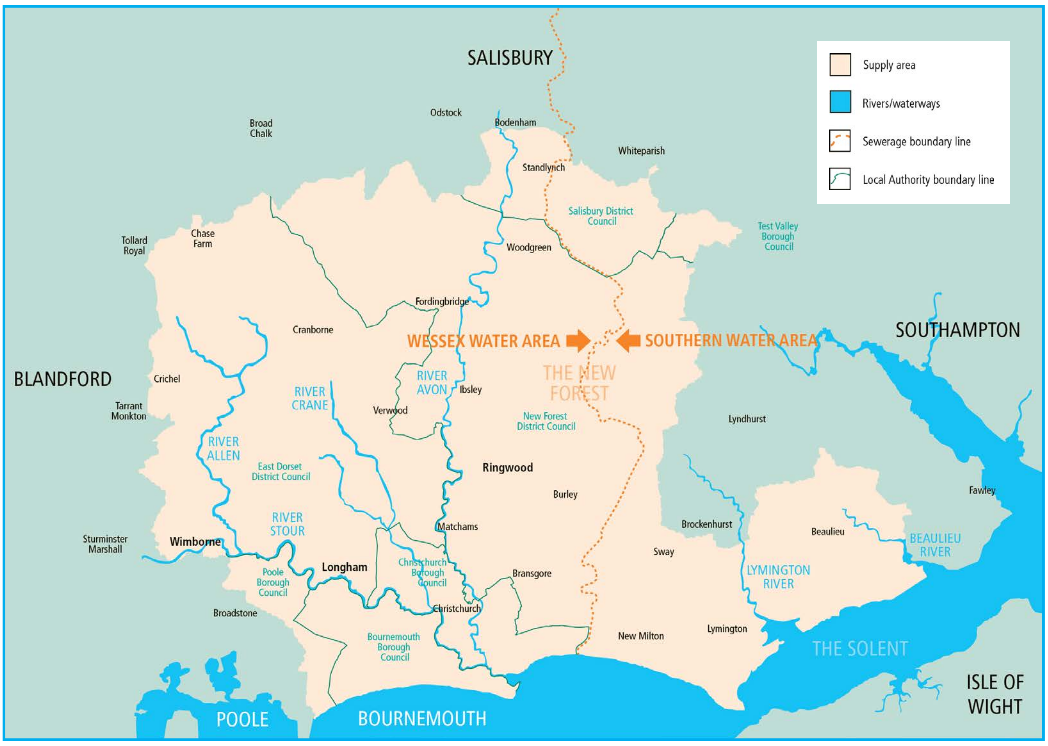
Our business plan summary for 2015-2020

December 2013

sembcorp
bournemouth water

Area of supply



Introduction

Sembcorp Bournemouth Water supplies water to just under half a million people. We have been in existence for 150 years as a local company employing local people to serve the local community consistently and reliably with safe drinking water, and to be responsive when customers contact us.

Our customers tell us that a safe and reliable water supply is their top priority for the service. We have made good progress over recent years in ensuring that the service is reliable and will remain so, well into the future by striking an appropriate balance between managing risks to the service and keeping bills as low as possible. Demand from customers has been slowly but steadily falling for over more than a decade as a result of metering and greater awareness of the need to conserve water.

Our customers also tell us they expect very good service, that we must operate efficiently and in a sustainable manner, and that we should continue to engage with the local community because we are part of it.

Our strategy in the past has been successful in providing a dependable service which 95% of our customers tell us they are happy with both in respect of the water supply and their experience of dealing with us.

This is our plan for the future, focussing especially on the five years from 2015 to 2020, but also considering the longer-term need to continue to provide a reliable and sustainable service at a reasonable price. We plan well ahead to ensure that we take into account longer-term issues such as population growth and the challenge of a changing climate.

A non-technical summary of our plan has been published on our website and hard copies are available on request.

Summary

Context

Sembcorp Bournemouth Water delivers its services efficiently and to high standards, and is one of the best-performing water companies across a range of indicators including:

- **Value for money** – average water bill in 2013/14 is 17% below the industry average
- **Customer service** – ranked equal top using the industry's Service Incentive Mechanism (SIM) over the two-year period 2011/12 to 2012/13; and received the Customer Service Excellence Award for the 13th consecutive year
- **Reliability of service** – number and duration of interruptions is one of the lowest in the industry, with 1% of customers experiencing a loss of supply for more than three hours in 2012/13
- **Costs** – retail and customer debt costs are amongst the lowest in the industry, with bad debt averaging £4.52 per customer per year over the last three years. Wholesale costs are also low.

We will continue to provide a 'best in class' service to our customers. We regard this as particularly important as customers do not have a choice in respect of their water supply. Our commitment is to improve the service and reduce our base costs even further, achieving more at a lower cost, which will benefit our customers.

At the 2009 price review, we made a series of commitments to maintain our network of assets in a serviceable condition overall; to deliver certain enhancements to the assets and service; and to take necessary action to ensure it is safeguarded into the future. The overall performance of our asset base is in a stable state and we are on track to deliver what we have committed to.

Our performance as a whole in the current Asset Management Period (AMP) has been strong, and we have met or exceeded targets across all key indicators.

