

Water Price Review

Briefing ahead of draft business plans submission by 11 August

By 11 August water companies in England and Wales must send to Ofwat Draft Business Plans (DBPs) containing their proposals for prices and investment for 2010-2015. This is the opening move in the process known as Price Review 2009 (PR09) of determining water and sewerage bills for the five-year period.

At the same time the companies will publish summaries of their plans giving customers information about bills and the service they can expect.

This briefing covers: what to expect in Draft Business Plans; why they matter; the background and next steps in the PR09 process.

Price Review Outline Timetable

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| 11 August 2008 | Companies submit and publish Draft Business Plans |
| December 2008 | National customer research survey findings on DBPs |
| April 2009 | Companies submit and publish Final Business Plans |
| July 2009 | Ofwat publishes Draft (Price) Determinations for consultation |
| November 2009 | Ofwat publishes Final (Price) Determinations |
| April 2010 | New water and sewerage prices take effect |

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Latest news and background information on PR09:
<http://www.water.org.uk/home/policy/pricereview>

www.water.org.uk

1 What to expect in Draft Business Plans

The main thing to expect is that company plans will be different from each other because of differences in the populations they serve; the pipes and assets they own; and the climate, environment and geography they must manage.

But all DBPs will cover the services and service levels the companies will provide; details of how much this will cost in operating and capital terms; the impact on prices and customer bills.

Water bills – up or down?

A vital question for everyone in the current testing economic situation is whether water bills are likely to go up or down. Many factors must be taken into account to make this assessment – some causing upward pressure on bills, some having the opposite effect.

Upward pressure on bills is coming from higher operating costs – most obviously soaring energy prices (some companies are reporting increases of 150% in the past 2 years); and the need for capital investment, to maintain or replace old pipes or systems or treatment works; or improve drinking water, the environment, security of supply and the resilience of assets.

Downward pressure on bills will come from expectations of future efficiency savings and potentially from lower assumptions about the cost of finance for investment. But companies will need to assess how much scope there is for improving efficiency; and the impact of the credit crunch could affect their ability to raise finance.

The net effect of these pressures will be different in different company areas, but the costs of energy, maintaining assets and improving resilience, and efforts to keep the impact on bills as low as possible, will be common to all.

Hard-pressed households

When producing their plans, companies have been acutely aware of the pressures on consumer and household budgets from many different directions. They have taken account of the affordability of water bills in the price limits they are seeking and in proposing specific measures to help customers on low incomes.

However it is unrealistic to expect that there will be no need for bill increases. Water companies are obliged by government to meet standards – notably for drinking water and environmental quality – that can only be achieved through real increases in expenditure. Efficient financing means that the additional costs can be shared with future customers, but it is unavoidable that many present customers will be faced with higher bills.

Water UK is not alone in believing that people on low incomes, who are genuinely finding it hard to pay their water bill, should receive more support from the public purse than is currently available.

Investment

Over the last two decades, average water prices in England and Wales have risen by 42% in real terms. The main reason for this increase has been continued high capital investment – around £72 billion at 2006 prices. Without this large capital charge prices would have fallen because of efficiency gains made by the companies.

Investment will continue to be important in the period to 2015 and beyond. In some areas environmental improvements required by government will be a priority. In others the focus will be on ensuring that we have enough water to meet demand.

Everywhere, investment in capital maintenance – replacing or repairing assets to ‘lock in’ improvements – will become more important as past investment has increased the stock of assets. Improving resilience will also be essential – to ensure that services are robust against extremes of weather such as droughts and floods.

Climate change

Climate change will be seen to influence company plans in two ways.

- 1) Companies will be seeking to reduce emissions by becoming more energy efficient, using low carbon solutions and increasing the renewable energy they generate.
- 2) They will be assessing how to adapt to inevitable changes and increased uncertainty in weather patterns in the decades ahead.

Sustainability

Finding sustainable solutions to problems is a developing theme in companies’ plans; for example, working with other sectors, such as farmers or highway authorities, to stop run-off from fields and roads polluting rivers and streams, rather than using traditional, costly, and carbon-intensive ‘end-of-pipe’ treatment.

However it is also true that the understandable demands regulators and government make on companies to deliver reliable results can be a barrier to this kind of innovative development.

Customer views

Each company has carried out research among its customers and used the findings to shape its Draft Business Plan. All Plans are to be published on company websites for everyone to read and customers can also obtain copies direct from their company. Comments from individuals or organisations will always be welcome.

In September and October this year the Plans will be ‘tested’ in a national customer research survey. The project will be overseen by a management team drawn from government, regulators, and the water industry. The results will be published in December, in time to influence Final Business Plans to be published in April 2009.

