

SUTTON AND EAST SURREY WATER PLC

**Periodic Review 2009
FINAL BUSINESS PLAN**

(April 2009)

Part A

PUBLIC DOMAIN SUBMISSION

Ofwat
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A0 EXECUTIVE SUMMARY

A0.1 Key Aim

Our key aim is to achieve the best balance of outputs, investment and prices that will:

- Meet customers' overwhelming requirements for adequate, reliable supplies of high quality water;
- Provide greater resilience to help withstand the challenges of climate change, and reduce our impact on the environment;
- Provide customers with a high level of service that represents fair and reasonable value for money;
- Enable us to carry out our operations in an environmentally friendly and sustainable way; and
- Let us make adequate returns to enable us to finance our functions.

We will deliver all this at realistic and fair price increases (once unavoidable increases in power and chemical costs are removed) averaging 3.6% pa.

A0.2 Background

We provide an essential, life supporting, service to the people living in our area of supply. This has been brought sharply into focus following our experience in the last four years during which the south east of England suffered two years of severe drought followed by a summer of flooding. Both of these situations showed the vulnerability of our resources and assets to extreme events. In a world where climate change is threatening more frequent, more extreme events, we consider it essential to improve the resilience of our assets. In a modern society the water supply system must not fail.

Our Business Plan has been developed from the research and stakeholder consultations that informed our Strategic Direction Statement (SDS) published in December 2007. The SDS, our 25 year vision for the Company, is by necessity a high level conceptual document. Since completing the SDS we have prepared and submitted a Draft, and Final Draft, Water Resources Management Plan (WRMP), and have formally responded to stakeholders representations on the Draft Plan. We are now awaiting direction from DEFRA. In August 2008, we published our Draft Business Plan (DBP) which presented in detail our proposals for the first five years of the 25 strategy outlined in the SDS, incorporating the water resources strategy set out in the WRMP. Since submission of the DBP we have carried out extensive consultations with domestic and commercial customers to understand their views of our Draft Business Plan (DBP) proposals. This consultation also tested our proposed plan in comparison with possible alternative strategies. Our customer consultation, the SDS, and the WRMP, form fundamental building blocks for this Final Business Plan.

Our Plan sets out the outputs we propose in order to achieve the key aims described above. It also recognises that we are governed by statute and regulation which require us to meet certain standards and levels of service.

Everything we have learned since our SDS was published, confirms that the issues and strategies identified in our SDS and DBP were the right ones for the Company.

A0.3 Strategic Objectives

Our strategic objectives, built around customer research and consultations with stakeholders, can be summarised as follows:

- to continue to maintain an adequate, uninterrupted supply of water to our customers;
- to overcome a deficit in resources to meet peak demands;
- to continue to maintain the supply of the highest quality water to our customers and achieve 100% compliance with water quality standards;
- to improve the resilience of the Company to the various challenges it faces;
- to continue to maintain very high levels of service to our customers;
- to carry out our operations in an environmentally friendly and sustainable way; and
- to maintain an appropriate level of return to our shareholders.

Implicit in achieving the above are that we have to:

- maintain our asset base;
- manage our water resources with a view to the future;
- meet our obligations;
- ensure our charges represent reasonable value for money;
- minimise our burden on the environment;
- continue to innovate and make the most effective use of modern technologies;
- meet new challenges and obligations;
- be efficient;
- maintain an appropriate level of security at all of our sites;
- be a good and progressive employer; and
- maintain our credit ratings.

A0.4 Key issues

The key issues that arise from our selected outputs and strategic objectives at this price review are:

- security of supply;
- renewal and maintenance of existing assets;
- large increases in specific uncontrollable operating costs;
- the cost of capital necessary to raise new debt and equity;
- the programme for metering customers;
- the sharing of risks and uncertainties between customers' and shareholders;
- competition;
- the need to continue to operate efficiently; and
- the need to maintain high standards of service.

A0.4.1 Security of supply

This is of overwhelming importance to us and our customers. The Water Resources Management Plan indicates a deficit in resources to meet critical period (peak week) demands. We have considered a range of supply side and demand side options (a twin track approach) and have adopted a balanced solution. The least cost option is to extend Bough Beech water treatment works, and improve the associated distribution network, at a cost of £49m, of which £23m is included in base expenditure. The licence variation required to enable the project to proceed has already been granted by the Environment Agency. The proposed project will provide risk free water, enhance service levels and improve resilience in the event of drought and emergencies. On the demand side, we propose to increase meter penetration, maintain leakage at its current low level, and meet water efficiency targets agreed with Ofwat.

A0.4.2 Renewal and maintenance of existing assets

We will maintain our assets to deliver stable levels of customer serviceability. The proper level of investment to maintain our asset base is fundamental to providing a reliable supply of high quality water. Our modelling shows that the proper level of investment for the AMP5 period is similar to the level of expenditure in the current period.

A0.4.3 Large increases in specific uncontrollable operating costs

Operating costs are currently rising significantly above the rate of inflation (as measured through the RPI). Most of these are due to items over which we have little or no control, for example: power costs, rates, traffic management, and abstraction charges. The final determination needs to put in place mechanisms that ensure we can recover costs outside our control that rise above those allowed in the price determination.

A0.4.4 The cost of capital necessary to raise new debt and equity

Our plan requires significant new tranches of debt and equity capital. To attract the necessary investment, the cost of capital needs to be set at an appropriate level, particularly in the current uncertain economic and credit climate.

A0.4.5 The level of metering

Customers, the Secretary of State for the Environment, and the Environment Agency, accept that the fairest way of charging is on the basis of water consumed. We support those views and have included a balanced, cost beneficial metering programme which should help ensure that further resource development is not required for twenty years after the completion of the Bough Beech scheme. The proposed level of metering has been set to minimise the impact on bills in the AMP5 period whilst recognising the importance of metering in suppressing demand. The programme in the AMP5 period is similar to that in the AMP4 period, and relies on metering on change of occupancy and free meter optants. It is a non-aggressive policy that will give time for the outcome of Anna Walker's review of charging and metering to be considered.

A0.4.6 The sharing of risks and uncertainties

Although large increases in costs are inevitable and will have to be met through increases in prices, it is possible that the actual increases incurred will be materially different from the best estimates allowed in the price determination. Material disallowed costs will cause investment to be cut, and unexpected lower costs will produce excess returns. Neither of these outcomes is desirable, particularly as they would not be corrected until the 2015-2020 price review. The way to avoid these undesirable outcomes is to designate all large and uncertain costs, obligations etc, as Notified Items.

A0.4.7 Competition

The Company believes that the introduction of competition will not benefit all its customers, and in particular, it is likely that large industrial and commercial users will benefit at the expense of domestic customers in the early stages of creating a competitive market.

We believe that the current system of regulation, comparative competition and capital market competition has delivered significant improvements for customers and society. The case for greater competition should include a realistic assessment of the costs of introducing competition and a recognition that the benefits that competition could bring can also be achieved (at less cost and much less risk) through development of the existing regulatory regime.

A0.4.8 Efficiency

Our undertaking to customers will be that we will carry out our functions as efficiently as possible, looking to introduce innovation where appropriate, to keep price rises fair and reasonable.

A0.4.9 Service to customers

We provide a very high level of service to our customers and believe that they are very satisfied with our performance. There is no demand for significant improvements or additions. Therefore, we have selected outputs for this plan that, apart from the security of supply which is our customers' clear priority, deliver current service levels plus a few minor changes to levels of service that are cost beneficial and for which customers are prepared to pay.

A0.5 Prices

A total price increase of 27.6% is needed for the five-year period 2010-15. The main reasons for the increase are outlined in the following table:

Base service	4.9%
Operating cost efficiency adjustment	0.4%
Increases in the costs of power and chemicals	9.5%
Other increase in base operating costs – rates, abstraction etc	5.8%
National Environmental Programme	0.5%
Security and resilience	1.2%
Flooding protection	1.1%
Bough Beech	4.2%
Total	<u>27.6%</u>

The following table gives the K factors for each of the five years. The reason for the 15.8% increase in the first year of the period, 2010-11 is because the majority of the cost increases and particularly power and rates impact immediately in that year.

2010-11	2011-12	2012-13	2013-14	2014-15
15.8	4.7	3.9	2.7	0.5

EXECUTIVE SUMMARY

Summary Table

Table A0 - Sutton & East Surrey Water - Explanation of the company's plan to deliver now and in the future**OVERALL STRATEGY FOR 2010-2015 PERIOD AND BEYOND****Introduction**

Sutton & East Surrey Water, together with its predecessors, has provided an essential service to the people living or working in its area of supply for 150 years.

Our strategic objectives, built around extensive customer research and consultations with stakeholders, can be summarised as follows:

- to maintain an adequate, uninterrupted supply of water to our customers;
- to overcome a deficit in resources to meet peak demands;
- to maintain the supply of the highest quality water to our customers and to achieve 100% compliance with water quality standards;
- to improve the resilience of the Company to the various challenges it faces;
- to maintain very high levels of service to our customers;
- to carry out our operations in an environmentally friendly and sustainable way; and
- to maintain an appropriate level of return to our shareholders.

Implicit in achieving the above are that we have to:

- maintain our asset base;
- comply with all relevant legislation and similar obligations;
- manage our water resources with a view to the future;
- ensure our charges represent reasonable value for money;
- minimise our burden on the environment;
- continue to innovate and make the most effective use of modern technologies;
- meet new challenges and obligations;
- be efficient;
- maintain an appropriate level of security at all of our sites;
- be a good and progressive employer; and
- maintain our credit ratings.

Key Issues

It is our key aim at this price review to achieve the best balance of outputs, investment and fair prices that will meet customers' aspirations for their water supply as well as enabling the Company to invest appropriately in existing and future assets whilst making an adequate return to satisfy its investors.

The key issues that arise from our selected outputs and strategic objectives, at this price review are:

- Security of supply and addressing a shortfall in resources to meet demand at critical periods;
- Renewal and maintenance of existing assets;
- The need to improve resilience of the Company to meet immediate challenges and prepare for longer-term ones;
- The need to continue to operate efficiently;
- The need to maintain high standards of service;
- Large increases in specific uncontrollable operating costs;
- The cost of capital necessary to raise new debt and equity; and
- Sharing of risks and uncertainties between customers' and shareholders.