We are preparing for, and welcome, competition in the non-household retail sector. We hold accurate information about our customers and understand our customer base. This is supported by work carried out by external consultants. Therefore, we do not anticipate the need to spend further time or money improving our customer databases in preparation for a new market, unless specific additional requirements emerge.

Our current position, performance and the economic climate has led to an overall approach to our plan as one of incremental rather than step change, ensuring continuous and measurable improvement across all areas while reducing bills, because we are very conscious of the pressure on customers' income at this time.

Indeed, because of this pressure and the scope we have to reduce bills from 2015/16, we propose to freeze our prices in 2014/15, thereby bringing forward part of the price reduction so that customers get the benefit as soon as possible. Our modelling shows that keeping bills low in 2015-2020 will not result in large rises at PR19.

Key features of the plan

79% of customers surveyed regarded the plan as being acceptable, 14% were neutral. This represents a high level of support.

The plan makes provision for:

	What	How
1	**Prices to fall by about 10% in real terms by 2020**	**A price freeze for 2014/15,** followed by a price reduction of 4.7% in real terms in 2015/16, and further reductions of 0.5% each year thereafter until 2019/20
2	**Meeting our statutory obligations**	Maintaining our assets in **serviceable condition** Delivering the **National Environment Programme** **Maintaining financeability** through prudent management
3	**Improving the service to customers**	**Achieving and maintaining** a Service Incentive Mechanism score of ≥ 90 **Reducing leakage** – by 5% from 21 Ml/d in 2014/15 to 20 Ml/d in 2019/20 **Reducing the risk of supply outage** – to 12,000 customers supplied though a single trunk main **Metering** – the remainder of households, where viable, over 10 years but more efficiently
4	**Reducing costs**	**Improving efficiencies** across the business. Reducing our base operating costs by about 5% or over £1m by 2019/20 when compared with 2013/14, after allowing for real input cost pressures, mainly in the areas of energy and construction **Keeping our retail costs low** – and maintaining our excellent performance relative to others **Reduced returns** – assuming a weighted average cost of capital of 4.5% **Managing customer debt** – and keeping debt levels at their current low level in real terms
5	**Keeping our promises to customers**	**Delivering outcomes** – based on customer engagement and discussion with our challenge group **Publishing our performance** against the schedule of outcomes annually **Imposing financial penalties** on ourselves for non-delivery of two specific service improvements, which customers have said they are prepared to pay for – leakage reduction and outage risk reduction **Sharing with customers** as soon as practicable during AMP6, any material unexpected gains from cost reductions

How we developed the plan

Our plan is set within the context of the long-term nature of our business and the need to ensure that the operation is sustainable. We have developed it in consultation with our customers, the customer challenge group, the Board and our shareholder. These parties have all challenged and endorsed our plan, with a very high proportion of our surveyed customers finding the plan and our interpretation of customers' views acceptable.

We have developed our plan based on:

- Continuing to provide an excellent service
- Customers' priorities and preparedness to pay for service improvements
- Minimising bills to customers as soon as possible
- Extensive work to review the performance of our network of assets and our operations
- Our ability to maintain and improve performance where necessary
- Our statutory obligations
- Reducing our costs
- The demand for water in the future
- New legal obligations, and
- Our aim to reduce our impact on the environment.

In arriving at this plan, we have carefully considered risks to the service, as well as risks related to fulfilling the commitments we have made. Risks to the service are closely monitored and key risks to the delivery of the plan are covered later in this summary.

Central to the planning process has been the extensive customer research undertaken and our engagement with our customer challenge group, known as the Customer Engagement Planning Forum (CEPF). Our research methodology, results, analysis and engagement programme has been thorough and subject to an independent report by the CEPF to Ofwat.

The plan has been developed around a set of outcomes we are committed to delivering. These outcomes are derived from the six key customer priorities identified through our customer research and endorsed by the CEPF. We have developed a series of measures and targets to evaluate our progress towards delivering these outcomes. We have detailed the targets, how we arrived at them, how we will measure our performance against them and what we will do if we do not achieve them. We will track our performance against the proposed outcomes and outputs and report publically on progress.

What our customers have told us

Customers would like to know more about what we do. Our research indicates that customers are very happy with the service and have had little problem with their water supply.

The most frequent 'top of mind' issue is leakage and they expect a rapid response from the company to visible leaks. They are keen to 'do their bit' to save water in the future, but want us to help them achieve it. And the large majority of them feel that everyone should be metered – because it's the fairest way to charge people.

More than 80% of customers find a bill increase at the rate of inflation to be acceptable provided that the current service is maintained. However, 9% of customers would like to see the bill fall slightly even if this means a drop in the level of service.

What they are prepared to pay for

We conducted a willingness to pay study as part of our programme of research and the following emerged:

- Customers are prepared to pay an additional £3.80 for a modest package of service improvements which include reducing leakage and reducing the risk of interruptions to supply.
- There were mixed views on paying for accelerating our metering programme.
- Customers are also prepared to pay a small amount towards the cost of environmental improvements – 80% willing to pay 25p on additional spend of £100,000, dropping to 60% on spend of £25,000.
- We found very mixed views about the preparedness to support social tariffs, with a significant proportion (29%) of customers simply not willing to subsidise these.

