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ANNUAL REPORT

1989



THE 29 WATER COMPANIES (continued)

COMPANY NAME	PRINCIPAL OFFICE
<i>South Staffordshire Waterworks Company</i>	Green Lane Walsall West Midlands WS2 7PD
<i>Sunderland & South Shields Water Company</i>	29 John Street Sunderland SR1 1JT
<i>Sutton District Water plc</i>	59 Gander Green Lane Cheam Sutton Surrey SM1 2EW
<i>Tendring Hundred Waterworks Company</i>	Manningtree Essex CO11 2AZ
<i>West Hampshire Water Company</i>	Knapp Mill Mill Road Christchurch Dorset BH23 2LU
<i>West Kent Water Company</i>	PO Box 129 1 Church Road Haywards Heath Sussex RH16 3DX
<i>Wrexham & East Denbighshire Water Company</i>	21 Egerton Street Wrexham L11 1ND
<i>York Waterworks plc</i>	Lendal Tower York YO1 2DL

**REPORT
OF THE
DIRECTOR GENERAL
OF WATER SERVICES**

FOR THE PERIOD 1 AUGUST 1989 TO 31 MARCH 1990
TO THE SECRETARIES OF STATE FOR THE ENVIRONMENT
AND FOR WALES

*Presented to Parliament
in pursuance of section 35 of the Water Act 1989*

*Ordered by the House of Commons to be printed
19 June 1990*

COMPANY NAME	PRINCIPAL OFFICE
<i>Folkestone & District Water Company</i>	Cherry Garden Lane Folkestone Kent CT19 4QB
<i>Hartlepool Water Company</i>	3 Lancaster Road Hartlepool TS24 8LW
<i>Lee Valley Water Company</i>	PO Box 48 Bishops Rise Hatfield Hersts AL10 9HL
<i>Mid-Kent Water Company</i>	PO Box 45 High Street Snodland Kent ME6 5AH
<i>Mid-Southern Water Company</i>	Frimley Green Camberley Surrey GU16 6IIZ
<i>Mid-Sussex Water Company</i>	PO Box 129 1-3 Church Road Haywards Heath Sussex RH16 3DX
<i>Newcastle & Gateshead Water Company</i>	PO Box 10 Allendale Road Newcastle upon Tyne NE6 2SW
<i>North Surrey Water Company</i>	Millis House The Causeway Staines Middlesex TW18 3BX
<i>Portsmouth Water Company</i>	PO Box 8 West Street Havant Hants PO9 1LG
<i>Rickmansworth Water Company</i>	London Road Rickmansworth Herts WD3 1LB

THE 29 WATER COMPANIES

COMPANY NAME	PRINCIPAL OFFICE
<i>Bournemouth & District Water Company</i>	George Jessel House Francis Avenue Bournemouth BH11 8NB
<i>Bristol Waterworks Company</i>	PO Box 218 Bridgwater Road Bristol BS99 7AU
<i>Cambridge Water Company</i>	41 Rustat Road Cambridge CB1 3QS
<i>Chester Waterworks Company</i>	Aqua House 45 Boughton Chester CH3 5AU
<i>Cholderton & District Water Company</i>	Estate Office Cholderton Salisbury Wiltshire SP4 0DR
<i>Colne Valley Water Company</i>	Blackwell House Aldenham Road Watford Herts WD2 2FY
<i>East Anglian Water Company</i>	163 High Street Lowestoft Suffolk NR32 1HT
<i>Eastbourne Water Company</i>	14 Upperton Road Eastbourne East Sussex BN21 1EP
<i>East Surrey Water plc</i>	London Road Redhill RH1 1LJ
<i>East Worcestershire Waterworks Company</i>	46 New Road Bromsgrove Worcester B60 2JT
<i>Essex Water Company</i>	Hall Street Chelmsford Essex CM2 0HH

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*Report of the Director General
of Water Services to the
Secretaries of State for the
Environment and for Wales*



I am required by section 35 of the Water Act 1989 to make you an annual report to 31 December in each year on my activities during the year and the activities of the Monopolies and Mergers Commission in so far as they relate to references made by me.

This is my first report and covers the period from my appointment on 1 August 1989 up to the end of March 1990.

The first section concentrates on what I believe are the key issues. The succeeding sections provide reports on the major areas of work completed and underway in the rest of the office.

Ian Byatt

IAN BYATT
March 1990

Office of Water Services
Centre City Tower
7 Hill Street
Birmingham B5 4UA

A P P E N D I X D

**THE 10 WATER AND SEWERAGE
COMPANIES**

COMPANY NAME	PRINCIPAL OFFICE
<i>Anglian Water Services Ltd.</i>	Ambury Road Huntingdon PE18 6NZ
<i>Northumbrian Water Ltd.</i>	Northumbria House PO Box 4 Regent Centre Gosforth Newcastle upon Tyne NE3 3PX
<i>North West Water Ltd.</i>	Dawson House Gt. Sankey Warrington WA5 3LW
<i>Severn Trent Water Ltd.</i>	2297 Coventry Road Sheldon Birmingham B26 3PU
<i>Southern Water Services Ltd.</i>	Southern House Yeoman Road Worthing West Sussex BN13 3NX
<i>South West Water Services Ltd.</i>	Peninsula House Rydon Lane Exeter EX2 7HR
<i>Thames Water Utilities Ltd.</i>	14 Cavendish Place London W1M 8DJ
<i>Dwr Cymru Cyfyngedig</i>	Plas-y-Ffynnon Cambrian Way Brecon Powys LD3 7HP
<i>Wessex Water Services Ltd.</i>	Wessex House Passage Street Bristol Avon BS2 0JQ
<i>Yorkshire Water Services Ltd.</i>	West Riding House 67 Albion Street Leeds LS1 5AA

A P P E N D I X C

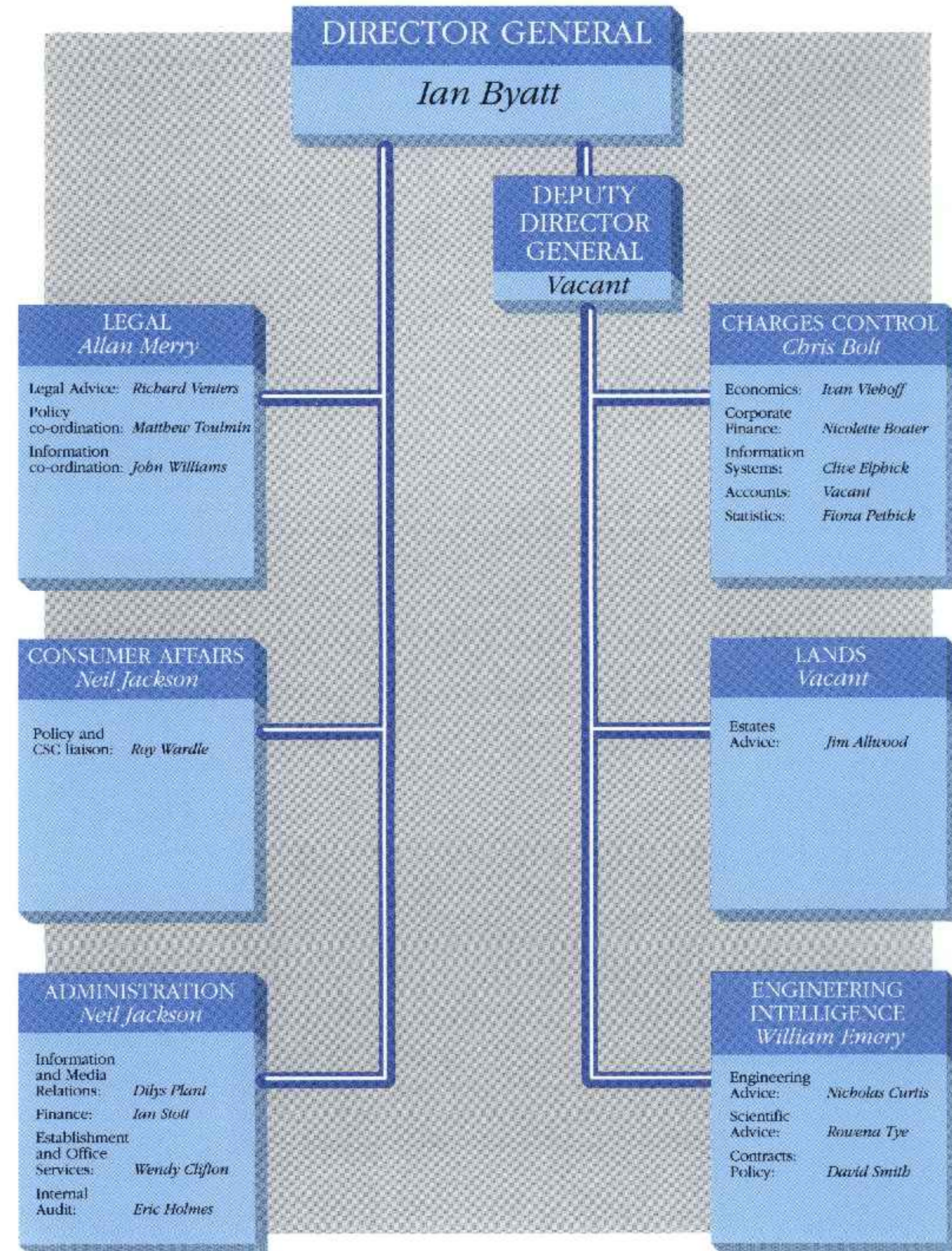
DEAR MANAGING DIRECTOR LETTERS

Distribution of the following letters is to the Managing Directors of all appointed companies except where the letters are of application only to either

- ◆ water and sewerage companies (suffix WS) or
- ◆ water only companies (suffix WO)

Number	Description	Dated
MD1	Disposal of Protected Land	29.09.89
MD2	Licence Condition G: Code of Practice for Customers	05.10.89
MD3	Mains Water Pressure	19.10.89
MD4	Financial Information	29.11.89
MD5	Requisition of Mains and Services: Approval of Interest Rate	11.09.89
MD6 (WO)	Effectiveness of Capital Investment	15.12.89
MD7 (WS)	Effectiveness of Capital Investment	15.12.89
MD8	Principal Statement for 1990/91 Charging year (MD/8a Letter: MD8h Notes)	19.12.89
MD9	Levels of Service	20.12.89
MD10	Condition F, Accounts: Appointment of Working Group	15.12.89
MD11	Code of Practice on Disconnection Code of Practice on Leakage	15.12.89 04.01.90
MD12	Working party on Accounting Issues	02.01.90
MD13	Principal Statement for 1990/91 Charging year (Additional to MD8)	22.12.89
MD14	Code of Practice for Customers	22.12.89
MD15	Regulatory Accounts for 1989/1989-90	04.01.90
MD16	Disposal of Protected Land	04.01.90
MD17	Allocation to Customer Service Committees	31.01.90
MD18 (WO)	Principal Statement: Auditor's Report	05.02.90
MD19	Standardisation of Financial Years	08.02.90
MD20	Reporting of Water Supply Disconnections	19.02.90
MD21	Infrastructure Charges	26.02.90
MD22	Interest rates for requisitions and infrastructure changes	27.02.90
MD23a (WS)	Levels of Service and Annexes 1+2 (Annex 1: 1990 Requirements; Annex 2: Targets 1990/91)	27.02.90
MD23b (WO)	Levels of Service + Annex 1 only	27.02.90
MD24	Regulatory Accounts: Current Cost Accounting Guidelines	08.03.90
MD25	Levels of Service	29.03.90
MD26	Monitoring of Capital Expenditure Levels of Service – annual report	11.04.90
MD27	Independent Certifiers	11.04.90
MD28	Infrastructure Charges	11.04.90
MD29	Charging Policy Consultation Document: Synopsis	10.05.90
MD30	Contact between the Director General and the appointed companies	14.05.90

Office of Water Services
ORGANISATION



DIRECTOR GENERAL'S STATEMENT

The Water Act 1989 set out a whole new regulatory regime for the water industry in England and Wales. It involves regulation on two fronts – one the quality of our drinking water and the water in our rivers, our estuaries and around our coasts, the other the economic regulation of prices and standards of service and new arrangements for the representation of customers.