Prices

A total price increase of 27.6% is needed for the five-year period 2010-15. The reasons for the increase are outlined in the following table:

Base service – including metering	4.9%
Operating cost efficiency adjustment	0.4%
Increases in the costs of power and chemicals	9.5%
Increases in other operating costs – rates, abstraction etc	5.8%
National Environment Programme	0.5%
Security and resilience	1.2%
Flooding protection	1.1%
Bough Beech – additional water	4.2%
Total	27.6%

If the costs of power and chemicals, which are outside the Company's control, are removed, prices increase at 3.6% per annum.

QUALITY AND SERVICE IMPROVEMENTS IN 2010-2015 PERIOD AND IN THE LONGER TERM**General improvements**

We will invest heavily in a twin track approach to solve a deficit in resources to meet peak demand. This involves extensive investment in Bough Beech water treatment works and the associated distribution network. We will also continue to invest in a metering programme to ensure that it is set at a level that is cost beneficial and affordable.

Water quality improvements

We have included projects to address emergency planning requirements issued by Defra and a programme agreed with the Drinking Water Inspectorate (DWI) to enable us to deal with the reduction of the lead standard to 10ug/l in 2013.

We have also included a proposal agreed with the DWI to further investigate the impact of the pesticide loading level on Bough Beech. The proposed 'catchment management' approach will include discussions with farmers and other end users, as well as extensive operational monitoring. We are also investing to improve the security and resilience of our assets.

Service Improvements

We have continued to deliver a high standard of service to our customers, and our research confirms that the vast majority of our customers are pleased with this performance. We will continue to deliver a high standard of service and will aim to improve this where there is no cost to customers. Our customers have also confirmed that they support our proposed investment programme of work over the next five years.

We have included a project associated with the implementation of the Ofwat framework 'Asset resilience to flood hazards' which requires investment at three water treatment works sites. This will meet with the recommendations of the Pitt Review following the floods of Summer 2007.

WHAT IS DRIVING THE CHANGES IN BILLS? (2007-08 PRICES)

		Water	Sewerage
Average household bill in 2009-10		154	
Less	(1) past efficiency savings and outperformance	1	
	(2) maintaining base services	24	
	of which		
	a) changes in revenue	0	
	b) changes in operating costs to maintain current services to consumers	25	
Plus	c) changes in costs of maintaining assets	2	
	d) changes in impact of taxation	0	
	e) the change in the cost of capital and financeability	-3	
	(3) maintaining and enhancing security of supplies to all customers		14
	(4) the impact of improvements in services		4
	of which		
	a) drinking water quality and security	2	
	b) environmental improvements	1	
	c) Improvements in service levels	1	
Less	(5) scope for reduction through future efficiency improvements		-1
Average household bill in 2014-15		196	

PRICE LIMITS AND EFFECT ON AVERAGE BILLS (2007-08 PRICES)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Proposed price limit						
W Indicative price limit (water service)	-1.1	15.8	4.7	3.9	2.7	0.5
1 Average measured household bill	138	147	153	158	162	162
2 Average unmeasured household bill	158	190	199	208	214	215
3 Average household bill	154	178	186	192	196	196
S Indicative price limit (sewerage service)						
1 Average measured household bill						
2 Average unmeasured household bill						
3 Average household bill						

ESTIMATE OF EXPENDITURE NEEDS (2007-08 PRICES)

		Annual average for the 2010-2015 period (£/property/annum)	
		Water	Sewerage
1	Operating costs to maintain current services to consumers	111	
2	Operating costs to improve services to consumers and protect the environment	4	
3	Cost of maintaining assets to deliver current services to consumers	54	
4	Cost of improving assets to deliver improvements for the environment and consumers	31	
		Pre tax cost of debt and post tax cost of equity basis (Vanilla)	Fully post-tax basis
5	Assumed cost of capital (%)	6.10	5.45

A1 The Company Strategy

A1.1 Introduction

A1.1.1 Our plan

This document is the Business Plan for Sutton and East Surrey Water (SESW) for the years from 2010 to 2015. This Plan has been developed over the last year based on full consultation with customers, the Consumer Council for Water, Natural England, the Environment Agency, the Drinking Water Inspectorate (DWI), and Ofwat (stakeholders). We have paid a lot of attention to the valuable feedback these processes have given us and have taken account of them within the Plan, together with guidance received from Government.

A1.1.2 The Company

Sutton and East Surrey Water provides an essential service to the people living in its area of supply. We have around 270,000 customers and serve a population of approximately 650,000 people. Around 250,000 of these are domestic customers and the remainder commercial. Our area of supply is around 322 square miles (833 sq kms) extending from Morden in the North to Gatwick airport in the South and from Cobham, Leatherhead and Dorking in the west to Edenbridge in the east. Groundwater (boreholes and springs) provides 85 per cent of our raw water with the remainder coming from the River Eden in Kent via our Bough Beech storage reservoir.

Our area is bisected by the North Downs and Greensand ridge, and the M25, all of which run approximately east/west. North of this line is chalk downland which, as you move further north, becomes highly urbanised and densely populated. This area includes part of the London Boroughs of Croydon, Merton and Sutton. To the south the area is Weald clay and characterised as largely rural with a few larger urban settlements such as Leatherhead, Dorking, Reigate Redhill and Horley. Our largest customer is Gatwick Airport which consumes about 1.7% of our output. Gatwick is about 10 times the size of our next largest customer.

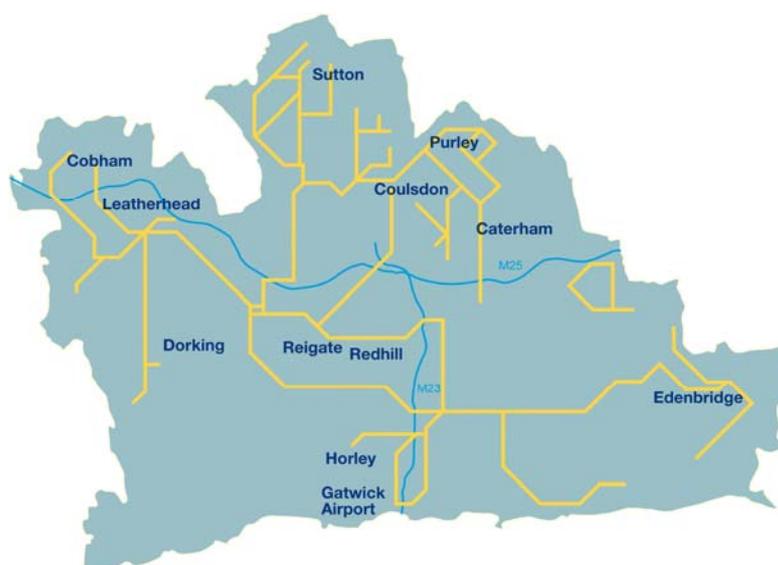


Figure A1-1 - Area of supply

South-East England is designated by Defra as being an area of serious water stress. Demand for water is high with our customers having on average one of the highest consumption rates in the industry. Natural recharge of our resources is relatively low with less rainfall per head of population than some of the driest places in the world.

A1.1.3 Our customers

We have a relatively affluent customer base, and the Acorn rating of the properties in our area is significantly above the average for the country. There are however pockets of poverty, and a small but growing number of immigrants.

All our consumer research shows that we have consistently high levels of customer satisfaction and are considered to offer good value for money.

A1.1.4 Our strategic objectives

Our strategic objectives can be summarised as follows:

- **to continue to maintain an adequate, uninterrupted supply of water to our customers;**
- **to overcome a deficit in resources to meet peak demands;**
- **to continue to maintain the supply of the highest quality water to our customers and achieve 100% compliance with water quality standards;**
- **to improve the resilience of the Company to the various challenges it faces;**
- **to continue to maintain very high levels of service to our customers;**
- **to carry out our operations in an environmentally friendly and sustainable way; and**
- **to maintain an appropriate level of return to our shareholders.**

Implicit in achieving the above are that we have to:

- maintain our asset base;
- comply with all relevant legislation and similar obligations;
- manage our water resources with a view to the future;
- ensure our charges represent reasonable value for money;
- minimise our burden on the environment;
- continue to innovate and make the most effective use of modern technologies;
- meet new challenges and obligations;
- be efficient;
- maintain an appropriate level of security at all of our sites;
- be a good and progressive employer; and
- maintain our credit ratings.

This strategy is in accordance with the expectations of our customers whose clear priorities are that we provide them with a water supply that is of good quality and reliable.

Essentially our Plan can be summarised as:

Business as usual plus improved security of supply.

A1.1.5 The immediate challenges

We face a number of immediate challenges which need to be addressed in the next five years. These are described below.

A1.1.5.1 Water resources to meet peak demands

We have a deficit in resources to meet peak demands which we have planned to overcome by increasing the treatment capacity at our Bough Beech water treatment works together with associated improvements and reinforcements in the distribution system. The proposed works will provide a number of added benefits, in particular increased resilience of the supply network.

A1.1.5.2 Metaldehyde

The molluscicide (pesticide) Metaldehyde has been detected in the water leaving our Bough Beech treatment works. This is not an issue solely for Sutton and East Surrey Water and we propose to work with the water industry, the Drinking Water Inspectorate, manufacturers and farmers to determine the best way to tackle the problem. This may well require a catchment management approach, working closely with farmers to minimise the amount of the chemical that reaches the water courses supplying our reservoir.

A1.1.5.3 Financing of the business

The current financial situation is making it very difficult to raise capital. It will be important that the cost of capital and financial ratios are set so that we are able to finance our proposed capital programme.

A1.1.5.4 Giving customers fair value for money

Our proposals will require our water bill to increase above inflation. Customer feedback tells us that our plan is affordable. Nevertheless, we have made great efforts to try and to ensure that our plan offers fair value for money, that proposed schemes are cost beneficial, and that our customers are willing to pay for any proposed improvements.

A1.2 Development of our Business Plan

A1.2.1 Background

A1.2.1.1 Introduction

Currently we are meeting the strategic objectives set out in our Company Monitoring Plan (April 2005) and fulfilling our obligations, despite extremes of weather experienced in the last few years. However, things have changed and will continue to change, and it is important that we recognise this and react accordingly. Two recent events illustrate the sort of climatic variations our assets and systems will have to deal with in the coming decades.

A1.2.1.2 Summer of 2006

From November 2004 to July 2006 (inclusive) there was an exceptional shortage of rainfall – a relatively rare event (in the order of 1 in 75 years). As a consequence, in the spring of 2006, our resources (in particular our groundwater sources) were at very low levels. In order to protect supplies for essential use we applied to the Secretary of State for a Non-Essential Use Ban. The application had the support of the vast majority of our customers, CCWater, the Environment Agency and DEFRA. The Non-Essential Use Ban was granted and put in place in May 2006. It expired in November 2006.