Their key priorities and what we will deliver

We grouped what customers told us into six key themes, which we then put before them to both validate the groupings and to identify their order of priority. The themes and how we interpret them in the context of what we will deliver are as follows:

	Customer wishes in order of priority	How we interpret these and what we will deliver
1	**A safe and wholesome supply of water**	Meet at least the minimum standards required by law Provide water which customers find acceptable in terms of taste, colour and odour Ensure that customers are not affected by significant events which lead to any temporary deterioration in the quality of the water
2	**A reliable supply that will not run out in the future**	Water supply 24/7 Occasional interruptions are acceptable provided that they are of short duration Ensure that we will have sufficient water in the long term Reduce water consumption by helping customers to save water Ensure that we do not waste water, by managing leakage Continue our metering programme Maintain our assets in a stable condition Ensure adequate pressure of the supply A quality-assured approach to all operations
3	**An excellent customer experience**	Best possible customer service and SIM score Choice in how to interact with us Fix visible leaks promptly
4	**Environmentally sustainable operations**	Be efficient in our water operations Protect the local environment Minimise our carbon footprint Reduce energy use, and work to a recognised standard for managing our carbon footprint Maintain and improve the ecology of our own sites and those we affect Cause no serious pollution events

	Customer wishes in order of priority	How we interpret these and what we will deliver
5	**A financially sustainable business**	Earn a fair profit and return for the shareholder Ensure customers who can pay their bills do so, and that we manage debt so as not to place an undue burden on those who do pay Customers have mixed views about the desirability of social tariffs so immediate implementation does not form part of our plan Maintain a strong investment grade credit rating
6	**Engage well with our community and customers**	Do the right thing and demonstrate that we put customers at the heart of what we do and that their interests are being looked after Contribute to the local community Be a good employer Govern the company well and transparently Stakeholders must see this to be the case Find out how well customers believe we do this so that we can respond with appropriate changes Better information to customers about the service, the industry and in particular who we are and what we stand for (Much of what is encompassed here relates to improving the way we communicate with and inform our customers of what we do)

Price limits and household bills

We have followed two main principles in determining price limits for customers:

- Prices must be as low as possible, as soon as possible, and must not rise by more than inflation in any year.
- Future price changes must be consistent and easy to understand.

In following these principles, we have sought to reduce prices in real terms every year and to bring the reductions forward as fast as we can.

The plan based on price limits being set from April 2015 leads to the following 'K' adjustments to revenue requirements:

Year	2015/16	2016/17	2017/18	2018/19	2019/20
K factor	Minus 7.5%	Minus 0.5%	Minus 0.5%	Minus 0.5%	Minus 0.5%

However, we want to give customers the benefit of paying less as soon as possible, so we propose to freeze prices for 2014/15 thereby bringing forward the impact. This leads to the following profile of 'K' factors:

Year	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
K factor	Minus 3.2%	Minus 4.7%	Minus 0.5%	Minus 0.5%	Minus 0.5%	Minus 0.5%

Ideally, we would prefer to freeze all tariffs for 2014/15 at 2013/14 levels, but accept that we must satisfy ourselves that doing so would not breach the terms of our licence.

This translates to an average household bill in 2012/13 prices of:

Year	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Average household bill (rounded to whole £)	153	149	142	141	139	137	136

What is driving a change in household bills (in 2012/13 prices)

Approximate figures and rounded		**£ per year**
Average household bill in 2013/14		153
Reductions	Adjustments from the 2009 price review including revenue correction, the capital investment incentive and operating cost efficiencies	-3
	Future efficiencies	-6
	Ensuring that present and future customers each pay a fair proportion of costs (pay as you go ratio)	-7
	Reduced shareholder return on investment	-6
Increases	New legal obligations	4
	Investment for improved services and growth	1
Average household bill in 2019/20		136

Revenue

The proposed service and associated costs of delivery lead to the following turnover requirements:

Year	**2012/13 (actual)**	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Turnover (in 2012/13 prices)	£43.1m	£43.1m*	£42.5m	£40.5m	£40.3m	£40.1m	£39.9m	£39.7m

* It is a coincidence that these numbers are the same

The above turnover figures include a 0.4% upward adjustment in respect of our SIM performance to reflect our relative position as reported by Ofwat in Information Notice IN13/11.

What delivering our plan will cost

Our plan proposes the following operating costs (£000s in 12/13 prices):

Cost savings fully offset new obligations

	AMP5 Period		AMP5 Period				
Real costs, £million	**13/14**	**14/15**	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**
Base costs net of falling demand	19.9	19.8	19.8	19.8	19.7	19.7	19.7
Loss of major customer			-0.3	-0.3	-0.3	-0.3	-0.3
Efficiency savings in our base day-to-day operational costs	-0.3	-0.4	-0.7	-0.9	-1.1	-1.1	-1.2
Real cost increases, mainly as a result of forecast upward pressure on energy and construction prices	1.1	1.5	1.9	2.1	2.2	2.3	2.3
Cost of delivering current obligations	**20.7**	**20.9**	**20.7**	**20.7**	**20.5**	**20.6**	**20.5**
New obligations	0.3	0.4	0.9	1.1	1.2	1.1	1.1
Service improvements and growth that customers have expressed a willingness to pay for		0.1	0.2	0.2	0.2	0.2	0.3
Total	**21.0**	**21.4**	**21.8**	**22.0**	**21.9**	**21.9**	**21.9**

Real price impacts and resultant upward cost pressures are forecast to be significant, mainly in respect of the price of energy, plant and materials. However, during the AMP6 period we will offset these as far as possible through operating cost efficiencies.