Ian Byatt –
Director
General



The new
regulatory regime

1.1 CLARITY IN OBJECTIVES The new regime is much more clearly articulated than the one it replaced. In contrast with the past, the water industry will be regulated from outside and not by its own procedures.

1.2 HIGHER QUALITY WATER At the same time new quality targets have been set. The new drinking water regulations are very tough. Standards for environmental protection have been raised substantially and there is constant pressure for further improvement. Meeting these standards will involve substantial expenditure, especially capital expenditure, over many years.

1.3 MEDIUM TERM FRAMEWORK The new regime sets a medium term framework for the industry. This provides the opportunity for a structured approach to the improvements needed in drinking water and the disposal of sewage, the consequences for investment and the prices paid by customers. In setting the initial price limits (RPI + K) investment programmes, looking ten years or more ahead, were drawn up. Regulation should ensure that improvements in quality and increases in price continue to be examined jointly so that customers do not have unwelcome surprises when they receive their bills.

1.4 ENVIRONMENTAL AND ECONOMIC REGULATION This requires effective co-ordination between my office and those responsible for the regulation of the quality of water, principally the Department of the Environment and the National Rivers Authority. I meet regularly with the Secretary of State and his senior officials and with the Chairman, Chief Executive and senior management of the National Rivers Authority.



Ian Byatt with John Elfed Jones, Chairman of Dwr Cymru Cyfyngedig, on a visit to Court Farm Raw Water Reservoir, November 1989

1.5 PERIODIC REVIEWS The regime provides a strong framework of co-ordination through the arrangements for conducting periodic reviews, which must take place every ten years and may take place every five years. They will ensure that the achievement of environmental standards is closely linked to the planning of investment. This kind of review is

CSC ADDRESSES AT 31 MARCH 1990

Thames CSC
4th Floor
30-34 Albert Embankment
London SE1 7TL
Telephone 071 793 0115

RESPONSIBLE FOR CUSTOMERS OF
Thames Water Utilities Limited
Colne Valley Water Company
East Surrey Water plc
Lee Valley Water Company
Mid-Southern Water Company
North Surrey Water Company
Rickmansworth Water Company
Sutton District Water plc

Secretary: Clive Ralph

Wales CSC
1st Floor
Caradog House
St Andrews Place
Cardiff CF1 3BE
Telephone 0222 239852
Secretary: Clive Sterl

Dwr Cymru Cyfyngedig
Chester Waterworks Company
Wrexham & East Denbighshire Water Company

Wessex CSC
Unit 1
The Hide Market
West Street
Bristol BS2 0BII
Telephone 0272 557001
Secretary: Terry Emm

Wessex Water Services Limited
Bournemouth & District Water Company
Bristol Waterworks Company
West Hampshire Water Company
Cholderton & District Water Company

Yorkshire CSC
10th Floor
Dudley House
Upper Albion Street
Leeds LS2 8PN
Telephone 0532 340874
Secretary: Wendy Lockwood

Yorkshire Water Services Limited
York Waterworks plc

A P P E N D I X B

CSC ADDRESSES RESPONSIBLE FOR CUSTOMERS OF AT 31 MARCH 1990

Anglia CSC Anглиan Water Services Limited
Ground Floor Cambridge Water Company
Carlyle House East Anglian Water Company
Carlyle Road Essex Water Company
Cambridge CB4 3DU Tendring Hundred Waterworks Company
Telephone 0223 323889
Secretary: to be appointed

Northumbria CSC Northumbrian Water Limited
2nd Floor Newcastle & Gateshead Water Company
35 Nelson Street Sunderland & South Shields Water Company
Newcastle NE1 5AN Hartlepoons Water Company
Telephone 091 221 0646
Secretary: Deryck Hall

North West CSC North West Water Limited
1st Floor
Boulton House
17-21 Chorlton Street
Manchester M1 3HY
Telephone 061 236 6112
Secretary: Robert Norris

Severn Trent CSC Severn Trent Water Limited
13th Floor East Worcestershire Waterworks Company
Centre City Tower South Staffordshire Waterworks Company
7 Hill Street
Birmingham B5 4UA
Telephone 021 625 1351
Secretary: Will Dawson

Southern CSC Southern Water Services Limited
4th Floor Portsmouth Water Company
30-34 Albert Embankment Mid-Sussex Water Company
London SE1 7TL Eastbourne Water Company
Telephone 071 793 0115 West Kent Water Company
Mid-Kent Water Company
Folkestone & District Water Company
Secretary: Clive Ralph

South West CSC South West Water Services Limited
Unit 1
The Hide Market
West Street
Bristol BS2 0BH
Telephone 0272 557001
Secretary: Terry Emm

essential if sustainable environmental improvement is to take place at price levels which are acceptable to customers. Substantial adjustments to investment programmes between periodic reviews could not only upset consumers' expectations, they could also be disruptive. The industry and its suppliers will be stretched to achieve a very large investment programme. Some rearrangement of priorities within the medium term investment programme may be necessary, but imposing new objectives may simply crowd out the achievement of existing ones.

2.1 FIRST SIX MONTHS During this period I have been concerned to establish a new office, to meet the industry, to set up Customer Service Committees and to put in place arrangements for monitoring the performance of the companies.

2.2 THE OFFICE OFWAT started operations in Birmingham on 1 September 1989. We were the first complete government department to locate outside London and the South East. I have been very fortunate in being able to recruit excellent and enthusiastic staff with strong professional skills and good knowledge of the industry. I have established a Policy Board and Management Board to assist me in the running of the office. (Appendix A.) I am also very grateful for the help of two part time experts, Sir Trevor Hughes and David Walker, both of whom are members of my Policy Board and have given valuable help in this critical phase of our work.



Meeting of the OFWAT Policy Board

2.3 CONTACTS WITH THE INDUSTRY One of my first tasks as Director General was to visit all of the 39 regulated businesses. I met key people, listened to their concerns and priorities and explained my approach to the new regulatory regime. I want to have an open relationship with the industry so that the concerns and intentions of both sides are understood and reflected.

2.4 CUSTOMER SERVICE COMMITTEES Consumers need to have a greater say in the industry. I have set up ten Customer Service Committees (CSCs) to be the local champions of the consumer. I shall meet regularly with their chairmen. Together we shall constitute a national customer service committee.

2.5 CHAIRMEN OF CSCs I am delighted to have been able to appoint a strong team of chairmen, who bring much varied experience as well as their own personal skills to this work. I look forward to working with them - and with the members of their committees.

The work of the office

2.6 CODES OF PRACTICE Each company is required to prepare three Codes of Practice for domestic consumers – on leakages from metered premises, disconnections, and customer services – and to submit them to me for approval. I was disappointed by their general standards of accuracy, relevance and plain English. I have been helped in raising the standards by bodies such as the National Consumer Council and expect to approve all codes shortly. I shall then look to the Customer Service Committees to ensure not only that companies live up to their codes, but also that the codes themselves are steadily improved and higher standards of service offered to customers.

3.1 STYLE OF REGULATION The function of the regulator is to set a framework which safeguards the public interest and which provides incentives to efficient management. I shall regulate by reference to outputs – what the customer receives and what he or she pays for – rather than by inputs, because the industry should be allowed to allocate its resources in the most effective way. In order to involve customers, I shall aim to operate an open system. I shall stimulate debate and explain the reasons lying behind my decisions.

3.2 DEAR M.D. LETTERS My formal method of communication with the appointed companies is by 'Dear Managing Director' letters. I have issued 30 of these. They are listed in Appendix C, and are available for public inspection in the OFWAT library.

3.3. INFORMATION FLOWS AND USE OF CERTIFIERS To regulate the industry without interference in matters which are properly the concern of the management I need regular and reliable information flows from the companies. I propose to use the conditions in the licences to ensure that information is validated by independent professionals who have a duty of care to me.

3.4 CONSULTATION WITH COMPANIES I shall work with the industry in developing regulatory information. I have already set up a working group on accounting issues, which includes experts in the industry. The proposals for monitoring the output of the industry's capital expenditure programme, amounting to some £25 billion, have involved extensive consultation. I shall also consult companies when assembling information for efficiency studies. I intend to publish these studies.

3.5 MONITORING INVESTMENT Customers' bills must rise substantially to allow large investment programmes and increased operating expenditure to be financed. Customers have a right to know that these programmes are being carried out and are producing results.

3.6 PURPOSE OF INVESTMENT I do not propose to monitor investment project by project, but I shall need to know about changes which may be made in the plans which underlaid setting of the initial price limits. I need to know whether plans are slipping because of shortage of supplies or key personnel, whether operating cost solutions are being used in situations where capital projects had been originally proposed, whether priorities for meeting levels of service or achieving compliance with quality standards are being changed, or whether more innovative solutions to problems are being used.

3.7 OUTPUT FROM INVESTMENT The annual report from each company, which OFWAT will require each July, will also include output measures. These will relate to improvements in the quality of assets and in levels of service and to achievement of quality objectives for both drinking water and waste water. In drawing up quality measures I shall work closely with the quality regulators.

A P P E N D I X A

OFWAT POLICY BOARD

Mr Ian Byatt	<i>Chairman</i>
Mr Chris Bolt	<i>Head of Charges Control</i>
Dr Bill Emery	<i>Head of Engineering Intelligence</i>
Sir Trevor Hughes	<i>Consultant</i>
Dr Neil Jackson	<i>Head of Consumer Affairs</i>
Mr Allan Merry	<i>Head of Legal Division</i>
Mr David Walker	<i>Consultant</i>

Mr Matthew Toulmin	<i>Secretary</i>
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OFWAT MANAGEMENT BOARD

Mr Ian Byatt	<i>Chairman</i>
Mr Chris Bolt	<i>Head of Charges Control Division</i>
Dr Bill Emery	<i>Head of Engineering Intelligence</i>
Dr Neil Jackson	<i>Head of Consumer Affairs</i>
Mr Allan Merry	<i>Head of Legal Division</i>

Mr Ian Stott	<i>Secretary</i>
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welfare services, pay and conditions of service. The branch provides the office services required by staff to enable them to sustain a high level of output. Where it is uneconomic to provide in-house expertise in specific services, such as welfare or training, they are bought in from other government departments or from the private sector.