The consequences of applying the ban, in conjunction with a high profile publicity campaign, were that peak and average demands reduced dramatically. Peak demands were up to 36% lower and average demand was 11% lower than an equivalent dry year. Customers responded well to requests to use water wisely, and recognised that we had managed our resources well.

By imposing restrictions, and by prudent management of our resources, we managed to keep all of our customers supplied with sufficient quantities of high quality water for essential purposes, without interruption, despite the exceptional conditions. We recognise however that had there been a third dry winter there may well have been a need to impose rota cuts or the use of standpipes. We therefore considered it very important to see if we could reduce the risk of restrictions to customers during future drought events, and have made that one of the priorities of our plan. This is all the more important as the perceived wisdom is that one of the effects of climate change is that similar events will become more frequent.

A1.2.1.3 Summer of 2007

During the summer of 2007 we experienced unusually high levels of rainfall. Similar rainfall patterns were experienced across much of England and Wales leading to flooding and operational difficulties for a number of water companies. Some customers in Severn Trent suffered loss of supply for a significant period of time. We were fortunate compared to many, but still suffered operational supply problems at one of our works for a short period. Climate change experts predict that we can expect similar major events on a more frequent basis as the world's climate continues to change.

A1.2.1.4 Consequences

We performed well in the events set out above, but in order to meet our customers' expectations, we propose to make the investment necessary to ensure that in all but the most exceptional conditions:

- our sources can be relied upon to give an adequate and reliable yield;
- our treatment works are robust enough to treat the raw water supplied without interruption; and
- our mains network is in a condition to deliver safely the treated water to our customers.

Our customers do not want to experience a loss of supply for any significant period of time. They want to turn on the tap and receive a reliable supply of high quality drinking water.

A1.2.2 Plan development

Our Plan has been developed over the last year, with these recent experiences in mind, taking account of the immediate challenges facing the Company. The process started with the Strategic Direction Statement (SDS) which is our 25 year vision for the Company and a review of our PR2004 Business Plan. There followed a period of consultations with customers and stakeholders which has informed our Draft Water Resources Management Plan (published May 2008) and our Draft Business Plan (published August 2008). The latest versions of all of these documents are available on our website www.waterplc.com, as were the current versions during the consultation periods. A further period of stakeholder consultation and regulatory feedback on these documents has helped us formulate this Final Business Plan.

The statutory water resources planning period has been running concurrently with development of the Business Plan. Comments on the Draft Water Resources Management Plan were received from Defra in August 2008. A "Statement of Response" to representations made by stakeholders on our Draft Water Resources Management Plan was submitted to Defra in February 2009 together with a draft Final Water Resources Management Plan.

Throughout these processes, we have taken care to ensure that customers, the Consumer Council for Water, Natural England, the Environment Agency, and the DWI, have been fully consulted on all these documents. We have paid close attention to the valuable feedback these processes have given us and have taken account of them within this Plan, together with guidance received from Government.

This plan has been extensively discussed by the Board and has their full support because it delivers the best balance of outputs, investment and reasonable prices.

A1.2.3 The right balance for customers - activities and choice of programme

A1.2.3.1 General

In developing our Business Plan we have used the processes described by Ofwat in "Setting Price Limits for 2010-15: Framework and approach", and have followed the

PR2009 Reporting Requirements, together with additional guidance. We have taken note of feedback from Ofwat in its report on the Capital Incentive Scheme, and on our Draft Business Plan.

When selecting the balance of activities in this plan we have taken into account the views of our customers, and other stakeholders, and our legal and regulatory obligations to provide a reliable supply of good quality water and to maintain our assets. Our plan will enable us to finance our functions and make reasonable returns for shareholders.

A1.2.3.2 Customers' views

Customers' views are one of the main drivers that have shaped our Plan and the most difficult one to gauge is their attitudes and perceptions. To understand our customers' views better we have engaged with them extensively during our comprehensive market research and have taken account of the joint-industry research carried out on behalf of Ofwat, Defra, the Welsh Assembly Government, CCWater, the Environment Agency, the DWI, Natural England, and Water UK.

We have listened and learnt from our customers throughout the industry consultation process, our market research and our on-going customer reasearch. We have found that the vast majority of customers are very satisfied with the service we provide and take our service for granted as long as they continue to receive good quality water, and we respond to enquiries and any supply problems in an efficient and effective manner.

A1.2.3.3 Joint-industry research

Initial industry wide research, conducted in the summer of 2008, concluded that:

- the attitude of customers is “one of non-reflective trust and reliance. They assume that the drinking water is safe”; and
- “customers want an efficient, safe, reliable supply of water at reasonable cost now and in the future and everything else is of markedly less importance”.

In January 2009, further joint-industry research was published. This comprehensive research concentrated upon the acceptability of the Draft Business Plans and researched the views of each company's customers to the Draft Business Plans that would affect them.

Overall the results confirmed the findings of earlier industry research. With reference to the Water Industry, the key findings in respect of consumers' views and needs were:

- The most important services delivered by the industry were to provide safe, reliable clean drinking water and the removal and treatment of waste water;
- That reducing greenhouse gas emissions and tackling climate change were only considered important by a tenth of customers; and
- Two thirds of customers thought that current services were good value for money.

In regards to Sutton and East Surrey Water, the research showed that:

- 86% of customers were satisfied with the service we provided and only 4% were fairly dissatisfied;
- 78% of our customers do not find it difficult to pay on time. None of our customers found they needed to delay payments as long as possible;
- Only 27% of customers thought that our plan offered poor value for money; and
- 58% of customers would be concerned if our proposals to ensure a reliable supply would be delayed.

This research confirmed that the large majority of customers broadly supported our Draft Business Plan, found it value for money and affordable.

A1.2.3.4 Company research

We have extensively researched customer's attitudes during the preparation of our plans. This is discussed in detail in sections B1.5.2 and C1. We provide a very high level of service to our customers and our market research shows that they are satisfied with our performance and that there is no demand for significant improvements over and above the service levels which we already provide. However, our market research has indicated they are willing to pay for some specific service level improvements.

Qualitative research - focus groups

The main findings of our qualitative research (focus groups) were:

- SESW is highly regarded as a company that provides a high quality service to its customers and good value for money.
- Customers' overwhelming requirement is for an adequate supply of good quality water.
- Customers were resigned to hosepipe bans but could not understand why drought orders or standpipes should ever be needed in modern day society.
- Most respondents simply accepted that interruptions to their water supply happened, but advance warnings of these would be much appreciated by customers.
- Water metering was embraced as a sensible way to pay for water and compulsory water metering was considered acceptable.
- Respondents considered climate change and water discoloration to be a low priority for investment.

Business customer research

Research amongst our business customers confirmed:

- We are generally held in high esteem.
- We met their core service need of providing them with a continuous supply of quality drinking water.
- The main priorities for investment are the conservation of water supplies through pipe maintenance, reduced leakage, water metering, and promotion of water efficiency measures.

- If the situation ever got to the stage where standpipes were required it should only be a ‘measure of last resort’.

Willingness-to-Pay research

A Willingness to Pay (WtP) survey was undertaken to enable us to prioritise which improvements, customers value most. We used this data to carry out a cost benefit exercise to help determine the appropriate level of investment for the AMP5 period. This research was based on customers being given two options of service improvements comprising various elements and were asked to decide how much they would value each element (Option 2 offered higher service levels). The results are summarised in Figure A1-2 below.

Overall the average WtP value, suitably adjusted for packaging effects, for our residential customers, is £18 per year. Surprisingly our customers think water efficiency has the greatest value (between £3/pa and £5/pa) followed by supply improvements and leakage.

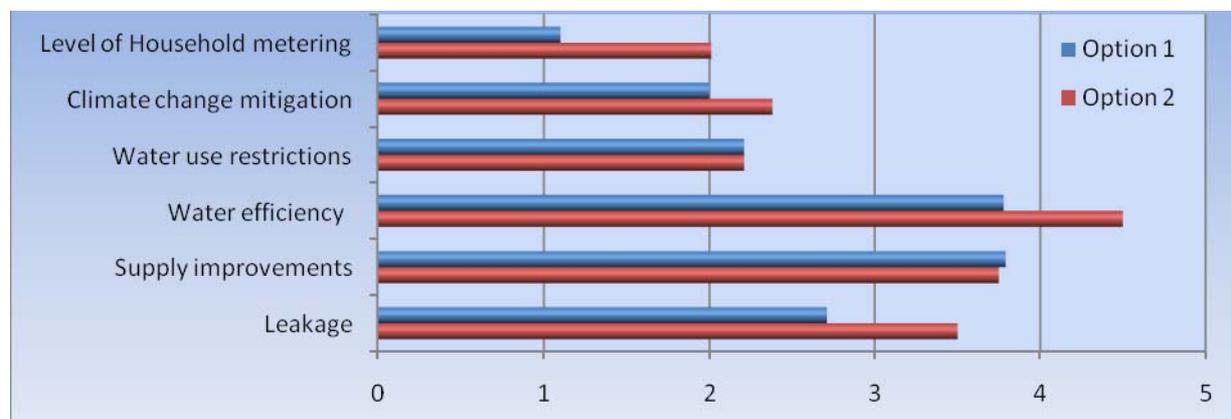


Figure A1-2 – Monetary Values (£/pa) identified by the WtP survey

Draft Business Plan research

We undertook further research to establish the level of customer support for the proposals in our DBP. In addition we wanted to explore in more detail customers’ acceptance of proposed solutions to our peak resource deficit. The format of this research was agreed with Ofwat. The findings can be summarised as:

- 90% of respondents are satisfied with the service they receive; and
- Over two thirds (70%) say they receive either ‘fairly good’ or ‘very good’ value for money for the current level of service.

All respondents were asked their reactions to each of SESW’s eight suggested improvements to the service levels, shown in Figure A1-3 below. Each improvement was shown alongside the bill impact per household on an annual basis. There was strong support for all of the proposed improvements in the DBP with between 67% and 88% supporting each of the eight improvements.