The plan includes the following capital investment costs (£000s in 12/13 prices):

Investment over 15 years is increasing

	AMP5	AMP6	AMP7
Maintenance of assets	41,596	43,136	43,744
Quality and security	1,793	200	0
Supply demand	8,775	9,936	9,678
Improved service, which customers are prepared to pay for	909	1,280	2,000
Total (gross of contributions)	**53,073**	**54,552**	**55,422**
Grants and contributions	3,986	4,480	4,132
Total (net of grants and contributions)	**49,087**	**50,072**	**51,290**

Our underground network of water mains and services performs well in comparison to others, and provides a service that customers are generally happy with. We forecast that in the longer term we will need to increase investment in our underground network. However, we do not need to substantially increase this during the AMP6 period and have included only a modest increase which will enable us to meet our customers' wish of not increasing bills in real terms, while ensuring that we begin to address longer-term needs. The proposed rate of investment in both above and below ground assets will enable us to meet our statutory obligations.

We have reviewed the DEFRA Statement of Obligations published in October 2012 and are satisfied that we will meet the obligations set out therein.

How we will deliver the plan

We will deliver our plan through innovation, a process of continuous improvement, and increasing efficiencies.

Innovation and continuous improvement

We need to continue to find ways to get better at what we do and at the same time reduce our costs, and have set ourselves challenging cost and service targets. Although benefits will arise from normal business management initiatives and challenging our own unit costs, we will identify new ways of operating our business without undue risk to the service.

The following is a list of our key planned initiatives:

Innovation and customer benefit	How we will achieve this
Implementing a customer relationship management system new to the UK water industry which will provide: • Seamless interaction with the company for customers, especially when carrying out follow-up operational work. End-to-end managed processes • Greater choice for customers in interacting with us and managing their account • Choice to multi-site customers as to how they are billed	• Putting in place a leading-edge billing and customer relationship management system by December 2014 • Providing a full on-line account management facility • Developing a smartphone 'App' for transactions
Introducing software new to the UK and the water industry, together with the use of renewables, to achieve: • Reduced energy use – 8% reduction by 2020 • Reduced carbon footprint, and • Reduced cost to customers	• Using sophisticated and newly-developed software to analyse energy consumption using operations data in order to identify opportunities for optimisation. Currently in implementation phase for use in following years. Guarantee of benefits from supplier
Introducing 'Network calming' to achieve: • A reduced number of burst water mains and impact on customers • Reduced costs	• Using 'big data analysis', a technique involving the analysis of large sets of operational data, to help identify opportunities to further reduce any negative impacts of our routine and emergency operations on the network

<table>
<tr><th>Innovation and customer benefit</th><th>How we will achieve this</th></tr>
<tr><td>Introducing a new method for field response with single-man units to achieve:
Faster and more effective response to technical or operational issues for customers</td><td>Changing the existing process and putting in place trained operational customer response technicians who will provide fast response and rapid resolution of customer needs</td></tr>
<tr><td>Systematically putting in place ‘sleeping meters’ to record customers’ water usage so that:
Customers currently charged by reference to a rateable value will be provided with their actual water usage information so that they can make an informed choice as to how they wish to be billed – which they have told us is important.
The cost of metering is reduced by around 8%</td><td>By metering properties more systematically, while maintaining the current rate of metering</td></tr>
<tr><td>Working collaboratively with a neighbouring water provider to improve resilience of the water distribution network to achieve:
Improved security of supply
Significant cost savings as this is a very cost-effective solution</td><td>Having jointly identified an opportunity to achieve benefits to the customers of both companies by linking our respective infrastructure, we will be able to connect two large treated water distribution zones allowing us to share treated water between them in times of operational difficulty.</td></tr>
</table>

Wholesale and retail efficiency

Wholesale

Published data on costs and activity show our operating costs as being amongst the most efficient in the industry, and our capital maintenance costs towards the lower end of the range. We forecast some significant real input cost increases over the coming years, largely related to energy and construction prices (energy prices are forecast to increase by 49% and construction-related prices by 7% between March 2013 and March 2020 in real terms). However, we have set ourselves a target to further reduce the base costs of our existing operations by an average of approximately 0.8% a year by 2020 from their 2013/14 forecast base, and so absorb most of the real input cost inflation. We have based this on advice received about likely cost pressures, together with our own detailed assessment of the scope for real efficiencies in the future.

Retail business

Our retail costs are low with an unmetered average cost to serve in 2012/13 of £16.74, including the cost of customer debt, amongst the lowest in the industry. We face some upward cost pressure in this area and despite having already reduced costs further and faster than others, we will manage costs to keep increases below inflation.