4.2 OFWAT's five policy divisions, Charges Control, Engineering Intelligence, Lands, Legal and Consumer Affairs, require high quality intellectual resources to create a new regulatory regime in a complex area at the focus of economics, engineering and consumer protection and involving 39 local monopolies. OFWAT faces uncertainty about the volume and precise nature of its work from year to year.

4.3 OFWAT's policy is to recruit a core of high calibre staff but to employ the expertise of outside consultants where necessary to deal with specialised problems or temporary increases in workloads.

4.4 The total number of staff will increase to approximately 100 as the work of the office develops. A chart detailing the divisions and branches is shown on page 7.

5.1 The OFWAT system of financial budgeting and control is based on the premise that the Director General is a Treasury-appointed Accounting Officer with his own Vote to cover the costs of his department. OFWAT funds are administered according to government accounting rules, with the proper weight attached to the need for accountability, propriety, regularity and value for money.

5.2 OFWAT Finance Branch is responsible for negotiating Public Expenditure Survey requirements with the Treasury and also for administering and monitoring internal cost-centre budgets. The branch also operates the payment system and aims to settle accounts promptly and efficiently. Following OFWAT policy of making sensible use of outside expertise, an agency agreement has been set up with DOE Accounts Division to process payments following OFWAT's initial certification. There is a similar agreement with the Treasury Chessington Computer Centre to deal with employees' pay. The Office of Fair Trading Internal Audit has been appointed to carry out an internal audit function. These arrangements are working effectively and more economically than in-house provision.

6.1 Information Technology (IT) equipment plays a major part in the work of all parts of OFWAT. The software requirements identified to date include financial modelling tools and database systems especially for the analysis and monitoring of regulated companies, together with word-processing, desktop publishing and spreadsheet systems. To allow flexibility and easy distribution of information, a network system was chosen as the basis for IT operations with a central core of records to be held on a file server. These operations are supported by networked printing facilities. Stand-alone PCs, including a system at each Customer Service Committee's office, portable computers and local printers complete OFWAT's current hardware capability.

6.2 In the area of telecommunications OFWAT has a digital switchboard with an initial capacity of 77 extensions linked to Mercury Telecommunications. An application to join the Government Telecommunications Network has been made. A traffic analysis system has also been installed to provide data on telephone activity.

Financial Control

Equipment

4.1 NO MARKET MECHANISMS Consumers cannot look to market mechanisms to protect them from unnecessarily high charges or poor service. My objective will be to achieve, through regulation, the same outcome as would normally arise from a competitive market.

4.2 COMPARISON OF COSTS AND EFFICIENCY I shall compare the performance of the 39 appointed companies and use the examples of the best to set standards for the others to introduce an element of comparative competition. Such comparisons will cover differences in operating cost, capital cost, levels of service and "customer care". There will be allowances for differences, such as geographical conditions, which are outside the control of efficient managements. These comparisons will help me achieve a better deal for all water customers in England and Wales.

4.3 TAKEOVER NOT INVOLVING LOSS OF COMPARATORS The Water Act 1989 does not inhibit the takeover of an appointed company by another enterprise, unless this involves a merger with another water enterprise operating in the UK. The possibility of takeover can put healthy pressure on management to be efficient and make good use of their assets. I welcome the existence of such pressure, as I welcome the involvement of French companies. In the long run, customers can only gain from an efficient industry.



Ian Byatt (centre) with Jerome Mouod, Chairman and Chief Executive and Christine Morn-Postel, Senior Vice-President, both of Lyonnaise des Eaux during a visit to France in March 1990

4.4 LOSS OF COMPARATORS Mergers between existing water enterprises in the UK and the integration of their management would reduce the number of comparators and prejudice my ability to make valid comparisons. I recognise, however, that there may be public benefits which could outweigh such a detriment. In such circumstances I would generally wish to see a single new appointment for merged or jointly managed companies with a new price limit (K) for that company. This would ensure that all the cost savings could be taken into account and passed on to customers as lower charges.

4.5 REFERENCES TO MMC IN 1989 The Secretary of State for Trade and Industry referred the proposed merger of the Lee Valley, Colne Valley and Rickmansworth Water Companies to the Monopolies and Mergers Commission. I gave evidence to the Commission. Since writing this report the Monopolies and Mergers Commission report has been published. The Secretary of State for Trade and Industry has asked me to explore with the companies ways to remedy the adverse effects of the proposed merger

Competition, comparative competition and mergers

through undertakings from the three companies which would ensure that cost savings from the merger would be passed on to their customers in the form of lower water charges.

4.6 INSET APPOINTMENTS The Water Act allows me to make a new appointment on a green field site within an area already allocated to an existing appointee. This provides for a useful element of competition or potential competition and I shall be interested to see what use is made of this provision. OFWAT has had discussions with a number of companies about the possibility of inset appointments, although no formal applications have been received.

5.1 CHARGING FOR WATER The existing pattern of water charges is complex and, arguably, in need of rationalisation. Rateable values for new properties are no longer available and charging by rateable value will be illegal after the year 2000. The industry needs to devise new methods of charging for domestic customers. In my view there is also a need to review the structure of tariffs.

5.2 METERING AND TARIFF STRUCTURES This raises the issue of whether metering should be extended generally to domestic consumers. Domestic metering has been examined in the past and a number of meter trials are in progress in different parts of the country. It would not be appropriate to take decisions in a hurry, especially before there has been a full public debate. This debate also needs to cover the structure of water charges, especially the relationship between standing charges and other fixed charges, and elements in the tariff which relate to the volume of water used. It would scarcely be sensible to go to the expense of metering unless the structure of the tariff signalled the cost of providing water and gave incentives to economy in its use.

5.3 CONSULTATIVE PAPER I propose to stimulate a public debate on methods of charging for water and on the structure of water tariffs. I see a major role for the CSCs in this debate. I plan to consult the CSCs during the summer and then, in the autumn, to publish a consultative paper inviting a response from the public. I will analyse that response and, on the basis of it, suggest the way these issues should be approached.



Ian Byatt sees how customer queries are dealt with during a visit to South West Water Services Limited

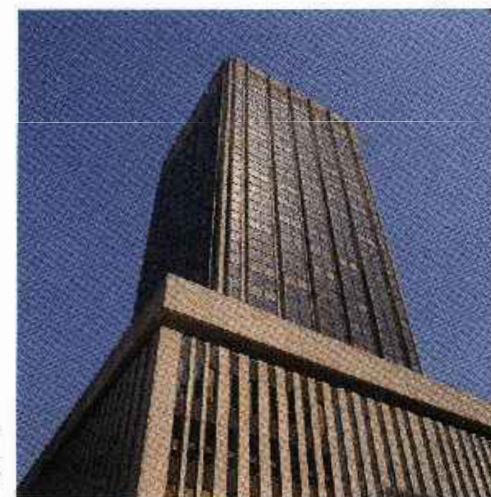
Photo: Courtesy of South West Water

ADMINISTRATION

The objective of OFWAT's administrative branches is to ensure that the people who work for the Director General have the colleagues, the means and the working environment they need.

1.1 We have successfully established, for the first time, a complete central government department in England outside not just Whitehall, but outside London.

2.1 OFWAT is a new, non-ministerial, central government department with its own Vote and Accounting Officer. It is a free-standing department entirely independent of the Department of the Environment and the Welsh Office. DOE prepared the ground for setting-up OFWAT; this included preparing Public Expenditure Survey bids for 1989/90, acquiring and preparing offices for OFWAT and CSCs, ordering office equipment, including IT and telecommunications equipment and handling the first wave of staff recruitment. OFWAT controlled the acquisitions and made all staff appointments on behalf of the Director General.



Centre City Tower
in Birmingham—
OFWAT headquarters

3.1 Ministers decided that, in line with their policies on decentralisation, OFWAT should be located outside London and South East England. Centre City Tower, Birmingham, was selected because it offers good quality accommodation and is situated in an excellent central position. It is within five minutes' walk of New Street railway station, with direct rail access to all CSCs' offices and many companies' principal offices, and is three miles from access to the centre of the national motorway system at 'Spaghetti Junction'. The accommodation was completely refurbished and made secure before occupation. The CSCs are based in Bristol, Cambridge, Cardiff, Leeds, London, Manchester and Newcastle-on-Tyne. Severn-Trent CSC is located on the 13th floor at Centre City Tower. The South West CSC will move to Exeter once suitable accommodation is found.

4.1 OFWAT was operational on 1 September 1989 with its own Establishments Branch taking over all personnel and office services functions from DOE on that date. Establishments Branch deals with all personnel matters including recruitment, training, career development,



Neil Jackson—
Head of
Administration
with Ian Stoll,
Head of Finance
Branch

The OFWAT
achievement

Preparatory
work

Location

Management
services

3.1 A general information leaflet explaining OFWAT's role has been prepared together with a leaflet explaining the complaints' procedure for customers. Exhibition display material has also been prepared for use by CSCs and headquarters.

4.1 A specialist library has been set up to provide a full information service to staff. The library is also open to the public for reference and information purposes.

4.2 The library houses the Register of the Director General. This is a register of specified documents relating to various activities of the water companies that the Director General is required, under Section 31 of the Water Act, to have available for public inspection. These documents can be inspected in the library, or can be copied for a small charge.



The OFWAT Library

ECONOMIC REGULATION

Charges Control Division is responsible for: advice to the Director General on adjustments to K either by way of interim adjustment or at a periodic review, including the collection, analysis, and assessment of financial information; developing comparative competition and carrying out efficiency studies; and developing policy on mergers and inset appointments. The division is also concerned with tariff structures and methods of charging customers. It works closely with Engineering Intelligence Division in monitoring the performance of the companies and assessing the costs and benefits of changes in their service standards. The division aims to limit charges to those which would be charged by companies competing directly with each other.

1.1 Price increases in the water industry have been limited by a formula – **Retail Price Index** – plus a variable – **factor K**. Determination of initial K values was the responsibility of the Secretaries of State for the Environment and for Wales. The initial determination covers a ten year period although either the Director General or the company can seek a review after five years and the limits can be reviewed on an interim basis in certain specified situations. The initial price limits were announced on 2 August 1989 for the ten water and sewerage companies which were successors to the former water authorities. Price limits for most of the 29 private water only companies were determined in February and March 1990.