2 Why the Price Review matters

PR09 affects everyone

The 2009 price review will affect everyone in England and Wales. In the short term, as consumers and bill payers, we all want an essential service that is efficient, affordable and good value for money.

In the long term, it is in all of our interests that water and sewerage services are sustainable. This means there must be sufficient investment to maintain the high standards we have now; to improve them where this is good value for money; and to ensure that these services are resilient to extreme events such as droughts and floods.

PR09 and the economy

Reliable, high quality and value-for-money water services are obviously crucial for successful businesses and the economy as well as households. Water is a core input for many industries and used by almost all businesses in some way. So providing the right water service at the right price and time really does matter for productivity and competitiveness.

PR09 and the environment

Water companies arguably have a deeper relationship with the natural environment than any other sector. Their raw material depends on it. They take water from the environment to supply many of society’s needs – and return it to the environment when society has finished with it. They are essentially environmental businesses and accept a large share of responsibility for managing society’s environmental impact.

Over the last two decades, they have made major environmental gains – although at the cost of higher carbon emissions and higher bills. The outcome of PR09 will be important in maintaining these gains and making further improvements where there are demonstrable benefits. Among the aims will be a substantial contribution to the government’s targets for reducing greenhouse gas emissions.

3 Background and next steps

Only just beginning

PR09 started in earnest in 2007, with Ofwat consulting on a policy framework for PR09, and the companies publishing Strategic Direction Statements (SDSs) covering the period 2010 to 2035. With their DBPs the companies will be turning these strategic visions into firm plans for the first 5-year block.

But the PR09 process is only just beginning. After receiving feedback on the DBPs the companies will submit and publish Final Business Plans (FBPs) in April 2009. Ofwat will consider the FBPs, set Draft Determinations of price limits in July 2009 and Final Determinations in November 2009.

Strategic Direction Statements – new for PR09

SDSs were not prepared at previous price reviews. They were designed to encourage sustainable planning and outcomes over a longer period than the 5-year price review cycle. This is vital, for many of the challenges facing the sector are long term ones, such as climate change, population growth, rising customer expectations, environmental constraints, and the need to maintain an affordable and resilient service that can sustain the financing of its large investment needs.

National guidance and legal requirements

In DBPs the companies aim to blend the interests of consumers, the environment, and investors. This is no easy task and they are given much guidance and advice from government, regulators, consumer and environmental interest groups. In addition they are of course obliged to follow continually developing water and environmental legislation.

The plans take account of Government strategy towards the water sector, as set out in ‘Future Water’¹ and the ‘Statement of Obligations’², which sets out the companies’ legal requirements for action on environment and drinking water quality standards. Companies have taken into account Ofwat’s approach and methodology to the review³, the Government’s guidance to Ofwat on social and environmental issues⁴, and the recommendations of the Pitt Review on Flooding⁵.

¹ <http://www.defra.gov.uk/environment/water/strategy/pdf/future-water.pdf>

² <http://www.defra.gov.uk/environment/water/industry/review/pdf/soo-0712-080702.pdf>

³ [http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/pap_pos_pr09method080327.pdf/\\$FILE/pap_pos_pr09method080327.pdf](http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/pap_pos_pr09method080327.pdf/$FILE/pap_pos_pr09method080327.pdf)

⁴ <http://www.defra.gov.uk/environment/water/industry/review/pdf/ofwat-socenv-guidance-0806.pdf>

⁵ <http://www.cabinetoffice.gov.uk/thepittreview.aspx>

Local diversity

Although companies have received national guidance, they have also carried out extensive customer research and stakeholder consultation to ensure that their DBPs reflect the wishes of their own customers. This means that the plans will have a strong local flavour, with different priorities in different regions. Companies, customers and stakeholders will be expecting that, in scrutinising these plans, Ofwat will take care to avoid a one-size-fits-all approach.

Final Business Plans

Companies submit Final Business Plans (FBPs) to Ofwat in April 2009. As well as incorporating feedback from stakeholders on DBPs, changes can be expected in FBPs because: not all statutory requirements are yet known; the findings of national customer research survey will become available; and some essential factors, such as the cost of capital and energy prices, remain uncertain due to volatility in the financial and energy markets.

Several of these factors may also change between FBPs in April 2009 and Ofwat's Draft and Final Determinations of prices in July and November 2009. And some potentially costly issues will still be unresolved by the end of 2009, not least requirements under the Water Framework Directive. If these lead to extra costs after the end of 2009, but before 2015, companies may apply for interim price determinations leading to revised price limits for the remainder of the period.

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