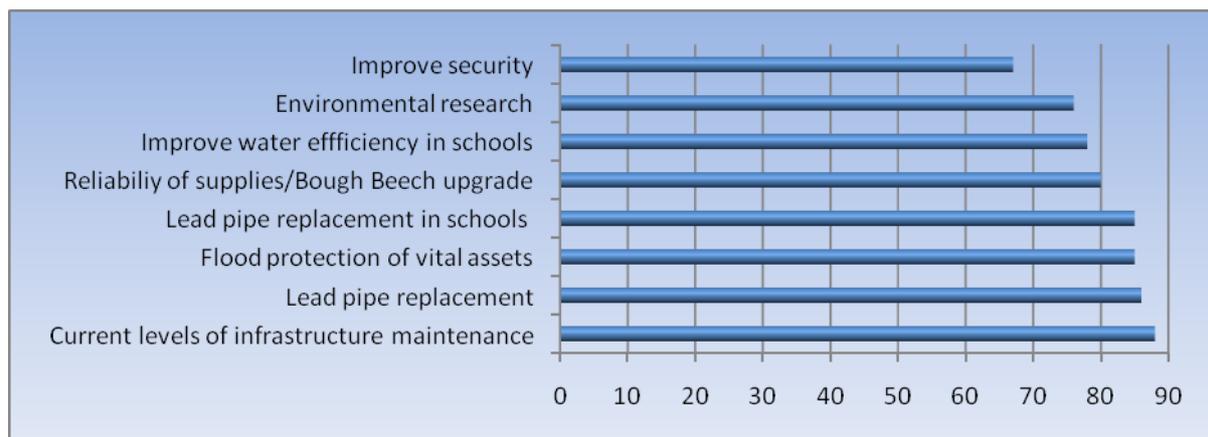


Figure A1-3 – % of customers in favour of proposed improvement

The main reasons for not supporting the planned improvements, albeit on a very small base, was that:

- We ‘should fund the improvements out of company profits’; followed by
- ‘the problem does not affect us’ and an ‘unwillingness to pay any more’.

Overall 79% of customers felt a proposed real price increase for the investment package represented adequate or good value for money.

We were interested in customers views on various solutions for overcoming the peak resource deficit. Each option had a combination of upgrading Bough Beech water treatment works to enable more water to be treated and supplied, a metering programme and, in one case, an enhanced leakage reduction programme. Each option was presented outlining their respective advantages and disadvantages.

In terms of the proposed Bough Beech upgrade solutions, the option proposed in the DBP emerges as the most preferred option, although there is statistically little to choose between the first three proposed solutions which all include upgrading Bough Beech. Having considered all the improvements and the impact of their preferred Bough Beech solution, in terms of the annual bill impact, 63% of respondents said that the improvements were ‘appropriate’ or ‘very appropriate’ to customer needs.

The conclusions are:

- that customers strongly supported our Draft Business Plan proposals.
- the proposed price increases are affordable by the majority of customers.

A1.2.4 Summary

To summarise, our 2009 Business Plan has been developed taking the following into consideration:

- A review of our 2004 Business Plan and Company Monitoring Plan (April 2005);
- Our Strategic Direction Statement (published November 2007) – our 25 year vision for the Company;

PR2009 Final Business Plan

- Extensive customer consultation, both National and that commissioned by the Company;
- The immediate challenges for the Company;
- Recent events including serious drought and flooding events;
- Feedback from customers', stakeholders and regulators, on our Strategic Direction Statement, our Draft Water Resources Management Plan, and our Draft Business Plan.

A1.3 Programme and costs

A1.3.1 Outline programme

Our programme has been developed as outlined above, to meet the strategic objectives set out in A1.1.4 and, to achieve the right balance for customers. The essential elements of our programme are summarised below.

Strategic Objective	Business Plan Programme
Maintain an adequate, continuous supply of water to our customers	Continue current levels of asset performance. Extend Bough Beech water treatment works and associated distribution network.
Overcome a deficit in resources to meet peak demands	Extend Bough Beech water treatment works and associated distribution network. Continue current metering programme. Implement targeted water efficiency programme.
Maintain the supply of the highest quality water to our customers and continue to aim to achieve 100% compliance with water quality standards	Maintain networks to ensure high quality water is deliverable. Manage any pesticide issues that arise. Meet the new standard for lead levels and target those most of risk from lead exposure.
Improve resilience	Improve flood protection and security at our sites. Maintain assets so that failures are minimised. Extend Bough Beech water treatment works and associated mains network so that it can supply extended areas in emergencies.
Maintain very high levels of service to our customers	Continually monitor performance and seek improvements where appropriate.
Carry out our operations in an environmentally friendly and sustainable way	Meet industry wide targets for green energy. Implement targeted water efficiency programme. Continue current metering programme.
Maintain an appropriate level of return to our shareholders.	Ofwat determine the appropriate cost of capital. Manage our business efficiently and effectively.

Our Business Plan proposes an integrated, cost effective strategy where a capital project could enable us to achieve several objectives. For example, upgrading and refurbishing Bough Beech water treatment works, and the associated mains network, will overcome the deficit in resources to meet peak demands, will assist us in maintaining an adequate, continuous supply of water to our customers, and will improve the resilience of our network.

A1.3.2 Total capital expenditure

Adequate capital expenditure is crucial to the achievement of our strategic objectives. The following table summarises the capital expenditure requirement for 2010-2015, and compares it to capital expenditure in the current period and the previous forecast.

Capital expenditure at 2007/08 prices	Final Business Plan 2010-15 £m*	Draft Business Plan 2010-15 £m*	Current Period 2005-10 £m
The renewal and maintenance of existing infrastructure assets	27.9	33.0	31.5
The renewal and maintenance of existing non-infrastructure assets	45.6	44.2	43.7
New investment in relation to new or enhanced supplies to satisfy the increasing demand for water	41.7	55.4	21.1
New investment to meet water quality standards and to meet environmental and security guidelines	3.6	4.1	0.9
New investment to meet customers demand for enhanced service	1.9	1.5	0.0
Total	120.7	138.2	97.2

* Before efficiency adjustments

These costs include all projects required to meet our strategic objectives. They have been critically reviewed following Ofwat's feedback on our Draft Business Plan and comments in their Capital Incentive Scheme (CIS) report.

The detail of these programmes is discussed in Section B of the Final Business Plan. Expenditure on renewal and maintenance of existing assets is broadly unchanged from the current period. The large increase in total expenditure arises from the Bough Beech project. Large projects we have included are:

- Bough Beech extension of the treatment works and increasing capacity of the distribution mains - £49m (divided between maintenance and additional water supply).
- Metering programme of 32,000 meters - £9m (additional water supplies).
- Flood protection - £1.9m (enhanced service).
- Security measures - £2.8m (quality)

The biggest changes between the Draft Business Plan and Final Business Plan are:

- Removal of the rehabilitation programme for iron from infrastructure maintenance.
- Reducing our metering programme from 62,000 to around 32,000 meters. This is part of our supply/demand programme.

A1.3.3 Total operating expenditure

The following table summarises our anticipated increases in operating costs (discussed in more detail in Sections B of the Final Business Plan) from 2007-08.

£k*	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15
Base operating costs to maintain services.	24,368	25,780	27,743	29,063	30,489	31,533	32,452	32,751
Cost increases resulting from new quality requirements.			57	77	102	102	102	49
Enhanced service for environmental studies.				262	262	263	263	263
Growth in demand		-49	486	619	641	660	717	741
Costs of additional meters			73	105	136	171	205	223
Total operating costs	24,368	25,731	28,359	30,126	31,630	32,729	33,739	34,027

* before efficiency

The large increase in base operating costs arises principally from the actual and predicted rise in electricity costs and chemicals. Electricity costs are currently significantly higher than allowed in the current price determination and are predicted to increase substantially over the plan period. The costs of rates, abstraction charges, traffic management, competition and bad debts are expected to rise substantially during the planning period. We recommend that many of these should be Notified Items at this price review.

Additional costs arise from:

- Water quality costs from additional monitoring of water supplies and catchment management.
- We are required to conduct environmental studies into endangered habitats as part of the National Environment Programme.
- The additional demand for water.
- The management of an increasing number of water meters.

A1.4 Prices

The impact on prices in the five-year period 2010-15 is summarised below. 57% of the total price increase of 27.6% is required in the first year, 2010-11, of the next five-year period. It is followed by a table which gives a breakdown of annual increases for the five-year period 2010-15.

Base service including metering	4.9%
Operating cost efficiency adjustment	0.4%
Increases in the costs of power and chemicals	9.5%
Other increase in base operating costs – rates, abstraction etc	5.8%
National Environmental Programme	0.5%
Security and resilience	1.2%
Flooding protection	1.1%
Bough Beech - balancing supply and demand	4.2%
Total	27.6%

Although the estimates are based on the best information currently available, there is considerable uncertainty about what the actual out turn costs will be. It is also the case that the differences between the current best estimates and outturn costs could be material. In order to deal with this uncertainty, and the amounts potentially involved, the Company proposes that these items should be included in the list of Notified Items.

The following table gives a more detailed analysis of reasons for the price rise that is required during the five-year period 2010-15. The up-front timing of the increases is driven by when cost increases arise (ie the majority arise in 2010-11).

	10/11	11/12	12/13	13/14	14/15	Total
Base service including metering	5.4	0.6		0.2	-1.3	4.9
Operating cost efficiency adjustment	0.4					0.4
Increases in the costs of power and chemicals	6.7	1.4	0.3	0.4	0.7	9.5
Other increase in base operating costs – rates, abstraction etc	2.7	1.0	1.3	1.0	-0.2	5.8
National Environmental Programme	0.5					0.5
Security and resilience		0.1	0.4	0.5	0.2	1.2
Flooding protection		0.1	0.5	0.5		1.1
Bough Beech - balancing supply and demand	0.1	1.5	1.4	0.1	1.1	4.2
Total	15.8	4.7	3.9	2.7	0.5	27.6

These price increases ignore the potential impact on charges arising from the current Competition Commission inquiry into our Special Adverse Effects claim.

These increases are 2.6% above those discussed in our Draft Business Plan due to the following factors:

Draft Business Plan K factor	25.0%
Additional operating costs (rates, abstraction etc)	4.3%
Increase cost of capital from 6.0% to 6.1%	0.4%
Reduction in capital expenditure	-1.8%
Reduction in infrastructure charge	-0.6%
Other	0.3%
Final Business Plan K factor	27.6%

A1.5 Delivery of the Plan

A1.5.1 Delivering existing service levels.

To meet the strategic objectives discussed above we have to ensure that we maintain our basic levels of service. Knowing that they are secure, we can confidently build upon them to deliver the programmes necessary to achieve proposed enhanced service levels.

Our aim is to maintain our existing assets in a condition that delivers “stable” levels of serviceability to customers. For example, we aim to keep the performance of the mains network, in terms of both asset performance (burst mains), and service performance (properties suffering supply interruptions as a result of burst mains), at the current level.

A1.5.2 The renewal and maintenance of existing assets

A1.5.2.1 General

Over 60% of the capital expenditure programme for 2010-15 relates to the maintenance of existing assets. The condition of these assets is critical to achieving a reliable supply of good quality water to our customers – which is their overwhelming requirement.