1.2 Initial K values average just under 5.5% for the first five years and 4% for the second five years. However, in the case of the 29 water companies, there has been some front-loading of the increase and the average permitted price increase in April 1990 was just over 13%, allowing for the increase in the RPI to November 1989 of 7.7% (see Diagrams 1 and 2 overleaf).

1.3 Diagram 3 (below) shows the range of permitted increases in charges in April 1990 and Diagram 4 (on page 16) the average bills that are likely to be charged.

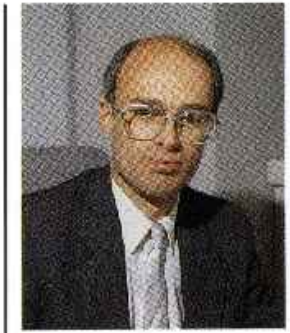
DIAGRAM 3

Total percentage increase (RPI + K) in household water and sewerage bills 1990/91, with population affected.

PERCENTAGE INCREASE	NUMBER OF WaSCs CHARGING	NUMBER OF WoCs CHARGING	POPULATION AFFECTED (MILLIONS)
10 - 15 %	10	8	42.0
15 - 20%	—	10	5.8
20 - 25%	—	3	0.7
25 - 30%	—	6	1.2
30 - 35%	—	2	0.4
TOTALS:	10	29	50.1

WaSCs = Water and sewerage companies
WoCs = Water only companies

1.4 Although companies are limited in their increases in average charges – the K factor applies to a basket of tariffs which covers all standard charges to domestic and non-domestic customers – they have some discretion about how individual tariffs are charged. Water and sewerage companies,



Chris Bolt – Head of Charges Control Division

K FACTORS

A company's K factor represents the average increase in prices allowed over and above inflation in any one year. K's vary from company to company and over time. They have been set for a 10 year period, although they can be reviewed after five years if the company or the Director General wishes.

K reflects what a company needs to charge to finance provision of services to customers. They take into account capital expenditure and operating costs, offset by productivity improvements and, where appropriate, proceeds from land sales. Companies are investing over £25 bn over the next 10 years to improve the quality of drinking water and to reduce pollution. Because of the scale of these programmes K values are positive, and charges will increase faster than inflation, at least initially. As investment programmes tail off, K values will tend to fall. In a number of cases Ks become zero, or even negative, within 10 years. Negative Ks, which imply charges increasing more slowly than inflation, are represented by a downward arrow in Diagram 2.

The diagrams show the actual values of K set in each year, and the total of K values over 10 years. Because increases are applied cumulatively, average bills will increase by a slightly higher percentage than shown.

WATER & SEWERAGE COMPANIES - K FACTORS
(YEARS ENDING 31 MARCH)

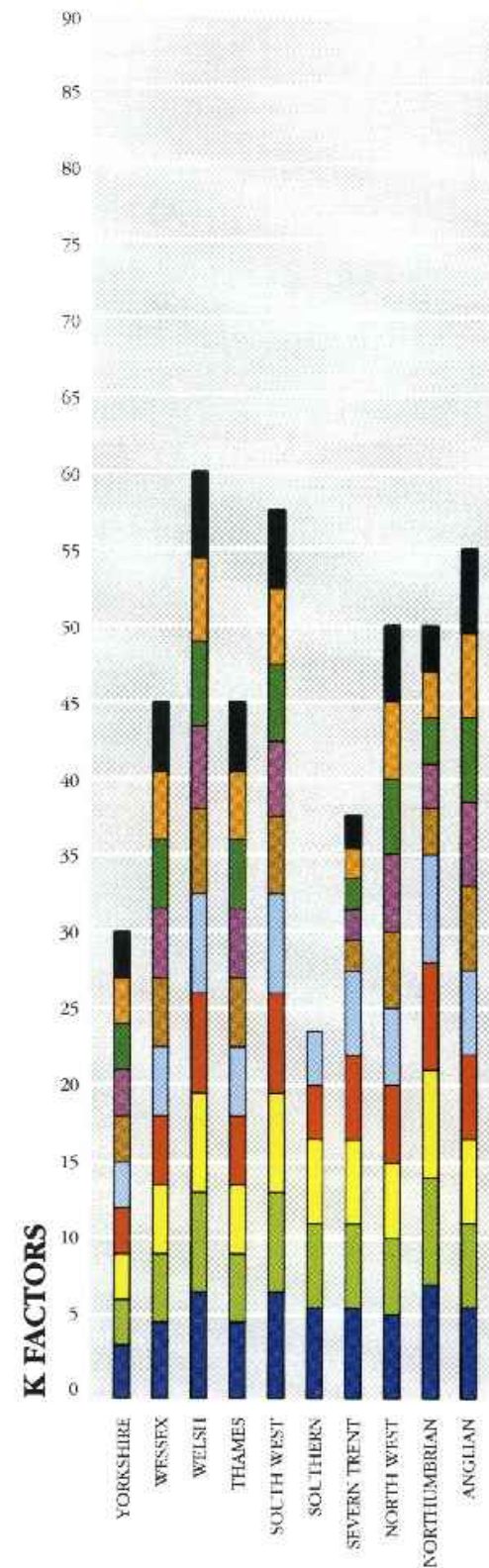


DIAGRAM 1

CHAPTER SIX

INFORMATION AND PUBLICITY

The Press and Information section's primary role is to inform the public about the work of the Director General of Water Services and his office. Its functions include dealing with enquiries from the public and the media and the provision of publicity material.



Dilys Plant - Head of Information

Press and broadcasting

1.1 At a press conference on 8 August 1989 the Director General issued a statement on the general approach he intended to adopt in the exercise of his regulatory powers. This was widely reported in the national media and the statement was incorporated within the water share offers prospectus.

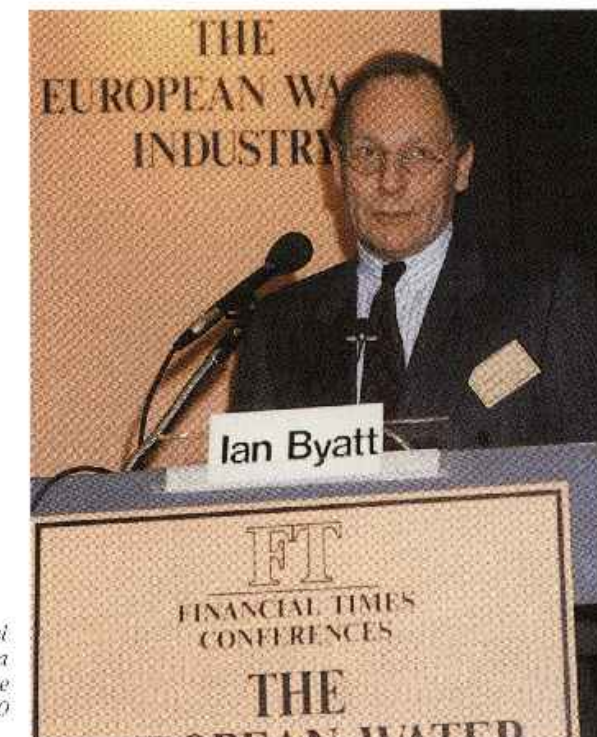
1.2 The Director General has taken advantage of several opportunities to broadcast on radio and television. Broadcasts included Call Nick Ross on Radio 4; You and Yours (Radio 4) and several local radio interviews. The Director General made TV appearances on Advice Shop, This Week, and Compass (TV South West). In addition briefings and interviews have been given to many specialist journalists.

1.3 A press conference was held in early September to mark the opening of OFWAT's headquarters in Birmingham. This was well covered by the regional media.

1.4 Regional press conferences were held for the announcement of the CSC chairmen. The regional media is becoming increasingly aware of OFWAT's existence, and looking to chairmen to comment on many issues.

2.1 Over the past six months the Director General has addressed many conferences and meetings of professional bodies to explain the new regulatory regime.

Talks by the Director General



The Director General addresses a Financial Times Conference in March 1990

land in statutory designated environmental areas such as National Parks, if they consult the Countryside Commission first and the Nature Conservancy Council in the cases of land in Sites of Special Scientific Interest. The DOE and Welsh Office have the responsibility to monitor these disposals and the environmental duties that the companies and other bodies have under Sections 8 – 10 of the Act.

4.7 A standing committee has been formed to monitor the effectiveness of the Code of Practice relating to environmental duties. This includes furthering conservation, protecting access, preserving the heritage and providing for recreation. The committee is chaired by the DOE with representatives from various conservation, heritage and recreational bodies, together with the Welsh Office, NRA, MAFF and the water industry. Lands Division represents OFWAT on that Committee.



*Kielder
Northumberland
– important for
recreation as well
as water
catchment*

Photo: Courtesy of Northumbrian Water Limited

WATER ONLY COMPANIES - K FACTORS (YEARS ENDING 31 MARCH)