We know our customers well in terms of having good data about their location and connections to our network. We are in the process of replacing our billing and customer relationship management systems and this will help us to provide an even better service in the future. The replacement system will be better able to deal with the needs of customers with multiple connections or multiple sites. It will also help us to ensure seamless end-to-end business processes, and will provide more choice and channels for customers to communicate with us and pay their bills.

We are committed to providing excellent service and we support the SIM being retained through the AMP6 period. We are aware that Ofwat is consulting on possible changes to the framework and we will comment on this shortly. On the infrequent occasions when our service falls short of levels assured by the Guaranteed Standards Scheme (GSS) or our own additional standards (in our Customer Charter), we compensate customers accordingly. We will continue to do this for non-household customers until the opening of a new retail market planned for 2017, after which we will further tailor our guarantees to emerging needs. We are concerned that very small businesses might subsequently fail to benefit from either the protection afforded by the current GSS or competitive market pressures. We will therefore continue to apply to very small businesses – those using up to 750 cubic metres a year – at least the standards required by the GSS and other promises we make to household customers.

For the retail service to household customers, we face no greater business risk in the future than in the past. Therefore, we have not included a margin on top of the cost to serve. For the retail service to non-household customers, we propose a net margin on sales of 2.5% to be used to set default tariffs. However, this is aimed at addressing only any increased risk faced by the non-household competitive retail arm of the business. We have included some costs of contributing to the management of the programme for implementing a market as will be enabled by the Water Bill currently in Parliament and via licence fees collected by Ofwat or any other agreed mechanism, as well as what we estimate to be our contribution towards the market set-up costs indicated in Ofwat's letter to companies dated 28 October 2013. These costs have been included in our wholesale costs.

Tariffs

We do not propose to make any significant changes to the structure of our household tariffs. The transactional component of retail costs will form the fixed element of the household bill and our calculations show that this should not cause any undue shift from current practice.

For non-household customers, we have reviewed our current approach to large users and simplified the structure of tariffs proposed for the future. We do not want to cause any undue incidence effects with changes to the way tariffs are set and our approach to charging. For non-household customers, the transactional part of the retail costs will form the fixed element of the bill with other volume-related costs being added to the wholesale volumetric charge.

We propose that the wholesale part of the total tariff will be a volumetric charge.

Financing the plan

We are satisfied that our plan is financeable. We have existing debt that is largely index-linked, long-term borrowing repayable in 2033, the indexation being added to the capital sum. This instrument was put in place in 2005/6 at a real cost of 3.08% per annum. The costs of refinancing this would far outweigh any benefits. The investment plan proposed for the AMP6 and AMP7 periods can be funded from cash flows from turnover and it is forecast that gearing (as measured by Ofwat) will remain between 60% and 70% during the period. We do not anticipate the need to raise any material amount of money during the AMP6 period.

How stakeholders can be confident that we will deliver our plan

While we have a good track record of delivering to our commitments in the past, we have developed a series of outcomes and associated outputs for which we have set ourselves targets. Some of these relate to meeting statutory obligations such as maintaining our assets and providing safe drinking water. The two measures listed in the table below carry a self-imposed financial penalty, and are in addition to the national comparative measures put in place to incentivise performance in respect of customer service and leakage. These measures relate to two service areas where customers expressed a willingness to pay for improvements to the current service.

We will regularly publish our performance against these indicators.

Area of service	Measure	Proposal for a one-sided penalty for under-performance
Total leakage management	Reduce from our current target of approx. 21 Ml/d in the AMP5 period, to 20 Ml/d by March 2020	For each 0.1 Ml/d that is not achieved we will return up to £94,000 to customers in the AMP7 period through price limits set in 2019.
Minimising interruptions	Construct and commission by March 2020 a new trunk main to reduce risk to 12,000 properties	If this is not completed, we will return up to £1.8m to customers in the AMP7 period through price limits set in 2019.

Key risks to delivery of the plan

There are risks to delivery, some of which are normal business risks. In addition, we have statutory duties in respect of the base service and maintaining our assets in a stable condition, as well as in respect of drinking water quality and environmental obligations. Key risks to delivery include:

Risk	Comment	Impact on customers
Major service failure	We operate two large treatment works where the combined output serves on average about 80% of our customers. A major problem potentially involving alternative supplies (e.g. tankers/bottled water) to customers served by one of these plants would place a very significant burden of cost and management resources on the company. The management of this risk must remain high on the Board's agenda.	Our plans allow for dealing with this and although the cost could be very substantial for the company, we conclude that it would not prevent us dealing with and resolving any event nor would it jeopardise the business in terms of financeability.
Reliance on a large industrial water supply	One large customer provides more than 10% of our regulated turnover. Should this customer's need for water cease, there would be a substantial effect on the company.	A determination of prices which does not include the turnover from this large customer would have a material and adverse impact on customer bills, as would loss of the customer for a period.
Water resources capacity and drought	Robust analysis of the supply-demand balance looking 25 years ahead. Comfortable headroom forecast. Demand falling and expected to continue to do so until about 2030. No forecast sustainability issues at this time.	There is a small risk that customers may face temporary use bans more frequently than planned.
Service improvements	We have set ourselves a financial penalty for non-delivery of two specific service improvements. SIM performance represents a risk but we have a good track record of delivering customer service improvements.	The worst outcome is considered to be that service levels will not improve but the current high level of service will not deteriorate.