For the FBP we have built on previous work. We have utilised a forward looking, risk based methodology that is fully compliant with the Capital Maintenance Planning Common Framework. The outputs of the process are robust, and consistent with our Asset Management Strategy document. The Company applies best practice in the management of its assets.

A1.5.2.2 Infrastructure assets £27.9m, (2005-10 = £31.5m)

Currently 49% of our mains network is over 79 years old, with an average age of 67 years. It is imperative that we can make the appropriate level of investment in these assets in order to maintain current levels of serviceability.

The maintenance of a mains network is necessary for two reasons. Firstly, mains in poor structural condition are more susceptible to bursts, causing interruption of supplies to customers, and are more liable to leak. Secondly, mains in poor internal condition lead to discolouration and failures of water quality standards. If a main is in poor structural condition it has to be replaced. Where the problem is associated with the internal condition of a main, it can be relined provided it is structurally sound. Mains relining does not feature in our FBP.

Our analysis incorporates an assessment of the impact of traffic disruption, climate change and carbon emissions upon the infrastructure renewals programme. The result of this analysis is that these factors add 8km of mains replacement to the programme. Our methodology has also identified £5.4m of mains to be replaced as part of the Bough Beech project.

During the current five-year period we expect to replace a total of 157.7 km of mains. This represents a replacement rate of approximately 0.93% pa. During 2010-15 we are proposing to replace a total of 134.3 km of mains. This represents a replacement rate of 0.78% pa.

A1.5.2.3 Above ground assets £45.6m, (2005-10 - £43.7m)

Our non-infrastructure maintenance programme has been forecast to cost £45.6m. This amount includes £8.3m of capital maintenance expenditure at Bough Beech. Some of the proposed expenditure at Bough Beech is allocated to maintenance because we are taking the opportunity to replace some parts of the works that are not output related and which should be replaced according to our capital maintenance methodology.

Maintenance expenditure is required at our Woodmansterne water treatment works where increased filtration capacity is necessary to enable the works to operate more effectively over its full range of output.

The proposed capital maintenance non-infrastructure expenditure is broadly consistent with average historic spend and long-term current cost depreciation ("CCD").

A1.5.2.4 Operating costs

During the current period, operating costs have continued to rise above the rate of inflation. However, by good management practice, we have so far constrained these costs to below the levels determined by Ofwat in 2004. The outlook for 2009-10 is that operating costs will be significantly higher than those determined by Ofwat.

Power and chemical costs

It has become increasingly apparent for the past three years that power costs are well above those allowed for in the last price determination. . By necessity our pumping requirements are comparably higher than other companies because of our high pumping head and consequently power costs are a high (14%) proportion of our operating costs. In total, power costs have exceeded the determination by £3.44m in the last four years.

We firmly believe that there has been a permanent shift in energy costs that will last throughout the next price review period. This view is supported in the recent research paper written by Bergen Energi. Their report shows how costs in the plan period will be significantly above those currently set by Ofwat. They expect baseload power costs to continue at high levels for some time. The price we pay for base load electricity within our existing contract which runs to March 2009 is £48/MWh. We have contracted for 2009/10 electricity costs (on specialist advice) at £79/MWh which will increase our power costs to £6.0m which is 120% above the amount allowed by Ofwat.

As a result, of the uncertainty indicated by Bergen's analysis, we have included power costs at the top of the range of their predictions on the assumption that it will not be a Notified Item. If power becomes a Notified Item then we would forecast costs using Bergen's mid-range forecasts.

Chemical costs are closely related to power costs. Therefore, we have forecast these to increase in line with the Bergen predictions. During this year we have suffered an 85% increase in Phosphoric acid costs which we have also factored into our forecasts. In addition, during 2007-08 and 2008-09 we have been refurbishing our Cheam works which has resulted in our ability to soften the water being temporarily reduced. Full softening will resume in 2009-10 and our forecast costs reflect that.

Bad debt

The costs of bad debt and debt collection (including Council Commission) costs can only continue to increase in the current financial climate and until there is a change in the legislation. We will concentrate our resources on debt collection and management and have increased our headcount accordingly. However, we do expect an increase in our bad debts charge.

Rates

The Valuation Office is currently reviewing water industry rating values. We have been advised that our Business Rates will increase in 2010 by around £1.0m/pa.

Other

There are a number of other costs from legislation and similar items that will come into effect in this period. These include the impact of the Traffic Management Act (more rigorous Fixed Penalty Notices, increased inspection charges and the introduction of permit schemes) and the proposed separate accounting for the supply chain costs as a result of Ofwat's competition agenda. Wage and salary costs will continue to rise ahead of RPI, particularly in the South East where the cost of living is high and employment remains relatively buoyant despite the potential recession.

Pensions

We currently contribute 30% to our closed defined benefit scheme (WCPS) and 10% to our defined contribution scheme. We have the latest triennial Actuarial Valuation for WCPS at March 2008, and it appears that increased employer contributions are not required. We have no plans to increase contributions to the defined contribution scheme.

Summary

It will be clear that the cost increases explained above are very largely beyond the control of the Company. Some, like electricity and chemicals, are due to market price increases, and in these areas our tendering and risk management processes are fully developed to obtain best value. Other areas, like rates and traffic management charges, are costs simply determined by Government or statutory bodies.

A1.5.3 Meeting customers' requirements for a continuous water supply. Capital expenditure required to meet the increasing demand for water £41.7 (2005-10 = £21.1m)

A1.5.3.1 General

In the last four years we have experienced the worst drought since the 1920's and severe flooding (see A1.2.1.2 and A1.2.1.3). The steadily increasing number of households in our area and the growth in water using devices associated with rising

affluence and changes in lifestyles means that the total demand for water continues to increase.

Our initial mid-range estimate of the underlying increase in domestic consumption of water for the next 12 years is 0.2% pa. We have assumed however that this rate of growth is wholly offset by assumed reductions in consumption as a result of domestic appliances becoming more water efficient, and an increasing awareness of the importance of water efficiency in the home. This results in zero growth in consumption from existing properties. This zero growth, combined with the assumed reductions in consumption associated with the metering of previously unmeasured properties, and the assertion that new homes are being built to improved environmental standards, means that we are forecasting per capita consumption to fall gradually over the next 25 years.

We have sufficient resources to meet average demands in a dry year up to 2035. However, we currently have a deficit in resources to meet dry year peak demands in both our water resource zones. This deficit can be addressed in a number of ways: by developing new resources, by increasing the output of existing sources, by reducing leakage from the mains network, increasing meter penetration, and by reducing customer's consumption by the introduction of demand management measures. It is incumbent upon the Company to use the most cost effective of these measures to balance supply with demand.

All these issues are fully explored in our Water Resources Management Plan. Our Water Resources Management Plan identifies that the most cost beneficial approach to this problem is to adopt the following twin track approach:

- Uprate the capacity of our Bough Beech treatment works (and mains network) to 70MI/d so that we can make more effective use of the reservoir capacity;
- achieve 90% meter penetration by 2025;
- maintain leakage at 24.5 MI/d (which is below the economic level of leakage) until 2015 and then gradually reduce it to 12.5% of distribution input by 2035.
- continue our base level water efficiency programme, and introduce a water efficiency programme for schools.

A1.5.3.2 Bough Beech uprating

New resource development will be required to meet the projected growth in demand over the planning period. Following a comprehensive review of all available resource options the Company concluded that the expansion of the treatment works capacity at Bough Beech to 70MI/d formed the most cost effective approach for future resource development within its supply area. This work is based on a detailed assessment of capital and operating costs, and environmental and social costs in line with industry appraisal guidance.

Utilisation of the full peak licence for Bough Beech, in conjunction with the proposed demand management measures, will provide substantial benefits to the Company and its customers including:

- It will overcome the existing deficit in resources to meet peak demands and, together with existing sources and our proposed demand management programme, will help ensure that we can meet average and peak demands for the next 25 years;
- It will provide an immediate improvement to the resilience of the Company's resources to cope with extreme weather conditions, complying with the recommendations of the Pitt Report. Target headroom will be maintained throughout the planning period, avoiding the need for other more expensive and environmentally damaging resource development;
- It will allow the more efficient use of raw water that is already stored and available for its use. The increase in output and network capacity will provide more flexibility for use in conjunction with other sources and will provide the opportunity to rest stressed groundwater sources, reducing the risk of supply side failure and the need for emergency measures;
- The scheme will also assist the Company in complying with the requirements of the Security and Emergency Measures Direction 1998 (SEMD) to ensure the provision of essential water supplies. For example, in the event of the loss of a major treatment works, the Company's ability to distribute water throughout the entire distribution network will be significantly improved; and
- It provides a low risk solution to a very real problem.

These benefits are explored in more detail in Part B5.

The new daily peak licence of 70MI/d for Bough Beech was granted by the Environment Agency (EA) in May 2007, recognising the important role that the reservoir can play in meeting peak demand and providing long term security of supply for the Company's customers. As part of the new 70MI/d licence granted in 2007, the EA have imposed a condition that the Company must install and operate sufficient treatment capacity at Bough Beech to treat at least 50MI/d by 2015, otherwise the peak licence limit will revert back to 45MI/d. This condition places even greater importance on securing funding for the enhanced Bough Beech scheme in AMP5.

In addition to the benefits discussed above, it is an opportune time for the Company to carry out work at the treatment works for Bough Beech. The treatment works is over 40 years old, and much of the plant requires a major overhaul in the period 2010 to 2015. The proposed works will also improve the performance of the filters which will provide enhanced protection to customers from Cryptosporidium.

The refurbishment and uprating of our Bough Beech treatment works, and the upgrading of the appropriate parts of the distribution network, is of fundamental strategic importance to meeting customers' requirement for a continuous water supply. Increasing the capacity of the treatment works at Bough Beech to provide risk free water which will allow us to overcome the existing peak deficit, it should also provide sufficient capacity to meet peak demands until at least 2035 (assuming 90% meter penetration by that date).