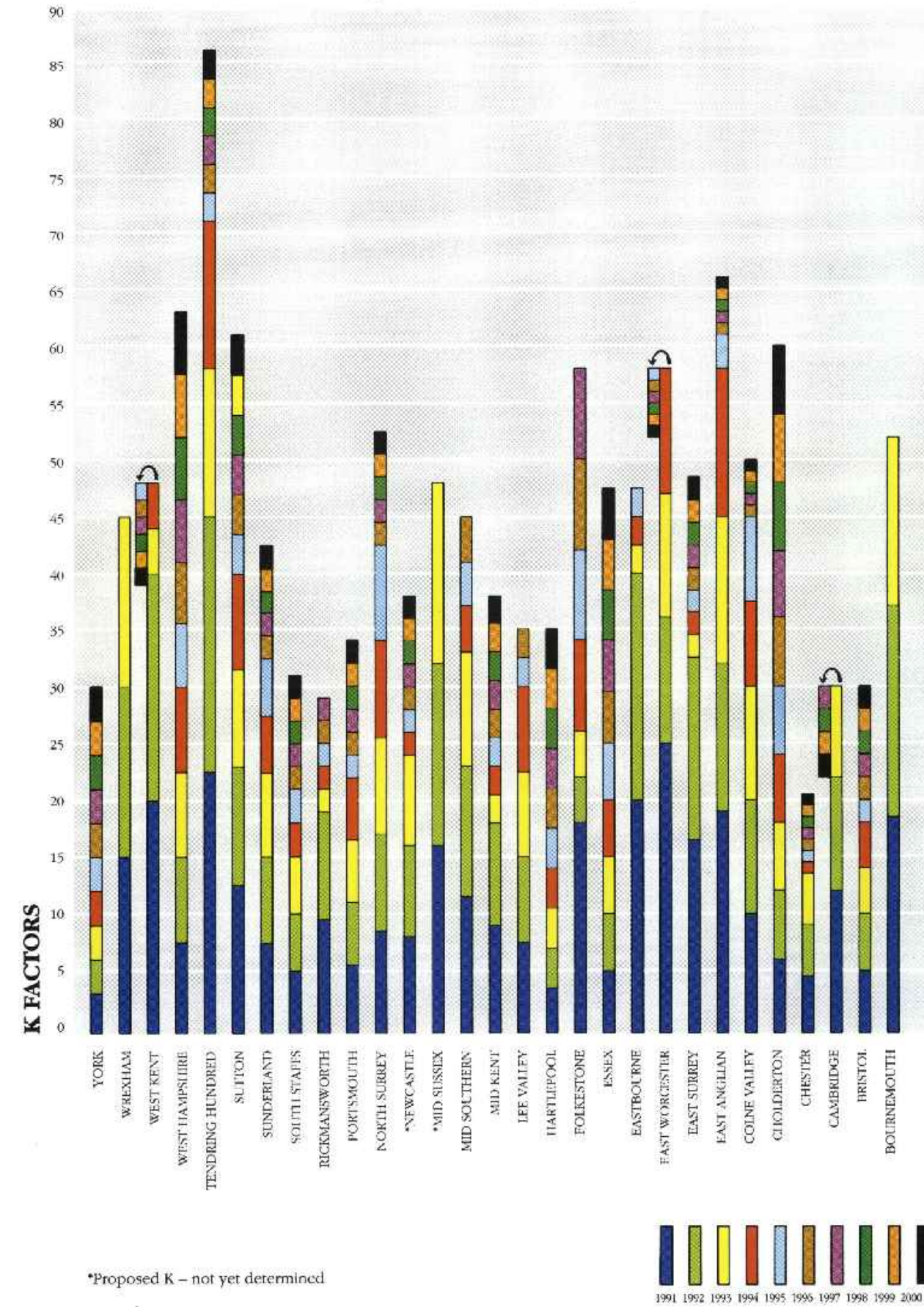


DIAGRAM 2

for example, have freedom to switch between water supply items and sewerage items in the tariff basket. All companies have a choice whether to cover the increases equally or differentially between standing charge elements and variable elements in the tariff, with the variable elements being related either to volume or rateable values. Companies do not however have total discretion. Under their licences they are required to ensure that no undue preference is shown to, and that there is no undue discrimination against, any class of customer or potential customers. This office will be concerned to ensure that costs are recovered fairly between water customers and sewerage customers, and that decisions on tariff structures reflect appropriately the costs of providing supplies. OFWAT has already been involved in discussions with several companies about tariff policies.

DIAGRAM 4

Average household bill for water and sewerage services in England and Wales 1990/91

AVERAGE BILL	NUMBER OF WaSCs CHARGING	NUMBER OF WoCs CHARGING	POPULATION AFFECTED (MILLIONS)
£100 - 120	2	5	11.5
£120 - 140	3	7	21.6
£140 - 160	2	4	5.4
£160 - 180	3	9	10.9
£180 - 200	—	3	0.5
£200 - 220	—	1	0.2
TOTALS:	10	29	50.1

WaSCs = Water and sewerage companies
 WoCs = Water only companies

Tariff structures and charging methods

2.1 All companies are required to phase out, by the year 2000, charging methods which relate to rateable values. In any case, from 1 April 1990, new domestic properties will not have a rateable value, so some alternative basis of charging will be required for new properties immediately. Although metering would appear to have a number of advantages, in particular the ability to relate charges to consumption, the costs of general metering would be substantial. The metering trials currently underway in a number of parts of the country confirm both the high cost of such a programme and the virtual impossibility of extending metering to all properties, in particular properties such as flats, which share supply pipes.

2.2 OFWAT is planning to publish a consultation paper to promote a debate on alternative charging methods, such as relating charges to the type of property. Decisions about tariff structures will also be important in this context. Although flat rate charges are one possible future charging method, and would be relatively cheap to implement, they have the major disadvantage that individual customers will pay the same irrespective of the amount of water consumed or waste produced. Consumers would not, in those circumstances, receive sensible price messages to enable them to affect their consumption pattern.

2.3 OFWAT envisages a wide ranging and well-informed debate on charging methods and tariff structures taking place during 1990, involving the Customer Service Committees. The results of this debate would inform decisions by individual companies on charging methods and tariff structures for subsequent years. Diagram 5 (on page 17) indicates the variation in the proportion of water and sewerage charges recovered through standing charges.

4.1 The Water Act prevents companies from disposing of "protected" land unless they have received either specific consent or the disposal conforms with a General Authorisation issued by the Secretary of State.

4.2 When disposing of land the companies must comply with Condition K of their licence entitled "Ring Fencing, Disposals of Land and Changes of Use of Land". The purpose of the Condition is twofold. The "ring fencing" provision ensures that companies retain sufficient rights and assets to enable a special administrator, if one had to be appointed, to manage the business of the company. The major part of the Condition is to ensure that companies dispose of the land at the best price, certified by independent valuers. The aim of this is to enable customers to benefit from 50% of any proceeds over and above those assumed in the initial K setting exercise.

4.3 There are detailed procedures to be followed by companies if they wish to dispose of land, but much is based on the principle of self-certification backed by independent professional advice. In the higher value cases the Director General must give his consent to disposals. There are stricter controls on disposals to property subsidiaries and joint ventures. In these cases a greater value of the land may be unlocked by those subsidiaries. This would not, prima facie, benefit the customers of the core company, therefore clawback provisions will normally be inserted to enable half of that increased value to be returned for the benefit of customers.



Peninsula Park, Exeter - a development project on surplus water company land

4.4 Since September the Land Division has had to process some 50 cases. These have varied in size from historic pumping stations leased to trusts to thousands of hectares of upland catchment land. The variety has ranged from surplus dwellings to a multi-million pound business park development.

4.5 The procedures and interpretation of new legislation are inevitably complex and Condition K is no exception. The first main task of Lands Division was to produce a comprehensive guidance note. This was distributed to companies in January, and is currently being revised. A number of the companies have been visited to discuss the issues further.

4.6 The General Authorisations issued last autumn allow companies to dispose of land previously compulsorily acquired as long as they follow modified "Crichel Down" rules. They also allow companies to dispose of

party's act or default, or exceptional circumstances. (S.I.1989 Nos. 1159 and 1383)

2.5 A more operational task is the determination of disputes between companies about the terms on which bulk supplies of water should be provided by one to another. (s.39)

2.6 Discharges of trade effluent from industrial premises to public sewers are controlled by consents issued by the local sewerage company. If a trader cannot get consent, or disagrees with the conditions imposed, he may appeal to the Director General. The appeals may be dealt with either through a formal exchange of documents or a hearing. Prescribed substances and processes are referred to Her Majesty's Inspectorate of Pollution (HMIP). (s.74 and schedules 8 and 9)

2.7 By the end of March six trade effluent appeals had been received. This was more than the DOE normally dealt with in a whole year. OFWAT has a procedure to ensure that appeals are properly examined and dealt with. Appeals will be considered by suitably qualified, experienced and independent inspectors, who will report to the Director General for his determination.

2.8 Such activities as these raise important questions about the nature and extent of the Director General's functions. The procedural framework within which they should be handled will be kept under review to enable the Director General and those acting on his behalf to deal confidently with matters as they arise.



Members of the Central Secretariat in the OFWAT offices in Birmingham

Central Secretariat

3.1 This co-ordinates cross-divisional policy development within OFWAT. It also has a number of central functions, including the servicing of internal meetings, and the distribution to the companies' Managing Directors of the series of letters which set out OFWAT's policy on key areas of its work. These "Dear MD" letters are listed in Appendix C. Copies are available from the library at a charge to cover handling and copying costs.

2.4 OFWAT is investigating the basis of individual companies' policies in determining standing charges. It was suggested to companies, when they framed their tariff structures for 1990-91, that there should be no widening of the present range as it was felt the underlying cost differences need considerable examination.

DIAGRAM 5

Standing charge (£) for unmeasured water and sewerage services as a percentage of the average household bill 1989/90, with population affected.

STANDING CHARGE AS PERCENTAGE OF AVERAGE BILL	NUMBER OF WaSCs CHARGING	NUMBER OF WoCs CHARGING	POPULATION AFFECTED (MILLIONS)
0 - 10%	1	3	8.3
10 - 20%	3	2	13.4
20 - 30%	3	14	16.9
30 - 40%	2	8	8.6
40 - 50%	-	1	0.1
50 - 60%	-	1	0.1
60 - 70%	1	-	2.7
TOTALS:	10	29	50.1

WaSCs = Water and sewerage companies
WoCs = Water only companies

2.5 Companies have adopted a range of approaches as a basis for charging new domestic properties from April 1990, given that such properties do not have rateable values. Again, OFWAT will wish to learn from the experience gained in implementing different approaches to charging as an input to the debate on the charging system to be applied to all customers to replace rateable values.

3.1 Under Section 7 of the Water Act the Director General has the duty to facilitate competition and to encourage efficiency and effectiveness.

3.2 Because of the high capital expenditure required to provide water and sewerage services, it is unlikely that customers would ever be able to choose between competing suppliers. However, there is the possibility of direct competition in the case of new developments on greenfield sites, and the Water Act allows "inset" appointments within the area of an existing company.

3.3 A much more important form of competition in the water industry is "comparative" competition. Unlike any of the other currently regulated monopolies, the water industry is organised on the basis of different companies providing services in different parts of the country. This enables the regulator to make comparisons between performance and to assess best practice. Such comparisons, which will cover not only operating and capital expenditure costs but also other measures of performance, including aspects of customer care, will be useful to the regulator in reviewing K values at a periodic review.

3.4 The Water Act contains special provisions in the case of the takeover of one water or sewerage company by an existing company to preserve the number of comparators available to the Director General. Under the Act, all mergers involving existing companies with assets of more than £30 million are required to be referred to the Monopolies and Mergers Commission. One such reference was made in 1989 in respect of the

Comparative competition

proposed merger between Colne Valley and Rickmansworth water companies and companies controlled by General Utilities plc. Further references were made in January 1990.

3.5 The Director General has given evidence to the MMC on these references and has attended a number of hearings.

3.6 The Director General attaches particular importance to his ability to make comparisons between companies and intends to develop, with the industry, informational procedures to enable him to form useful conclusions on the benefits to consumers generally.

3.7 As well as making comparisons of management performance both the Director General and the financial markets will be able to make judgements about different quoted companies. Again, the structure of the industry is unlike that of other regulated monopolies and, while the privatised water and sewerage companies have "golden share" provisions, it is already clear that there is some concentration of ownership. Where such activity results in a more efficient management this is obviously to be welcomed. Again it can only operate properly if the financial markets have sufficient comparators to enable them to judge good and bad performance.

4.1 A key element in the Director General's powers is his ability to obtain information from the regulated companies. The licences lay down in some detail the accounting information to be provided, in particular distinguishing between appointed water and sewerage activities and other activities carried out within the appointed company and by associated companies. This breakdown is essential to ensure that any trading between the appointed business and other parts of a group structure is done on a fair basis and involves no cross subsidy.

4.2 The Director General has established a working group on accounting issues for regulation with a membership drawn from individuals from the water and sewerage companies, water companies and from OFWAT itself.

