken

**The first is to focus on the two groups who matter most – customers and investors – and recognise that their interests are inextricably linked.**

The connecting factor between customer and investors is that both want the same thing – long-term certainty. Customers want the tap to run, and the loo to flush, on every occasion, forever and ever, amen – no bother, no fuss, with minimum effort on their part. To get this they're willing to pay a fair price – and they accept that it has to cover investment to make up for the neglect of past generations.

Investors recognise and respond to this demand – and to the industry's commitment to meeting it.

The financial crash has meant the idea of utilities keeping strange company recently. We've heard how banks should be run more like utilities and less like casinos. Long-term security, in every sense of the word, is at the heart of a well-run utility business. It's the duty of all of us to strengthen the promise these businesses make to the community – especially in such anxious times.

Let's look at how the industry manages relations with the two groups.

**Customers first.**

All successful companies make customers' wishes and needs the number one priority. Successful water companies are no exception – and this is true even though they have a lot of other obligations which customers pay for, often without knowing.

For PR09 it's no exaggeration to say we've carried out the biggest-ever consultation with customers. There has been willingness-to-pay research, deliberative qualitative research, and national quantitative research. At each stage stakeholders, including the Consumer Council for Water, have been involved. The companies are using this research in their Final Business Plans, along with data on other requirements including social and environmental needs.

There are several important messages. One is that customers are broadly satisfied with their water and sewerage service. The most recent work was carried out last autumn with the financial crisis head-lining every news bulletin. But levels of satisfaction were in the middle eighty per cents in every company area. Another is that the basics are non-negotiable. Time after time, customers show they're willing to pay for maintenance and renewal, to secure current standards, and for necessary improvements.

It's also true that a substantial minority already feel that bills are too high and won't be happy with any price rises.

How should we respond?  The answer isn't rocket science.

> Prioritise essential investment – which has been made much more difficult in the deflationary environment
> Do what is necessary for vulnerable and low income people
> And – don't play games with customers' patience or investors' confidence – this mother of all recessions is no time for 'nice-to-haves', or innovations where the costs are certain but the benefits unknown.

**Now investors.**

The confidence of investors has never been more important. By next year capex since 1990 will be over £80billion. The companies' draft business plans contain major new capex proposals up to 2015 – there is no prospect of this need falling off in the medium term. This puts the spotlight on the relationship with investors – and particularly avoiding regulatory and political risk.

We will be hearing later from NERA, on setting a cost of capital in the current climate, and Indepen, on the latest Water UK Investor Survey, so I won't go into detail now. All I will say is that the events of the past year have, not surprisingly, made investors cautious and sensitive to events. In the uncertainty about the economy and markets, the need for expert advice has never been greater.

Now, my….

**Second basic for the future – build on success.**

Those of us in the water industry perhaps see the last few years as a roller coaster. But I suspect it seemed less up-and-down from the outside. We've been able to go on raising standards and delivering steady returns to investors for a long time.

It's true that bills have risen, but it's worth remembering that the difference in real terms between the average customer in 1999 and 2009 is £17. I won't go through all the achievements but: leakage is down 35%; sewer flooding cut by three-quarters; rivers and bathing waters transformed; a £100 efficiency saving on the average bill. Also in recent years, we've upped our game on infrastructure renewal.

The main thing is we've proved we can deliver. But the question is: what happens now and in the next few years as the world struggles painfully out of the hole it's in? Will we batten down the hatches on cost grounds? Will we put off work we know needs doing? There is really only one sustainable answer. We must hold to the things that matter and continue to invest and build where we know we can succeed.

The need is undeniable. The current rate of renewal and repair of assets is better than it was, but still too low given people's expectations.

Also, we're about to get the starkest warning yet from UKCIP of how climate change could disrupt our way of life. The floods of 2007 and droughts of 2005 and 2006 are there to remind us how we feel when nature asserts itself (with human help or not).

So here is my…..

**Third basic proposition for us in the recession – we have to ensure long-term certainty for planning safety and resilience.**

The industry invests to maintain and improve customer service, the quality of water, and the environment. The level of investment is significant in economic terms. Taking the sector and its contractors together we employ up to 100,000 people at any one time.

Government guidance must be crystal clear on the value of the industry in the current situation. We may be small in the big picture of value-added, but not in strategic terms – and if anything the downturn highlights the difference.

Look at what needs doing. Water infrastructure must be made resilient in the face of climate change, population and housing growth, water scarcity, and the reliability of very old networks. We have to maintain and replace mains, sewers, treatment works, pumping stations and reservoirs – but also the newer technologies of a modern service – monitoring, scientific and communication hardware and software.

This is investment for the medium and long-term. It’s done with maximum attention to cost-effectiveness and long-term performance. Its national value shouldn’t be in doubt.

But we need regulators and government to recognise and act on this. They must reassure companies and investors that the ship won’t be blown off course by the financial storm. Recessions have a habit of emphasising regional differences. This may happen with the water industry. Companies are different – by nature, climate, heritage and population, in different parts of the country.

So this is my….

**Fourth basic action point – treat diversity as a strength, not a nuisance.**

I appreciate that this is easier said than done. The default position on big issues in this country tends to be central, rather than regional or local. But if we want to get it right, this has to be resisted. I raised this a moment ago when I talked about one-size-fits-all regulation.

Each company has to plan for different customer priorities and different investment obligations but also individual circumstances covering geography, hydrology, climate, population, local economy, and the condition of its inherited assets. They have a lot in common, of course, but it’s counter-productive to pretend they’re all the same. One-size-fits-all makes for tidy public administration and consistent regulation, but we should know it can also lead to poor outcomes.

An example of this is the vexed question of target-setting. Targets are obviously important in the regulated and public sectors. But they can produce perverse outcomes. This has been recognized in many sectors, but we’re still adding targets – most recently to measure companies’ water efficiency work. One-size-fits-all said “all must have targets”, when it was obvious that companies were in totally different positions and some had even met the target before it came into effect!

The problem is the potential for wasted effort and wasted resources. We can’t afford this at any time, but we particularly can’t afford it now.

On the upside, the opportunity in diversity is to play to strengths – for example in encouraging catchment-based solutions to water quality. Different needs often drive change and this brings me to…..

**My last action point: promote innovation – where it benefits customers.**

You may ask how innovation fits with back to basics. But the use of catchment solutions I mentioned is an example – because customers benefit. Ofwat has helped by recognising that if companies can work with farmers and others to stop pollution at source, we can meet water quality standards at lower cost and cut carbon emissions.

We can also innovate to save money and carbon in other ways. But the support of regulators – all regulators, is essential. One way is to replace wastewater discharge consents based on absolute standards with variable consents. This would give companies flexibility to meet their obligations by working with the water environment rather than wasting resources in processes that are actually unnecessary. The result would be genuine financial and environmental benefits.

Another example is to focus directly on carbon reduction. The industry has a strong record for change and innovation here, and it's excellent to see this being publicly recognised by the Carbon Trust among others.

To conclude….

Things are difficult now. If deflation gets worse (which seems a real possibility) they could become more difficult still. This week's news from the rail sector shows the potential damage to industry, customers, and investors – and to the prospects for a rapid recovery.

I've proposed a back to basics strategy which I hope everyone will support. It can take us out of the downturn in good shape to support a reviving economy and give our sector the sustainable future it wants and the country needs.

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