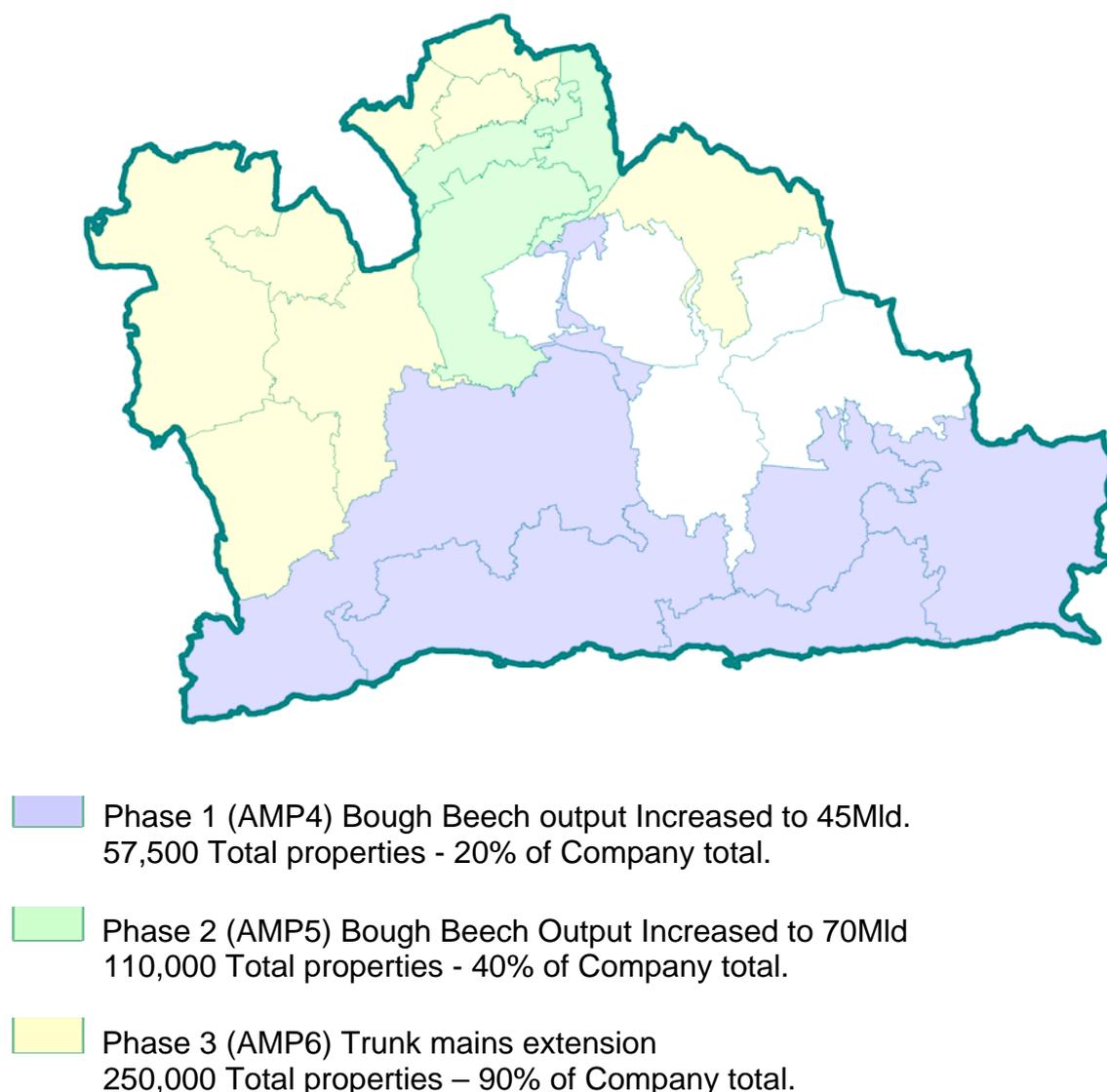


Figure A1-4 Potential availability of water from Bough Beech

The extent to which Bough Beech will enable us to support our area during periods of peak demand is shown in Figure A1-4. It increases our resilience and enables many more customers to be supplied from Bough Beech in the event of emergency or shortage.

This project has been developed over several years. The first stage was agreed by Ofwat in 2008 and construction work will be completed by March 2010. The next stage, included in the FBP, is the result of a long and detailed design process which ensures that the work in the current construction phase dovetails precisely with this project. Because of the detailed design work that has been completed we have been able to develop accurate cost estimates. We will be in a position to go to tender as soon as the final Determination is known with a view to starting construction in April 2010.

A1.5.3.3 Demand Management

Metering

The Company's area of supply has been designated an area of serious water stress. Unrestricted demand is rising, and the number of new households is forecast to increase by over 65,000 over the planning period. The Company already meters all new properties, and will have metered an additional 28,900 previously unmeasured properties in the period 2005-10. At the end of March 2008, over 71,000 households within the Company supply area were metered, equivalent to approximately 28% meter penetration. By the end of March 2010 this will have increased to over 87,000, or 34% of billed households. Through consultation we know that our customers believe that the only equitable way to pay for water is by meter and that the level of metering should be increased substantially. We also take this view and enhanced metering forms an essential element of the Company's strategy.

We propose to install 32,000 meters during the period 2010-2015, similar to the existing rate of metering for 2005-2010. We expect that the metering programme to 2015 will be achieved through a combination of metering of optants and metering on change of occupancy. The rate of metering to 2015 has been reduced from the programme set out within the Draft WRMP due to concerns over the impact on customer bills. The revised programme of 32,000 meters is also consistent with Ofwat's draft CIS.

Beyond 2015, the Company proposes to accelerate its metering programme to achieve full metering (90% penetration) by 2025 using a combination of metering on change of occupancy, compulsory metering, and free meter optants. The proposal to move towards universal metering is strongly supported by our customers and the Environment Agency. Our proposed metering programme is supported by Cost Benefit Analysis.

High levels of meter penetration mean that it should be possible to try to influence demand by using tariff control. We propose to introduce a large scale tariff trial in part of our Croydon area of supply once sufficient meter penetration has been achieved after 2015. We will also investigate the possibility of carrying out smaller scale trials in other areas before then (perhaps on new housing estates where all properties are metered) and will review the results of trials being carried out by others.

We also propose that from 2015, homes, built in accordance with the new Code for Sustainable Homes (CfSH), will be billed on a rising block tariff basis.

Leakage

Over the last 15 years, the Company's most significant demand management measure has been its positive approach to leakage management. We operate a well organised and efficient leakage management strategy. This strategy is of long standing and our performance in this area is at the forefront of the industry. Leakage has been reduced to below 24.5MI/d (approximately 15% of distribution input), which is below the Company's calculated economic level of leakage (ELL). The Company has consistently met the regulatory leakage target set by Ofwat, and remains the only company in the UK water industry to operate a performance contract where its leak detection contractor is paid solely on measured reductions in night flow rates.

Following completion of the Company's Economic Level of Leakage assessment, Ofwat has issued new guidance on the calculation of the Sustainable Economic Level of Leakage (SELL). The SELL takes into account a wider array of environmental, social and carbon related costs and benefits, as well as customers' preferences for leakage reduction. The SELL replaces the previous ELL calculation.

The Company is currently operating below its calculated Sustainable Economic Level of Leakage (SELL) and has no justification for further leakage reductions in the period from 2010-2015. We therefore intend to maintain leakage at the current level of 24.5Ml/d to 2015.

Beyond 2015 we have a longer term leakage reduction target of 12.5% of Distribution Input (DI) by 2034/35. We believe that this longer term target can only be achieved through a substantial mains renewal programme and that further leakage reductions are unlikely to be economic when compared to other demand management or supply side options. However, we believe that further leakage reduction should be progressed as it is such an important issue with our customers and it promotes the correct message that water is a precious resource and must be conserved. In the Defra publication "Action taken by Government to encourage the conservation of water", it is stated that Government want, and expect to see, reductions in leakage. We recognise however that Cost Benefit Analysis (CBA) will be required by Ofwat to justify any further reductions below the SELL and this will be reviewed in the AMP5 period.

Water efficiency

We fully recognise our obligation to promote water efficiency and we fully support our customers' views that we should promote new efficiency measures and enhance educational initiatives. We believe that the key areas for achieving water efficiency savings are: the education of our customers, assisting customers to reduce household consumption, reducing business use, and working with Local Authorities and Housing Associations to reduce the consumption of their housing stock and business premises. This is the very successful approach we have adopted in the AMP4 period which has resulted in the award winning Preston Park project. In the AMP5 period we plan to build on the initiatives we have developed during AMP4 and propose to double our spending on water efficiency. Water efficiency training has become an integral part of our extensive schools education programme.

We will meet the new Ofwat base service water efficiency targets for the period 2009 to 2015 and have included these savings within our final planning solution within the Final Draft WRMP.

We have carried out a detailed review of additional water efficiency options, and these are included within the Final Draft WRMP alongside other demand management and supply side options. This work has included a review of the Waterwise final report, 'Evidence base for Large-Scale Water Efficiency', published in October 2008.

As a result of the additional work on water efficiency options we have included a schools water efficiency retro-fit programme within our Final Business Plan and Final Draft WRMP. The schools programme will include advice and assistance in installing

water efficient devices and fittings, and/or replacing sanitary ware with new modern water efficient equivalents. The programme also gives us the opportunity to educate the schools' pupils and staff about a whole range of sustainability matters. The schools retrofit programme has been identified as an economically viable scheme and its implementation will achieve the Company's Sustainable Economic Level of Water Efficiency in accordance with Ofwat's guidance.

A1.5.4 Meeting customer requirements for high quality water. Capital expenditure of £3.6m (2005-10 = £0.9m)

A1.5.4.1 General

We supply water of the highest quality and have a very good compliance record. We aim to achieve 100% compliance with all water quality standards. In the first three years of the period we achieved an average overall water quality index of 99.98%, with the majority of occasional failures being due to iron and associated turbidity from unlined iron mains.

In 2008 a reduction in our overall water quality index to 99.89% was due to the deterioration in the quality of the raw water source at Bough Beech water treatment works in respect of the pesticide Metaldehyde. The Company's plans to deal with this issue are detailed in A1.5.4.4 below.

A1.5.4.2 Lead

In 2013, a mandatory, enhanced lead standard (lower PCV) will be introduced. Although we do not envisage this being a major issue for our water quality compliance in the future, we do expect to see a small increase in the number of lead failures.

Compliance with the water quality standard for the amount of lead in water remains a major issue for the water industry. During the current period the Drinking Water Inspectorate ("DWI") has focussed on ensuring that companies optimise the process of dosing water with orthophosphate. This creates a protective barrier on the lead pipe and prevents lead being leached into the drinking water. The results of our work indicate that we are relatively well placed in that we are seeing very few failures of the lead standard.