4.3 The Director General is also encouraging all companies to adopt a common financial year. At present a number of the water companies have year ends other than 31 March (see Diagram 6). Given that all companies' charges are controlled on the basis of a common "charging year", running from 1 April to 31 March, the Director General sees advantages to both companies and to himself in regulating the industry if financial years were in all cases on the same basis.

**DIAGRAM 6
SUMMARY TABLE OF FINANCIAL YEAR ENDS**

YEAR END	WATER COMPANIES	WATER & SEWERAGE COMPANIES
30 SEPTEMBER	1	0
31 DECEMBER	15	0
31 MARCH	13	10

**THE DIRECTOR GENERAL'S FUNCTIONS
INTERPRETATION AND APPLICATION**

Legal Division, including its Compliance Branch, is responsible for legal advice on all aspects of OFWAT's work, for supervising litigation and for monitoring and enforcing companies' compliance with their licences and statutory obligations. It contains a Central Secretariat which co-ordinates the policy work of the office as a whole.



Allan Merry - Head of Legal Division

Legal work

1.1 Two solicitors from outside the Government Legal Service joined OFWAT in March 1990. Until then the Department of the Environment's lawyers were asked to assist.

1.2 There is a considerable amount of new work to be covered. OFWAT's work rests upon the Director General's functions which are set out in the Water Act 1989 and in the 39 companies' licences.

1.3 The creation of this new regime has given rise to a steady stream of questions about the precise meaning of points in the Act and licences. They vary from the comparatively detailed to the absolutely fundamental.

1.4 It is already apparent that these key texts are going to give rise to difficulty in a number of areas. As these emerge it will be the lawyers' job to understand the nature of the difficulty, what is required to overcome it and how that might be achieved. They will also be involved in any licence amendments.

1.5 Legal advice is a resource which must be available to every part of OFWAT. At the same time the newly-created Customer Service Committees need advice on the extent of their powers and about the subjects with which they deal. Advice of this sort, although triggered by a particular inquiry, is likely to be of use to all CSCs. Each CSC must be able to rely upon the same 'advice base'.

1.6 The Director General operates within a legal framework, but problem-solving must look for the reason why, rather than why not.

Appeals and other determinations

2.1 Apart from the Director General's regulatory functions in the Act and the licences, there are some additional requirements upon him which are of legal and wider interest. They involve arbitration or adjudication between companies and third parties.

2.2 For example, the Director General is required to deal with claims for compensation, for inconvenience and loss caused through pipe-laying on private land. He may award compensation of up to £5,000. (s.162)

2.3 Another important area of activity is the investigation of any complaint against a CSC about the way it has dealt with a customer's grievance. (s.27(2)(e))

2.4 The Director General is required to settle unresolved claims by customers under the Customer Service Standards Regulations (see chapter 4 para 4.1). Most decisions will turn upon the availability, to the company, of one of the statutory defences - for example, industrial action, third

sent to all companies. On the other hand, all 39 leakage codes were approved.

3.4 The objective in this first round was to achieve approved codes which are customer friendly and meet the basic requirements of the licence. There will, however, remain scope for improvement in terms of content, language, structure and presentation. Companies are required to review their codes not less frequently than once every three years. The Director General may also request a review not more frequently than once a year. The CSCs will be consulted on the approved codes during 1990 to establish the need for such reviews. In carrying out any reviews each company must consult its CSC and consider any representations made by it about the codes or the manner in which they are likely to be or have been operated.

Customer Service Standards Regulations

4.1 The Division will carry out the role of the Director General in hearing appeals under the statutory Customer Service Standards Regulations (Guaranteed Standards Scheme). Where a company fails to meet certain prescribed standards of service to customers, the scheme entitles customers to payments of £5 or, for certain sustained failure, £5 per complete day. If the company refuses to meet a claim for a payment, the customer can appeal to the Director General. No such appeals have yet been received.

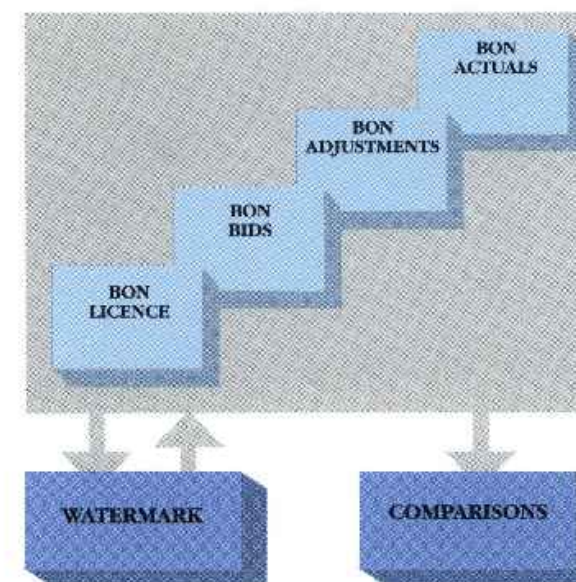
Section 82: Resale price of water

5.1 The Director General is considering whether to make an order under section 82 of The Act to limit the resale price of water supply or services. The Division will advise him on the possible scope and effect of such an order. If he decides to go ahead, OFWAT will consult interested bodies in the Autumn.

4.4 In order to provide a common framework for analysing both accounting information and financial projections over the period for which price limits have been set, OFWAT is enhancing software produced by Coopers & Lybrand Deloitte for the Department of the Environment as part of the initial K setting process. This software comprises the so-called "Book of Numbers" which contains expenditure projections in detail for a ten year period and, in outline, for a twenty year period, and other accounting information required to produce detailed financial projections for each company. The "Watermark" model uses information in the "Book of Numbers" to produce detailed financial projections – profit and loss accounts, balance sheets and sources of applications of funds statements – over a ten year period. This software is being developed by Coopers & Lybrand Deloitte for OFWAT, in particular to provide additional facilities for comparing information between companies and over time, in a way which was not required for initial K setting. This work is expected to be complete by Summer 1990.

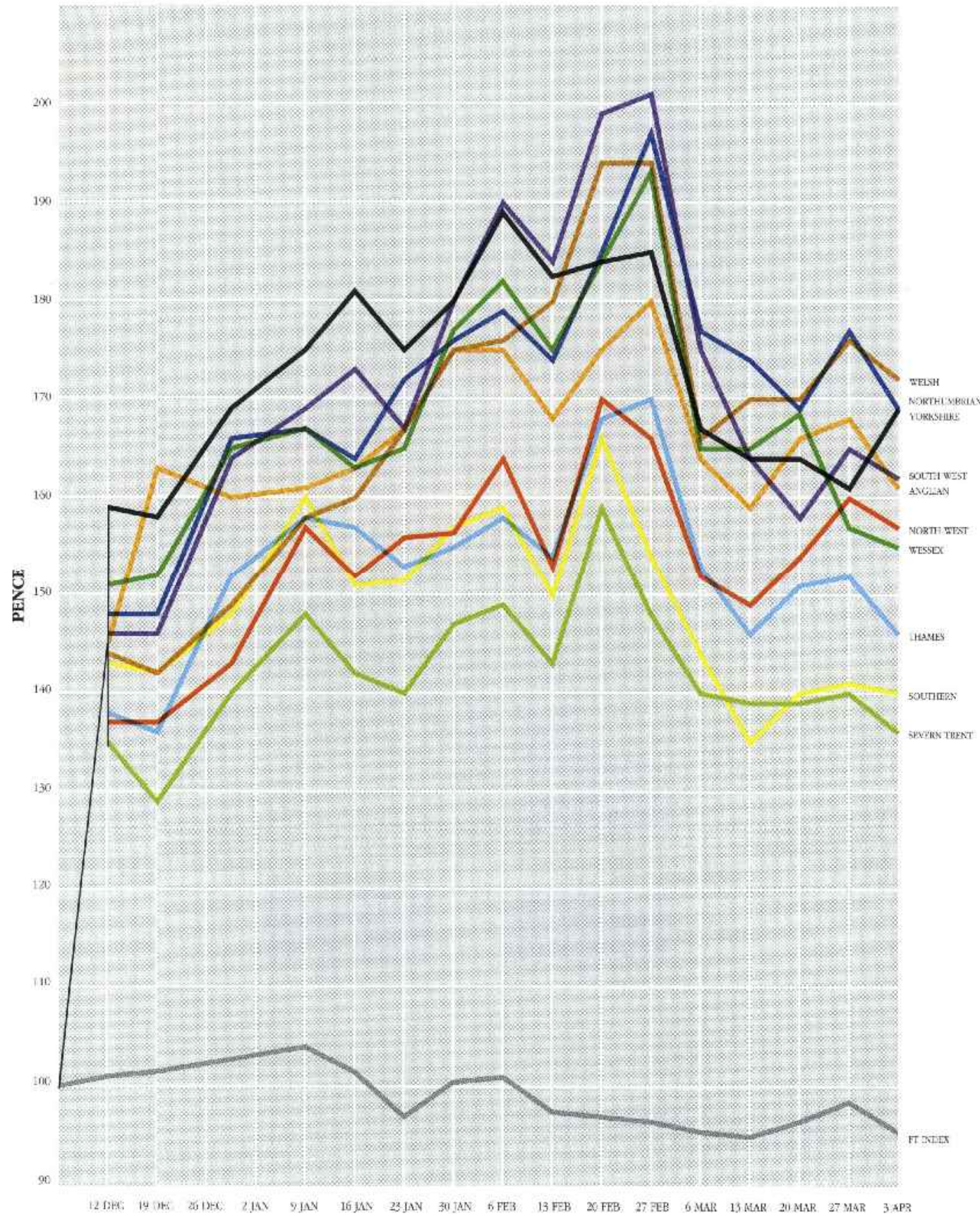
4.5 When complete, the "Book of Numbers" will be the main central database on financial and performance data for OFWAT; although it will, of course, be supplemented by a number of more detailed systems as described in other sections of this report. All the basic software is being made available to the industry. Diagram 7 illustrates the main information flows between the industry and OFWAT and the relationship between the various software facilities being developed.

DIAGRAM 7



4.6 OFWAT is also developing monitoring information on stock market prices, shareholdings etc., and generally developing a better understanding of the corporate finance issues which are relevant to performance and assessment of water and sewerage companies. The share price movement of the Water and Sewerage Companies is shown in Diagram 8 overleaf.

**DIAGRAM 8
WATER & SEWERAGE COMPANIES -
SHARE PRICE MOVEMENT**



31 March 1990, 541 complaints were received. Of these 298 were accepted for investigation. At 31 March 1989, 116 had been resolved. 243 complaints were not accepted for investigation either because the companies concerned had not been given an opportunity to respond to them or because they concerned matters outside OFWAT's remit.