Risk	Comment	Impact on customers
Capex costs	The large majority of the investment needed is to maintain the assets. Our experience over the last 20 years and our understanding of the assets enables us to be reasonably confident in our forecasts in real price terms. We will bear the risk of real construction cost increases above those assumed in the plan.	Little – maintaining the asset base in a serviceable condition is a requirement of our licence.
Customer debt	Although a challenge, paying customers expect us to do whatever we can to avoid them subsidising the debts of others. There is an asymmetric risk here which we will bear.	Paying customers will have a positive view if the company is successful in minimising any future cross subsidy. We believe the risk to the company is acceptable.
Operating costs being materially more than forecast	There will always be a risk of costs exceeding those assumed in the plan	No impact on customers unless a substantial change of circumstance occurs.
Costs of market opening	There is considerable uncertainty about the costs of developing, implementing and operating a market for non-household retail customers. We have included a central estimate of these costs provided by Ofwat but expect any variance from this to be addressed through logging up or down at the 2019 price review.	

We have considered and reviewed a number of possible scenarios that could impact on customers or our ability to deliver the plan.

Board involvement in the planning

The Board has dedicated an appropriate amount of time to understand where the company will be at the end of the AMP5 period in March 2015 and what issues it faces in both the medium and longer term.

The Board welcomes the much stronger focus on customers and the need to fully understand how they perceive the service, as well as what their preferences are for the future, and for the company to identify the outcomes that are important to customers. Customer challenge group members have met with Board members over the last two years and the Board has received regular information regarding the process put in place for this group to challenge the company to engage well with its customers, listen to their views with an open mind and ensure that they have been addressed in the business plan.

The Board has overseen and challenged the development of this plan; how it can be reconciled with current and targeted future performance, both in respect of meeting statutory obligations, and ambitions for the service; and the associated costs and self-imposed targets for operating more effectively in the future and for delivering certain elements of the plan.

The Board recognises that there is more work to be done in raising awareness of the company and the industry with customers and in helping them to achieve a common aim – saving water in the future, as well as demonstrating to them openly and transparently that the company does a good job and can be trusted to earn a fair return.

This plan is put forward by the Board, and the directors of the company are satisfied that they have been provided with sufficient information so as to be able to approve this plan as being one that: is based on reasonable assumptions; will enable the company to continue to meet its obligations; and will provide service enhancements that customers have said that they want, at an overall price that customers are willing to pay.

A full explanation of the involvement of the Board in the development of this plan and description of the governance arrangements in place, together with a statement by the Board is provided in the Board assurance statement on the following pages.

Board assurance statement

Summary

The Board develops strategy and steers and directs its implementation. The Board has been involved in the developing approach to, and methodology for the 2014 price review for many months, having sought expert third party advice on how the periodic review was to be approached.

In particular, the Board welcomes the much stronger focus on customers in terms of how they perceive the service, their preferences for the future, and the optimal outcomes in the next regulatory period. The Board recognises that more work is needed to build on the work already done to foster a climate of greater understanding and transparency with appropriate commitments to deliver promised services, and sharing of benefits from any unexpected gains, should these arise. The Board is satisfied that this plan is based on reasonable assumptions which will enable the company to continue to meet its obligations and provide service enhancements for customers at prices that most customers are willing to pay.

The company established a customer challenge group following guidance issued by Ofwat, appropriately constituted for the company's circumstances. Its members have met with the Executive Directors over the last two years and its Chairman has met the Board on a number of occasions. The Board has therefore received regular feedback on the group's views to ensure that these have been addressed in the business plan. The Board has overseen and challenged the development of this plan and how it can be reconciled with current and targeted future performance in respect of both statutory obligations and proposed service improvements.

Specific actions taken

Leadership and strategy

The Board comprises directors with a broad range of skills and experience, whose aim it is to ensure that customers remain the focus of the business and are appropriately protected through the right balance of innovative thinking and management of risks, while recognising shareholder needs. The Board understands the monopoly nature of the business, its obligations under the terms of the Water Industry Act and its Licence, and the need for real legitimacy with customers. In particular, the developing strategy for the future has been considered over many months in the context of feedback from customers and other stakeholders in deciding the way ahead, which must be affordable for customers.

In preparing this plan, the Board has been advised of and has discussed and challenged at least the following areas:

- Ofwat's consultations on setting price limits
- The Water Bill with proposals for a non-household competitive market
- The company's developing water resources management plan
- Performance in AMP5
- The establishment and composition of the customer challenge group
- The approach to engagement with customers, research methodologies, feedback from customers, and feedback from the challenge group
- Shareholder requirements and balancing these with those of customers and other stakeholders
- Outcome-based setting of objectives
- Outcome delivery and setting appropriate incentives to achieve these
- The need for a strong evidence base to support the plan
- Proposals for wholesale and retail price setting
- Potential for adjustments based on FD09, e.g. SIM, revenue correction and capital incentive scheme
- Proposed service level improvements, both through challenging the team to continually improve, and based on customers' wishes and willingness to pay
- Impact of totex and pay as you go ratios
- Forecasts of operating and capital investment costs, innovation and efficiency
- The financial impact of modelled scenarios
- Assurance processes and confidence in the plan