We are not planning a large lead replacement programme. We propose to continue the opportunistic replacement of lead communication pipes as part of our infrastructure renewals (capital maintenance) programme, and the optimised dosing of orthophosphoric acid which controls plumbosolvency (base Opex). As part of the quality programme, we will continue replacing lead communication pipes when a failure occurs. Based on the results of our lead related sampling programmes, our Plan anticipates a very small number of lead communication pipe replacements during 2010-15, even following the change to the lead standard in 2013. This is in the context of a total of approximately 110,000 lead communication pipes in our area, and assumes there is no request from the DWI or customers for wholesale lead pipe replacement. We would expect any change in the position of the DWI with respect to the replacement of lead pipes to be covered by a Notified Item.

In addition to our ongoing lead pipe replacement programme, we have decided to enhance our protection of vulnerable customers (schoolchildren) and propose to

implement a programme of replacing lead pipes supplying schools at a cost of £0.8m. This programme has been given support by the DWI.

A1.5.4.3 Discolouration

We propose to continue controlling discolouration (iron) in the distribution system at current levels through normal operational activity (eg flushing), and replacement of unlined iron mains as part of our mains replacement programme. The costs of this are included within the infrastructure renewals programme.

Customers did indicate in our Willingness-to-Pay studies that they would be prepared to pay for some additional work to reduce discolouration events and interruptions to supply. However, we felt that the benefits arising out of this programme were so marginal that we have decided to remove it from our FBP.

A1.5.4.4 Pesticides

In February 2008 we detected the pesticide, Metaldehyde in the treated water from Bough Beech. The levels detected have exceeded the PCV (but remain well below any levels that would endanger health) for pesticides. Metaldehyde has also been found by other water companies in the UK and is proving very difficult to remove using conventional established pesticide treatment processes. Metaldehyde contamination is being discussed at a national level with the involvement of the manufacturers, users and DWI. In the absence of a cost effective treatment solution, we propose to deal with this pesticide by working with the manufacturers and the businesses (predominantly the farming community) that use the product, to reduce the amounts of Metaldehyde entering water sources.

We have exceeded the PCV and we have notified the DWI. In March 2009 the DWI confirmed that it will now consider an undertaking from the Company to deliver the steps proposed in the scheme they have already supported for PR09, rather than proceed with an authorised departure as was initially proposed. The Company has already initiated a communication programme to try to reduce the amounts of Metaldehyde reaching our water sources and an extensive monitoring programme to monitor our progress and we plan to continue these catchment management activities and the investigation of potential treatment processes. We have incorporated the costs of those activities in Quality Enhancement operating expenditure. The DWI has supported the actions described above. Since the detail of the undertaking has yet to be agreed, there is a high degree of uncertainty within the AMP5 period as to the final costs we might have to incur in respect of metaldehyde. We are therefore proposing that the costs of any additional processes we may be obliged to install and operate for the treatment of Metaldehyde, should be treated as a Notified Item.

A1.5.4.5 Securing our assets

Our Plan includes an allowance for complying with the increasing requirements of the revised Security and Emergency Measures Directive (SEMD), reflecting the latest guidance from Government and the security services. In the absence of clear guidance, and the possibility of future developments, any additional costs of compliance with security and SEMD should be treated as Notified Items or Relevant Change of Circumstances.

A1.5.4.6 New environmental standards. Operating costs £1.5m (2005-10 = £nil)

The Environment Agency's ("EA's") environmental programme covers two main areas; sustainability reductions, waste discharges to rivers and the sea, and improved flood protection. The Company has not been asked to make any sustainability reductions, and in general does not deal with waste treatment or flood protections, which are the remit of the water and sewerage companies.

The Environment Agency has asked the Company to carry out two environmental investigations under the National Environmental Programme. The first of these concerns the effect of abstractions on groundwater at Reigate Heath. The second is concerned with the river Wandle, a stream fed by springs in the unconfined chalk of the North Downs. The cost of completing these studies is included in Opex.

A1.5.5 Delivering Enhanced service levels to customers. Capital expenditure £1.9m (2005-10 £0.0m)**A1.5.5.1 Resilience to flooding**

In our Final Business Plan, we have included for capital expenditure for one programme of improved service to customers, other than quality or supply/demand balance enhancements. This programme, to improve the resilience of our assets to flood events, is supported by customers in our Willingness to Pay study.

The flooding resilience element of our plan is based on the Pitt review recommendation that we should provide for a 1 in 200 storm/flooding event. We have also used guidance provided by Ofwat when calculating the costs of the required protective measures. We expect that the precise requirements for flood resilience to be clarified in a Flooding and Water Bill to be presented to Parliament in the spring. However, we have included the cost of this programme in our Plan because there is little doubt there will be a legal duty to provide these defences. The alternative to allowing for these costs would be to rely upon the change protocol mechanism (notified item or similar). It is however unlikely that the costs of the work would exceed the financial threshold for a Notified Item.

A1.5.5.2 Customer satisfaction

As well as improving resilience to flooding, we will, at no extra cost, enhance the experience our customers have when dealing with us. We will:

- Continue to develop our customer literature regarding our services and customers water use, taking advantage of this to actively promote water efficiency;
- Continue to extend our award-winning telephone and internet facilities to give customers further contact points with the Company;
- Continue to engage with our customers' through customer research to determine what other services customers require and to monitor their overall satisfaction with our performance; and
- Continue our extensive schools educational programme and expand it where appropriate.

A1.5.5.3 Other customer service enhancements

In our Draft Business Plan we considered a number of other service enhancements which have been dealt with as follows:

- Improved level of service for restrictions on the non-essential use of water in the event of a drought. There was not a willingness to pay for an improvement so this has been omitted from the Final Business Plan.
- Water efficiency activity. Customer surveys indicated a willingness to pay for additional investment in water efficiency. Our proposal to carry out a water efficiency project at schools in our area of supply proved to be cost beneficial, so the project has been included in the Final Business Plan. The costs of this programme are covered in supply/demand balance expenditure;
- Network improvements. Customers were also willing to pay for service improvements associated with the performance of the mains network. Two cost beneficial schemes were included in the Draft Business Plan: expenditure to reduce the numbers of interruptions to supply, and the number of discolouration contacts. However, we felt that the benefits arising out of the amount customers were willing to pay were almost intangible and so we have not included this project within our Final Business Plan.
- Improvements to comply with the Security and Emergency Measures Direction are included in quality enhancement expenditure.

A1.6 Efficiency

The evidence we have provided in this Plan shows that the vast majority of the efficiencies in the industry have been made since privatisation. We recognise though, that there is an ongoing process of efficiency improvement throughout the economy, and we believe therefore that it is appropriate to include for efficiency improvements in the Company's Business Plan. It should be noted however that an element of this ongoing efficiency improvement will be captured within the RPI.

Based on a report by Frontier Economics, the following efficiency assumptions are included in this Plan.

- An improvement of 0.3% per annum, applied to all categories of operating expenditure (frontier shift), is appropriate.
- The frontier shift for capital expenditure will be minus 0.8%pa therefore capital costs will increase.
- The operating cost catch-up factor is 0.0%.
- The catch-up factor for capital enhancement should be 0.0%.

We will, as always seek ways of carrying out our capital programme as efficiently as possible, but generally, as in the past, where we are able to make capital efficiencies these will be reinvested in the capital programme as part of the Company's deal with customers to spend what we have been allowed.

There is limited scope for reducing operating costs, but the increased metering programme may make the introduction of remote read meters more attractive. The Company is currently trialling some intelligent meters, but as yet the cost of these is prohibitive. The use of telemetry and SCADA is already well developed and while there are always improvements to be made, there is little opportunity for any significant operational savings.

The Company does not envisage having to increase its human resources significantly to be able to meet the challenges of the next five years, despite the proposed increase in metering and its programme of capital expenditure.

A1.7 Carrying out our activities in an environmentally sustainable way.

Our customer research indicates that our customers have an interest in sustainability and the environment, but it is not one of their top priorities.

We are working to reduce emissions as far as we can to help reduce the impact of our activities on climate change. We have agreed that by 2020, 20% of our power requirement will be derived from renewable sources. However, we have been advised by our consultants, Entec, that the prospects of generating our own power are very limited because of the proximity of airports, microwave and radar pathways, and conurbations. We have therefore planned to obtain 10% of our energy from green sources by 2015, although it should be noted that this will be at additional cost.

In selecting new and replacement plant, and when choosing whether to replace or refurbish plant, we take into consideration the energy efficiency of the plant. Selecting energy efficient plant helps us to minimise our operating expenditure and reduce our carbon footprint.

When carrying out feasibility studies and designing new works we aim to limit the impact of the new works on the environment, taking into account operating and capital costs. These different requirements are not always complimentary and it is a case of finding the right balance.

Sometimes, this means selecting a project solution that isn't necessarily the cheapest option. For example, when a booster pumping station was built at Buckland (part of the scheme that allows water to be transferred from the East Surrey water resource zone to the Sutton water resource zone), the design required the majority of the structure to be built below ground to minimise visual impact on the environment. This of course increased the capital cost of the plant, and the amount of embedded carbon.

We aim to act sustainably and in an environmentally responsible way. We carry out Environmental Impact Assessments on major projects, and look for ways to carry out our works more sustainably (for example, using recycled material for trench backfill). We endeavour to meet our customers' expectations in these areas especially where solutions can be found at little or no extra cost.

We also look to manage our network and pumping costs to minimise power consumption and the amount of water that is wasted. The distribution system is managed to control and minimise pressures, and its performance is continuously monitored. Pressure control and monitoring enables pumping heads to be minimised, and is used to reduce leakage and accidental waste. The benefits are twofold; less water is lost to the environment, and operating costs are reduced leading to a smaller carbon footprint.

This argument applies to all demand management, and is used to support our metering and water efficiency programmes. However, in promoting all demand management activity we have to ensure that the value of the benefits outweighs the costs of implementing the programme.

The Company is also concerned that its abstraction activities do not have any adverse impact on the environment. The impact on the environment of all abstractions is being considered, together with other matters, under various pieces of legislation, in particular the Water Framework Directive. To date, we have not been required to make any sustainability reductions. The Environment Agency has asked the Company to carry out two environmental investigations under the National Environmental Programme. The first of these concerns the effect of abstractions on groundwater at Reigate Heath. The second is concerned with the river Wandle, a stream fed by springs in the unconfined chalk of the North Downs. There is the potential for both of these investigations to lead to sustainability reductions. We have made no allowance for sustainability reductions in our Business Plan.

A1.8 Financing the future

A1.8.1 General

The availability and cost of financing post April 2010 will be a major issue for us and the whole industry. At privatisation the plans were for a period of heavy new investment and for the industry to be cash generative by now. This is not the case. Significant investment is likely to be required for the foreseeable future as described in our SDS.