2.5 A significant number of the complaints received have been about water quality matters. Customer dissatisfaction with water quality can arise whether or not the company is in compliance with the regulations. For example the water may meet the regulations but the complaint is about its aesthetic qualities which the customer finds unsatisfactory. In other cases, although the supply does not comply with the regulations, the Secretary of State has accepted an undertaking from the company under Section 20 of the Water Act that it will implement remedial action by a specified date. A number of complainants have sought rebates or compensation and OFWAT is pursuing with companies, on a case by case basis, approaches to resolving complaints where the product or service supplied is below the standard for which the customer has paid.



The OFWAT exhibition at Consumer Congress 1990, Liverpool

3.1 Under Conditions G, H and I of the Licence each of the 39 companies was required to submit for the approval of the Director General three codes:

- (a) a code of practice for relations with customers and the Customer Service Committee;
- (b) a code of practice giving guidance to domestic customers who have difficulty in paying their bills, and describing the procedure to be followed before disconnection for non-payment;
- (c) a code of practice and procedure for dealing with leakage with respect to metered domestic premises.

3.2 The codes had to be submitted by 1 November 1989. Most of the codes arrived late, although all arrived before the end of November. Within two months of receipt approval had to be given to the codes or modifications specified to enable approval to be given. A number of consumer bodies were consulted on a sample of the codes received and their constructive criticism and advice was welcome.

3.3. The companies have, like the Director General, been feeling their way on drafting the codes. Informal discussions with companies would have been helpful, but that was not practicable within the timescale. None of the 39 companies submitted customer or disconnection codes which were sufficiently well written, complete and accurate to meet the basic requirements of Conditions G and H, and proposed modifications were

Codes of Practice

Chairmen	CSC
Mr David Edwards	Anglia
Mr James Gardner CBE DL	Northumbria
Mr Anthony Goldstone MBE DL	North West
Mr Clive Wilkinson	Severn Trent
Professor Judith Rees	Southern
Mr Arthur Green	South West
Mr Philip Chappell CBE	Thames
Mr Anthony Clothier	Wessex
Mrs Diana Scott	Yorkshire
The Ven Raymond Roberts CBE	Wales

1.4 Selection of nominees for appointment as CSC members also took place during March. The list of appointed members appears on Page 26.

1.5 Each CSC has a full-time secretariat. Addresses of the CSC offices are listed in Appendix C. All offices are operational, with the South West CSC office temporarily located in Bristol and due to move during 1990 to Exeter as soon as suitable accommodation and staff can be found.

1.6 The 10 new CSCs provide a streamlined and effective system of customer representation. They are independent of the water and sewerage companies, with all their costs met by OFWAT out of money provided by Parliament. The CSCs have statutory duties to keep under review matters of interest to customers and to consult and make representations to companies; to investigate customer complaints; and to advise and report to the Director General.

1.7 The CSCs may, with the Director General's approval, establish local and other sub-committees. Until the CSCs, with the Director General, have had some experience of the new regulatory regime and the effectiveness of the arrangements for consumer representation it would be premature to consider the establishment of any such committees.

2.1 The Director General considers that water companies should have an opportunity to respond to complaints before they are considered by OFWAT. Many complaints are capable of early and satisfactory resolution in this way. Companies are required under their licence to have a procedure for handling complaints and this must include particulars of the training to be given to staff in the handling of complaints.

2.2 The Director General intends that the CSC offices should become established as the first point of contact with OFWAT for customers with unresolved complaints about water and sewerage services. The CSCs have a statutory duty to investigate many types of complaint. Others must, however, be referred to and considered by the Director General who, in some cases, may forward them to the Secretary of State. For example, the regulation of drinking water quality, about which there is much public concern, is a matter for the Secretaries of State for the Environment and for Wales and the Drinking Water Inspectorate. The local authorities also have statutory functions to perform in relation to water quality.

2.3 CSC offices will ensure that all complaints received are passed to the right body and OFWAT has been participating in discussions with the Department of the Environment and the other regulators about complaint handling responsibilities and procedures.

2.4 Prior to the establishment of the CSCs all complaints work was dealt with by the Director General and his staff. Between 1 September 1989 and

MONITORING PERFORMANCE

The Director General has established an Engineering Intelligence Division to provide him with advice on technical, engineering and scientific aspects of the water industry and to assist him in the monitoring of company performance. The approach has been to appoint a small team of permanent staff and to utilise independent professionals to report on and certify the information submitted by companies.

1.1 The division's objectives are:

- (a) to formulate and put in place the necessary reporting arrangements to enable OFWAT to monitor and compare a company's operating performance, levels of service, and investment expenditure.
- (b) to evolve systems that will support planning for periodic reviews and the efficient and economic integration of new obligations into both the short and medium term plans of the industry.

1.2 In the first six months the focus of work in the division has been on setting up information and reporting systems that will provide the basis for effective monitoring of and comparisons between companies. After consultation with the industry companies now have to submit, every July, a comprehensive annual report to the Director General.

2.1 The provision of effective and economic water and sewerage services to customers requires companies to manage, maintain and improve their substantial asset base. These assets include impounding reservoirs, water treatment works, water pumping stations, service reservoirs, distribution mains and, for the sewerage companies, sewers, sewerage pumping stations, sewage treatment works and sludge disposal plants. The water and sewerage company of the 1990's will manage by means of modern telemetry and computer systems.

2.2 Privatisation of the water authorities has enabled customers and financial institutions to gain a better appreciation of the scale of the industry and the technical, engineering and scientific complexity of the business.

2.3 The new regulatory framework set out in the Water Act 1989 has required all the appointed companies to complete detailed long term plans – Asset Management Plans – for the maintenance and improvement of the services they provide.

2.4 These plans, and the associated investment and levels of service projections, have formed the cornerstone for the initial "K" setting described in the previous chapter on economic regulation. The overall scale of the investment plans which has been allowed for in the first ten years is shown in Diagram 9 overleaf.

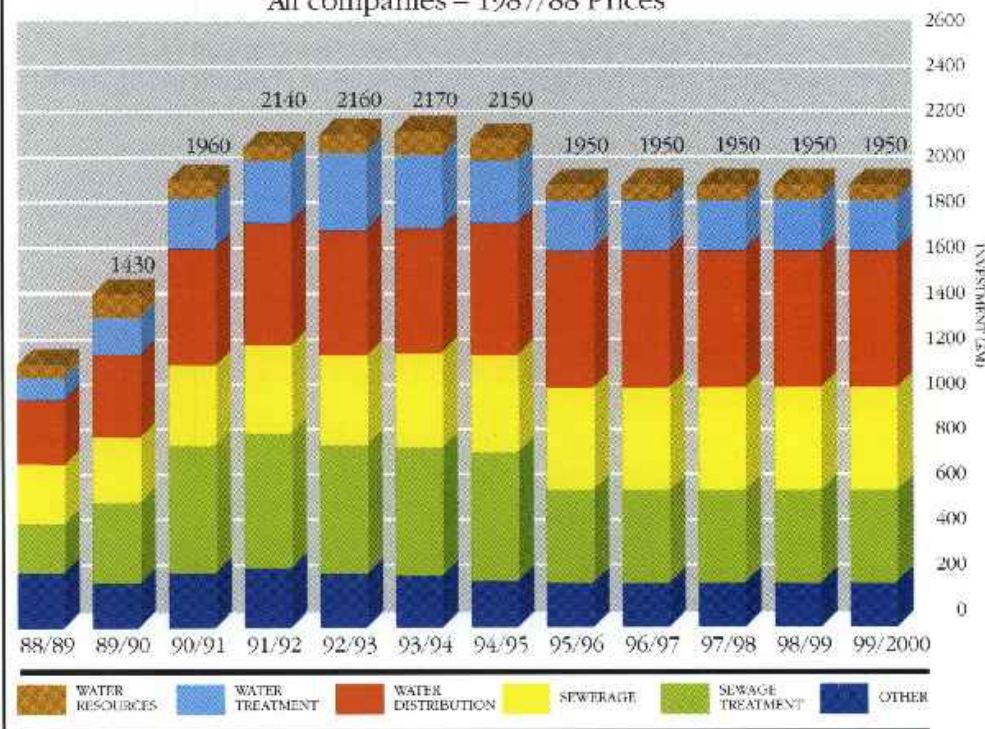


Bill Emery –
Head of
Engineering
Intelligence
Division

Objectives

Technical advice

DIAGRAM 9
WATER INDUSTRY INVESTMENT PROGRAMME
 All companies – 1987/88 Prices



2.5 The success of the industry depends on the companies' ability to deliver the improvements in service provision and asset condition. The industry, and its suppliers and contractors, have embarked on a course that will radically improve the quality of service provided to water customers. It is OFWAT's job to ensure that the improvements are achieved on time, and at the lowest acceptable cost to customers. The engineering division's key tasks are in this area.

3.1 On his appointment the Director General commissioned David Walker to report on the monitoring requirements for the companies' investment programmes and levels of service provision. The report was accepted in December 1989 and detailed draft proposals in both areas were circulated to all companies.

3.2 Following a constructive dialogue with the industry in the early part of 1990, guidelines for a company's "Annual Report to the Director General" were issued in April. The annual report integrates the various reporting and information requirements into a single, comprehensive format.

3.3 The annual reports from companies will provide a framework for the submission of the majority of information required to enable OFWAT to monitor progress and compare performance between those companies. The reports will also be linked to OFWAT's "Book of Numbers" database to enable the generation of time-series information and facilitate non-financial comparisons.

3.4 The requirements for "Annual Report – July 1990" are not prescriptive since the reporting regime is at a formative stage. The guidelines suggest the following content for the reports:

- (a) an executive summary;
- (b) progress report on medium term strategy – an overview of progress in 1989/90 and confirmation of the company's medium term strategy as

CHAPTER FOUR

CONSUMER AFFAIRS

Consumer Affairs Division is responsible for policy development of consumer aspects of regulation. The Director General has particular duties towards existing and potential customers of water and sewerage companies.

The division's principal functions, laid down in the Water Act 1989, are:

- section 6 and 27(4): to establish customer service committees and co-ordinate them nationally;
- section 7(3): to protect the interests of customers, in particular in rural areas;
- section 7(4): to take into account the interests of the disabled or elderly;
- section 27(2): to investigate complaints (a function also of CSCs under s.27(1)); and
- Licence conditions G, H and I: to approve or to propose modifications to three Codes of Practice prepared by each company.

The division co-ordinates the work of the CSCs, managing their secretariats and looking after their resource and accommodation needs. The division's objective is to persuade companies to set themselves higher standards and to deliver these higher standards of services to customers as they would if they were under direct competitive pressure.

1.1 The Water Act requires the Director General to establish up to 10 Customer Service Committees to represent the interests of customers and potential customers of the 39 appointed companies. The Director General has decided that there should be 10 CSC areas each broadly corresponding to the area of one of the former water authorities in England and Wales. Each of the 39 appointed companies has been allocated, by the Director General, to a particular CSC (see appendix B).

1.2 Each CSC must consist of a Chairman and between 10 and 20 members appointed by the Director General. Nominations were invited from a large number of bodies representing business, agriculture, local government, the voluntary sector, including bodies looking after the interests of the elderly and the disabled, and consumer organisations. Members of the public also nominated themselves. OFWAT also received nominations from the industry's former Consumer Consultative Committees.