Current performance and delivery of AMP5 obligations and objectives

In arriving at this plan the Board has carefully considered the company's current performance and how it is progressing in delivering its AMP5 obligations and objectives. As part of the process in place to assure the Board, the company has continued to use the services of an independent engineering expert in the role of a 'Reporter', with terms of reference very similar to those which applied when the independent expert also had a duty of care to Ofwat. The following are the key means by which the Board is made aware of performance:

Aspect of performance	How reported	Assurance
AMP5 delivery obligations and objectives	A 'Monitoring Plan' is in place for reporting progress against key outputs and objectives in the AMP5 period. Progress has been regularly reported to the Board.	The 'Reporter' reviews an annual return as part of the company's processes for assurance of reported performance. The data and systems used for monitoring AMP delivery progress are closely linked.
Annual Return	The company chose to continue to compile what, until 2010, formed the June Return, with commentary by managers for detailed tracking of service performance.	The data and commentary are reviewed by the independent 'Reporter', who reports in person each year to the Audit Committee of the Board.
KPIs published in Annual Report	These form part of the company's Annual Report, but are intentionally reported in a manner and style aimed at the lay reader.	The 'Reporter' and Auditor review this report and present their findings and any concerns to the Audit Committee.
Monthly internal reporting	Monthly management reports include a range of key performance indicators designed to highlight any areas of potential concern including information on service performance and the capital investment programme. There is a structured system of internal audit.	The core data used for reporting service performance is the same data used to report annually and as such is reviewed by the 'Reporter' on an ongoing cyclical audit basis.

Aspect of performance	How reported	Assurance
Risk management	All managers review risk on an ongoing basis. The Senior Management Team reviews risk and reports progress against any agreed actions at least twice a year to the Audit Committee. The Board periodically reviews key operational risks and the actions in place to mitigate and manage them and the Board challenges the executive on its management of risks.	Key individual managers in the company have direct access to the Audit Committee. These cover at least the areas of: • Risk management and safety • Compliance with standards • Whistleblowing policy • Internal audit • Systems of financial control
Comparative performance	Key aspects of performance relative to other water companies are reported as and when available and if material.	This mostly uses published information.
Standards	The company operates to a number of externally accredited and audited published standards (e.g. ISO 9000, 14000, 18000, Investors in People and the Government's Customer Service Excellence Award)	These help to ensure consistency and repeatability of operations, and to assure the Board that the company is doing what it says.
Costs	The Board sets annual budgets for operating and capital investment costs.	Forecasts and outturn are reviewed periodically against FD assumptions and executives challenged to explain variances.

Aspect of performance	How reported	Assurance
Incentives for employees	The Remuneration Committee determines and recommends to the Board remuneration and incentives for executive directors and key senior managers. The Board determines appropriate incentive arrangements for the company's staff that align reward to delivery of service to customers while meeting target financial performance.	The Board ensures that remuneration at all levels is linked to service performance.

Assurance

The following mechanisms, together with other processes in place, allow the Board to be reasonably satisfied that the activities needed to ensure the meeting of statutory obligations in the future have been appropriately identified and are included in the plan. In addition, it is satisfied that engagement with customers has ensured that their views about the service and their preferences for the future have been understood and taken into account in compiling the plan. The mechanisms in place to satisfy the Board as to the robustness of the plan have included:

Component	Brief description of activity	How this is considered appropriately robust
Customer views and preferences	Customer challenge group, appropriately constituted to include other stakeholders based on Ofwat's guidance. Customer challenge group reviewed and challenged research proposals, feedback received from customers, and the company's interpretation of it. During its work, the group probed the company's investment proposals, costs and general objectives for the service. The challenge group report has been seen by the Board. Research material has been reviewed by Dr Scott Reid of ICS Consulting, a leading expert, who has also 'peer reviewed' willingness to pay studies.	Professional market research organisation advised as to appropriate research methodology and gave its professional opinion on feedback. The combined impact of the challenge group, which involved other key sector regulators, a professional market research firm, and a third party industry expert gives assurance that customer views have been genuinely sought and honestly reflected in the planning.
Service performance and delivery of AMP5 outputs in AMP5	See previous above	A multi-strand performance-monitor to forecast outcome of the AMP5 period

Component	Brief description of activity	How this is considered appropriately robust
Assessment of capital maintenance needs in the future	Company experts' assessment of needs, supported where necessary by the use of external experts, with appropriate third party review by the 'Reporter'	Third party expert review of investment needs in maintenance of the infrastructure Supported by EA and DWI commentary through the customer challenge group that based on the plan, the company should be able to meet its statutory obligations
Financial forecasts	Use of third party constructed model (also used by three other water companies) quality assured by the provider, Frontier Economics, and tested against Ofwat's model	An appropriate process to assure the Board about the integrity of forecasts of input activity and costs, turnover requirements and proposed price limits
Assurance of data in submitted tables	'Reporter' and Auditor review of data in tables	The 'Reporter' and Auditor have detailed knowledge of the company, together with appropriate knowledge and experience to assure the Board that reasonable assumptions have been made and that data is of sufficient accuracy for the purpose.
Reflection of legacy FD09 adjustments in forecasts	'Reporter' has reviewed the calculations (SIM, RCM, capital incentive scheme, opex efficiency adjustments)	Expert third party review, considered to appropriately support the plan
Service improvements	The Board has over a period of time challenged the management in respect of the service customers want and expect, how it can be improved at little or no extra cost, and how the plan will meet those expectations.	The processes involved have given the Board a really good understanding, that even though the company provides good service by current industry standards, expectations are increasing and there are lessons to be learned from leaders in other sectors.
Need for specific changes to the level of service provided i.e. reducing leakage and risk of supply interruptions	Requirements developed from the customer research process	High level of satisfaction but some concerns to reduce leakage and the impact of distribution network failures. The Board is very aware of the sensitivity of leakage and repair times with customers.

Component	Brief description of activity	How this is considered appropriately robust
Outcomes	The executive team has developed a series of customer-based outcomes.	The Board has been provided with regular updates on emerging thinking over many months, and is satisfied that these appropriately reflect customers' views.
Outcome delivery incentives	'Reporter' has reviewed the company's interpretation of the required logic and reasonability of proposals	Expert third party review of interpretation. The Board is satisfied that the company has identified appropriate areas to apply financial incentives to deliver what it promises.
Future efficiencies – general	Professional advice from economist John Earwaker on the scope for future efficiencies	Helped the Board to challenge its executive team in respect of ensuring that projected costs are no higher than they need to be. This has included challenge of individual components of costs.
Future efficiencies – customer debt	Review of performance and Board challenge in respect of the cost of customer debt and the Board's desire to maintain at current levels	The Board is conscious that a significant portion of the customer base does not wish to cross subsidise those who do not pay and places great store in keeping this as low as possible.
Risk	The Board regularly reviews potential risks to delivery of the plan to ensure provision for sufficient resources to meet statutory obligations. The Board regularly challenges the management to demonstrate that risks are appropriately controlled.	Allows the Board to understand the risks faced by the company and measures in place to mitigate them where necessary
Returns to investors	Review of the cost of embedded debt and the options available, together with expert advice on the appropriate weighted average cost of capital	The work carried out by an expert advisor (Oxera) and has been specific to the company and its circumstances. The independent directors have discussed in an open manner and challenged the shareholder in respect of target returns on equity.

The Board has received advice directly from third party experts in respect of the developing regulatory approach and methodology so that its members have been able to fully understand what is expected of the company.

The Board is acutely aware of the current climate and pressure on customers in respect of the cost of living. The plan represents a challenge to the company in controlling costs while maintaining the serviceability of the assets, continually improving the service to customers, as well as making some limited specific service improvements where customers have expressed a desire and willingness to pay for them. The Board is satisfied that the plan represents a reasonable balance between the interests of customers, the shareholder, and other stakeholders.

The plan is based on data, forecasts and estimates of costs that have been arrived at independently of other water companies or competitors. The company has made limited specific use of sharing resources in two areas:

- Financial modelling – for reasons of controlling costs, a group of four water-only companies have employed a common resource, Frontier Economics, to construct a financial model. The Board is confident that no data has been shared with other companies.
- Advice on the cost of capital – again for reasons of controlling costs, a group of four smaller water-only companies have jointly commissioned an expert, Oxera, to advise. No discussions have taken place between this company and any of the others, other than those necessary to jointly appoint the advisor.

Governance

The Board is fully aware of the need for transparency and good governance and its obligations in this respect, in particular the requirements under the conditions of the licence to act and report the affairs of its Appointed Business as if its sole business is a water undertaker having its equity share capital listed on the London Stock Exchange.

The Board is committed to applying the principles of leadership, transparency and governance as published by Ofwat in draft form in October 2013. A draft code setting out how the company will meet the principles proposed by Ofwat will be provided by the end of December 2013.

The Board aims to comply fully with the UK Corporate Governance Code and will explain any areas where this is not possible or appropriate, although it is expected that the need in the future for such explanation will be very limited.

Statement

The Board is satisfied that this business plan proposing price limits for the period April 2015 to March 2020 is based on sound data and information regarding the company's current performance, and that assessments of the resources and activity needed for the company to meet its statutory obligations in the future, in addition to other proposals made in respect of the service, have been appropriately identified and quantified.

The directors are satisfied that they have been provided with sufficient information to fully understand the company's current and projected performance, customers' views about the service, what they want for the future and what they are prepared to pay for this, and that the business plan reasonably reflects those views.

The Board considers that in preparing this plan:

- Appropriate methodologies have been used which have been supported by reasonable judgement and estimates where necessary
- The data used and its accuracy has been reasonable for the purpose
- There are sufficient systems of internal control in place to enable the company to meet its obligations in respect of the provision of information to the regulator
- There is adequate provision for the resources necessary to enable the company to meet its statutory obligations, and
- The risks faced by the company in delivering this plan are adequately understood and managed.

Jim McGown

Independent Chairman

Peter Millward

Independent Director & Chair Audit Committee

Angela Lane

Independent Director & Chair Remuneration Committee

Tan Cheng Guan

Non-executive Director and shareholder representative

Dr Paul Gavens

Non-executive Director

Roger Harrington

Executive Managing Director

Peter Bridgewater

Executive Finance Director

November 2013

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