1.3 A large number of nominations was received; the priority was to appoint the CSC Chairmen. The executive search firm, Tyzack and Partners, assisted in identifying suitable candidates for the post of Chairman. The Director General interviewed all short-listed candidates and consulted the Secretaries of State for Trade and Industry and for Wales on those he proposed to appoint. On 27 February 1990 the Director General announced the appointment of the following as Chairmen of the 10 CSCs.



Neil Jackson
 Head of
 Consumer Affairs
 Division

Customer Service Committees

Responding annually to the Director General

CUSTOMER SERVICE COMMITTEE NETWORK

THAMES



Members
 Mr Robert Russell CBE
 Mr David Horton
 Mr Clive Collier
 Lady Foster
 Brig John Moore MBE
 Mr John Hills
 Mr Stephen Timms
 Mrs June Smith
 Mrs Elisabeth Monck
 Mrs Adele Thorpe

Mr Philip Chappell CBE
 CSC Chairman

WESSEX



Members
 Mr Ian MacDonald
 Mr Leslie Keyte
 Mr Charles Barber
 Mrs Hazel McDeermid
 Mrs Jean Watkins
 Mr William Collins
 Mr Graham Turner
 Ms Jane Aspden
 Mr Jeffrey Horde
 Mrs Diana Tory
 Mr Piers Feiden

Mr Anthony Clothier
 CSC Chairman


ANGLIA



Members
 Mr Roy Thompson
 Mrs Zena Scoley
 Mr Charles Simeons
 Mr Walter Ablett
 Mr Philip Larratt
 Mrs Barbara Harold
 Mrs Barbara Ruffell
 Mr David Howarth
 Mr John Tapp
 Mrs Deidre Sanders

Mr David Edwards
 CSC Chairman

NORTHUMBRIA



Members
 Mr Jack Millican
 Mr Ron Durr
 Mrs Josephine Turnbull
 Mrs Mary Storer
 Mr Tom Yellowley MBE
 Mrs Ann Morris
 Mr Harry Thomson
 Mrs Evelyn Black
 Mr Douglas Thompson
 Mr Gordon Potter BEM

Mr James Gardner
 CBE DL
 CSC Chairman

NORTH WEST



Members
 Mrs Beryl Allan
 Dr Peter Coackley
 Mr Chris Muir OBE
 Mr Michael Robinson
 Mr Philip Farrar
 Mr Colin Reynolds
 Mr Arnold Barcroft
 Miss Maurcen Vince
 Mr Hugh Lloyd
 Mrs Deborah Morton

Mr Anthony Goldstone
 MBE DL
 CSC Chairman

SOUTH WEST



Members
 Dr Stuart Coverley
 Mr Aubrid Bourne
 Mr Graham Andrews
 Mr Martin Rich
 Mr Graham Facks-Martin
 Mrs Ann Maller
 Mrs Joyce Glench
 Mrs Anne Mayes
 Mr Mike Cox
 Mrs Janet Pearce

Mr Arthur Green
 CSC Chairman


SOUTHERN



Members
 Mr John S Wihbey
 Mr Mike Dobson
 Mr John O Stirling ISO
 Lt Col Leslie F Gray
 Mrs Janet Graham
 Mr Christopher Gwyn-Evans
 Mrs Christine Swan
 Mr Brian Drake
 Mr Nick Bagnall
 Mr Roy Elkington

Professor Judith Rees
 CSC Chairman

WALES



Members
 Mr David Patch
 Mr Derek Bryer
 Mrs Penny Brickle
 Mr David Evans
 Mr John Warnau
 Mrs Sheila Fistratt
 Mr Patrick Moriarty
 Mrs Heather March
 Mr Maldwyn Rees
 Mrs Maureen Freeman

The Ven Raymond
 Roberts CB
 CSC Chairman

YORKSHIRE



Members
 Miss Jose Brooks
 Mr Roy Collinge
 Mr John Dawson
 Dr Thomas Morris
 Mr William Newman
 Mrs Rosalind Perry
 Mr Gordon Polley
 Mrs Jean Turner
 Mr Steven Whitehead
 Mr Donald Wilcox

Mrs Diana Scout
 CSC Chairman

SEVERN TRENT



Members
 Mr Tom Rees-Jones
 Mr Derek Davis
 Mr Bernard Zissman
 Mr Philip Heighway
 Mr Gerald Godby
 Mr Clive Falls
 Mrs Mary Milton
 Mrs Barbara Venes
 Dr Neil Richardson
 Mr Martin Hudson
 Mrs Patricia Tomlinson
 Mr Robin Thompson

Mr Clive Wilkinson
 CSC Chairman

- indicated in their Asset Management Plan submissions and other published information;
- (c) investment programme procurement strategy – the approach being adopted by the company to achieve and maintain the much higher levels of investment;
- (d) reports on each service – a series of reports covering specified numerical data on “outputs” i.e. levels of service, investment, and activities such as mains laid. The report should include projections and medium term totals, where appropriate, and the requirement for commentaries for significant variations from the agreed base used for initial “K” setting;
- (e) reports on each key compliance programme – a report on the progress in both physical and financial terms for each of the key compliance programmes on drinking water quality, sewage treatment works consent and bathing waters compliance;
- (f) Levels of Service (Condition J) Appendix – an appendix covering the methodology and procedures being adopted by the company to provide accurate information on each of the eight levels of service indicators prescribed;
- (g) independent certifier’s report and certificate.

3.5 It is considered that the requirements for the annual report are a satisfactory balance between OFWAT’s aim of arm’s length regulation and an assurance that customers’ monies are being effectively and economically managed. Key elements of the OFWAT approach which have been incorporated into the reporting regime are outlined in the following sections.

4.1 The monitoring of company investment programmes has been based on the requirement to be able to compare updated actual and projected expenditure with that assumed in the setting of “K”. The “water only” companies’ investment is subdivided into 19 categories and the water and sewerage companies into 36 categories.

4.2 OFWAT has indicated to the companies that comparisons will be made of both cash flow and medium term totals.

4.3 OFWAT recognises that the proper management of investment programmes requires companies to have flexibility in the allocation of investment resources. It is expected that short run variations would be corrected in the medium term. The annual report system requires companies to identify and explain significant variations from the agreed base.

4.4 It is an important part of the regulatory regime to stimulate companies to seek solutions that minimise overall costs and hence reduce charges to their customers. This will be an important method of identifying the best performers in the industry.

4.5 Moves away from restrictive concepts of “capital” and “operating costs” to that of “total costs” are part of OFWAT’s longer term approach to regulation.

5.1 The Director General has indicated that OFWAT intends to focus on “outputs” provided that the information is accurate, soundly based and has been independently and professionally certified.

Monitoring of investment expenditure

Output and activity performance measures

5.2 The “outputs” are currently divided into four distinct groups; the Condition J Levels of Service Indicators, other performance indicators, Levels of Activity measures, and Asset Condition Indicators.

5.3 Condition J – Levels of Service Indicators: The water industry has, for several years, been providing the Department of the Environment with information on levels of service using common definitions. The eight indicators which have been initially specified in Condition J of the Licence, are itemised below.

- DG1** raw water availability – identifies the number of customers whose water resource availability is below the reference standard.
- DG2** pressure of mains water – identifies the number of customers’ properties that are subject to mains water pressures below the reference standard.
- DG3** interruptions to water supplies – identifies the number of customers’ properties that have experienced a loss of supply for longer than the reference standard without notice from the company.
- DG4** hosepipe restrictions – identifies the number of customers who have been notified of hosepipe restrictions.
- DG5** flooding incidents from sewers – identifies the number of customers’ properties where flooding from public sewers has occurred at a frequency that is greater than the reference standard.
- DG6** response to billing queries – identifies the number and banded response time for meaningful responses to customers’ billing queries.
- DG7** response to written complaints – identifies the number and banded response time for meaningful responses to customers’ written complaints.
- DG8** response to development control consultations – identifies the number and banded response time for responses to development control (planning) consultations.

5.4 For DG2, DG3 and DG5 companies are required to achieve a series of service targets which demonstrate minimum short and medium term improvements in the current positions associated with investment plans and improved management practices.

5.5 Consultation on clarification of the reference standards for DG1, DG2, DG3, and DG5 and the methods for registering incidents on DG2, DG3 and DG5 has been extensive and in some areas it has not been possible to reach a consensus. In these areas the Director General has decided on the appropriate measures and definitions.

5.6 The aim has been to remove ambiguities and create a series of reference standards that can be used to compare company performance realistically. The reference standards are related to, but not synonymous with, a minimum acceptable level of service.

5.7 Other performance indicators: The Condition J Indicators do not cover significant areas of the service related to water quality and environmental quality. The NRA and the Drinking Water Inspectorate (DWI) are the quality regulators of the service and OFWAT is discussing with them appropriate mechanisms for monitoring company performance in these areas. Through the annual report system OFWAT is seeking summary information on performance and projected improvements to supplement the information provided by the quality regulators.

5.8 Levels of activity: The links between levels of service and other performance indicators and investment in underground assets are long term. For this reason OFWAT has requested summary information on company activities in these areas for 1989/90. Typically this would be in the form of, for example, length of water mains of diameter 150mm to 300mm that have been renewed.

5.9 Asset condition indicators: OFWAT has indicated to the industry that in future annual reports it is intending to seek summary information on current and projected asset condition using standard classifications for structural and hydraulic capacity.

6.1 OFWAT will utilise the skills of consulting engineers and other professionals to provide quality assurance on the information submitted by companies under the terms of the licence.

6.2 The independent certifiers are appointed by the company but approved by the Director General and they will have a “duty of care” to him and hence to customers.

6.3 The use of independent certifiers as described in the licence is considered to be appropriate to minimise the direct involvement of OFWAT in the day-to-day management of the companies whilst protecting the interests of customers by promoting cost effective investment and sound operational practices.

6.4 Guidelines on the roles and the approval procedures have been issued to enable independent certification of a company’s annual report.

6.5 In the longer term the division will be integrating annual reports into the development of systems to manage interim determinations and periodic reviews. These tasks can be considered in two elements, namely asset management planning and new obligations.

7.1 Updated asset management plans covering all the regulated company assets, using a common methodology and based on agreed assumptions, is the appropriate system to support periodic reviews. In the short term OFWAT is seeking, through the annual report, details of company progress and proposals to maintain and extend the current asset management plans.

7.2 A major divisional task for 1990-91 is to set out the framework to evolve asset management planning.

8.1 No industry is immune from change, and the water industry is no exception. With all the pressures for rapid environmental improvement, this industry is, in many ways, more prone to new obligations than other industries. The success of the new regulatory regime hinges, in no small part, on how the industry accommodates change. The division will play a key part in the OFWAT approach to this area.

*Independent certification
of companies'
information returns*

*Asset management
planning*

*New
obligations*