If the industry is to be able to raise the necessary finance for new investment, it is essential that the return to the providers of debt and equity finance is at the level necessary to attract them, and that the associated financial ratio requirements are met.

At this stage we anticipate that we will have to raise new equity during the AMP5 period. To be able to do this, the Company requires a price determination that will enable payment of the appropriate level of dividends on existing and new investment.

A1.8.2 The cost of capital

The ability of a water company to deliver its strategic objectives principally depends on it being properly funded. Failure to fund properly any aspect of the Company's business (therefore its operating costs, capital expenditure or finance costs) will result in a reduction of investment on the maintenance of assets, and eventually to asset and service failure.

The cost of capital determined at the last price review was appropriate to the industry at that time. Since then, and until last Autumn, there has been a benign economic environment with low inflation, high growth rates and the emergence of various large infrastructure funds seeking long-term, modest, but inflation proofed returns. This has led to water companies being sold at prices above their RCV's. Since last Autumn, economic growth has slowed dramatically, credit and capital markets have become very unstable and commodity prices have increased dramatically.

Our Plan demands a large financing requirement to be completed. Therefore we need to attract capital (both debt and equity) and we need a sensible and realistic cost of capital to do that. In these uncertain times in the capital markets it is not the time to be too aggressive on the cost of capital.

The market evidence from the current period is that the cost of capital (post-tax) determined for the Company is 6.1%. This includes a small company premium that is justified by the additional borrowing costs etc that are applied by capital providers to small companies.

A1.8.3 The balance of risks between customers and shareholders.

There are mechanisms intended to deal with situations where the uncertainty about future events or costs is such that there is a likelihood of significant differences between the costs allowed in a price Determination and the actual out-turn costs

incurred by a Company. Once the accumulated value of these differences exceeds a specified value, prices are re-determined by an Interim Determination of K (“an IDOK”). The IDOK process is restricted to those items specified in the price determination as Notified Items.

For various reasons that have been explained in the relevant sections above, there are currently a significant number of uncertainties that could affect our Plan. Further, it appears unlikely that the majority of these uncertainties will be clarified by the time of the final price Determination. It is our view that it is fair and transparent, and therefore in the best interests of customers, that material uncertain items should be treated as Notified Items.

Our current view is that the following should be treated as Notified Items. It is also our view that the uncertainties surrounding these items, except possibly non-domestic rates, are unlikely to be resolved in time for the price Determination.

- Power and chemical costs
- Increasing bad debt and the costs of collection
- The Traffic Management Act (inc Section 74, permits, and increased inspection fees)
- Changes in Accounting Standards
- Meter optants (numbers)
- The replacement of lead pipes and orthophosphate dosing
- The costs of compliance with Security and Emergency Measures Direction and any security and flood prevention measures required
- Treatment of Metaldehyde and other pesticides.

Changes in costs that arise as a result of new legislation, etc constitute Relevant Changes in Circumstance (“RCCs”) under companies’ licences, and flow automatically into the IDOK process.

A3 The Company Strategy – Tables

A3.1 Introduction

The data tables in Section A summarise the Company's:

- proposed price limits and infrastructure charges which are required to fund the Company's expenditure programmes;
- projected household bills;
- key supply/demand balance projections;
- current performance and planned outputs with regard to service performance, quality and environmental compliance and serviceability to customers, and carbon emissions;
- key activity projections in the areas of water resources, water treatment, water distribution, metering and management and general;
- capital and operating expenditure out-performance compared with AMP4 projections;
- proposed efficiency improvements;
- proposed capital and operating expenditure projections;
- financial projections; and
- a summary of the justification of the Company's investment proposals

Generally, the figures on the tables in section A are built up from data entered on the tables in sections B and C. Full explanations of the figures are not repeated in the commentaries on the section A tables.

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Table A1

Final Business Plan 2009

Sutton and East Surrey Water plc
Price limits, bills, water sales and supply/demand balance

		AMP4			AMP5					
		2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	
Line description	Units									
A	Price limits & infrastructure charge limit									
1	Proposed price limit "K" (including U)	nr	0.0	0.0	0.0	15.8	4.7	3.9	2.7	0.5
2	Water service indicative "K"	nr	0.0	-1.0	-1.1					
3	Sewerage service indicative "K"	nr								
4	Proposed infrastructure charge limit - water service	£	276.81		276.81					
5	Proposed infrastructure charge limit - sewerage service	£	276.81		0.00					
6	RPI - year by year assumption	%	3.9%	4.3%	3.0%	2.0%	2.5%	2.5%	2.5%	2.5%
B	Projected household bills - water service									
7	Typical unmeasured h'hold bill (base yr avg chg) - real terms	£	165.94	159.69	157.68	190.09	199.55	207.57	213.60	214.70
8	Typical measured h'hold bill (base yr avg chg) - real terms	£	131.63	138.74	138.29	147.34	153.06	158.22	161.74	162.49
9	Average h'hold bills - real terms	£	156.73	151.69	153.83	178.12	185.65	191.68	195.75	195.69
10	Average h'hold bills - nominal terms	£	156.73	158.18	165.23	195.14	208.47	220.63	230.95	236.66
C	Projected household bills - sewerage service									
11	Typical unmeasured h'hold bill (base yr avg chg) - real terms	£	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
12	Typical measured h'hold bill (base yr avg chg) - real terms	£	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
13	Average h'hold bills - real terms	£	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
14	Average h'hold bills - nominal terms	£	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
D	Water sales & supply/demand balance									
15	Billed water delivered	MI/d	135.75	147.06	147.32	147.66	147.71	147.99	148.14	148.33
16	Total volume of sewage collected	MI/d	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
17	Total water available for use baseline (dry year annual average)	MI/d	200.65	200.65	200.90	199.60	199.60	196.00	196.00	197.40
18	Distribution input (dry year annual average)	MI/d	170.55	171.39	171.61	172.04	172.63	173.46	174.19	174.97
19	Total leakage	MI/d	24.29	24.50	24.50	24.50	24.50	24.50	24.50	24.50
20	Total water savings achieved or assumed from company's water efficiency strategy	MI/d	0.00	0.00	0.00	0.11	0.22	0.33	0.44	0.55

A3.2 Table A1 – Price limits, bills, water sales, and supply/demand balance

A3.2.1 Section A – Price limits and infrastructure charge limit

Line 1: Proposed price limit “K” (including U)

Line 2: Water service indicative “K”

The level of “K” that the Company has calculated is necessary if it is to:

- maintain its asset base and level of serviceability to customers;
- meet new statutory requirements and environmental obligations of which the Company is aware;
- overcome the deficit in resources to meet peak demands;
- provide any enhanced levels of service for which the customer is willing to pay; and
- give a reasonable rate of return to investors.

Line 4: Proposed infrastructure limit – water service

No change is proposed to the infrastructure charge for AMP5. The numbers are at 2007/08 prices

Line 6: RPI year by year assumption

The Company’s RPI assumptions.

A3.2.2 Section B – Projected household bills – water service

Line 7: Typical unmeasured household bill – real terms

Line 8: Typical measured household bill – real terms

The typical measured and unmeasured household bills reflect “K” factors. The Company maintains its tariff differential close to the maximum calculated in accordance with the latest guidelines.

Line 9: Average household bill – real terms

No comment required.

Line 10: Average household bill – nominal terms

No comment required.

A3.2.3 Section D – Water sales and supply/demand balance

Line 15: Billed water delivered

The billed water delivered figure for 2007/08 consistent with JR2008. 2007/08 was considered to be a year of below average consumption. The forecast figures for the remainder of the table are for a year of average consumption consistent with the demand forecast submitted with the Final Draft Water Resources Management Plan, and Part B5.

Line 17: Total water available for use baseline (dry year annual average)

Water available for use figures consistent with the Final Draft Water Resources Management Plan before planned resource development. The

Company has adequate resources to meet average dry year demand, however, following reassessment of deployable outputs, the Company has established that it has a shortage of resource to meet critical period (peak week demands). The Company's Water Resources Management Plan proposes the uprating of Bough Beech treatment works to overcome this deficit by 2012.

Line 18: Distribution input (dry year annual average)

The forecast dry year annual average consistent with the Final Draft Water Resources Management Plan.

Line 19: Total leakage

The Company aims to maintain leakage at, or just below, the leakage target of 24.5MI/d agreed with Ofwat.

Line 20: Total water savings achieved or assumed from Company's water efficiency strategy

This line excludes the Company's base level target, as agreed with Ofwat, of 0.27MI/d per annum throughout the AMP5 period.

The figures shown are the savings from the Company's proposed new water efficiency scheme for schools as detailed in Part B5. This initiative is expected to achieve 0.11MI/d annual saving over and above the base target.

Total annual water savings during AMP5 including the base level target will be 0.38MI/d in each year.

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Table A2

Final Business Plan 2009

Sutton and East Surrey Water plc
Water service - Current performance & planned outputs

			Level of performance		Level of performance	Level of performance	Level of performance
			2002-03	2007-08	by 2009-10	by 2014-15	by 2019-20
Line description			Units				
A	Service performance						
1	DG2 properties at risk of receiving low pressure	nr	94	40		40	
2	DG3 Supply interruptions (overall performance score)	nr	0.30	0.45		0.30	
3	DG6 % billing contacts dealt with within 5 days	%	100.0%	99.9%		100.0%	
4	DG7 % written complaints dealt with within 10 days	%	100.0%	99.7%		100.0%	
5	DG8 % metered customer's receiving bill based on a meter reading	%	99.8%	99.9%		99.8%	
6	DG9 % calls abandoned	%		7.5%		5.0%	
7	DG9 % calls receiving engaged tone	%		0.7%		0.4%	
8	Security of supply index (dry year annual average planned levels of service)	nr	100	100		100	
9	Security of supply index (critical index)	nr		83		100	
B	Quality & environmental compliance						
10	% distribution input covered by section 19 undertakings at water treatment works	%		0.000%		15.000%	
11	% distribution input not affected by section 19 undertakings or temporary relaxations or Authorised Departures	%	100.000%	100.000%		85.000%	
12	% of properties in water supply zones affected by section 19 undertakings in distribution or Authorised Departures	%		0.000%		0.000%	
13	% mean zonal compliance with drinking water regulations	%		99.99%		99.93%	
C	Serviceability to customers (maintaining asset systems fit for purpose)						
14	Below ground assets assessment - infrastructure pipelines	Text	STABLE	STABLE		STABLE	STABLE
15	Surface assets assessment (non-infrastructure)	Text	STABLE	STABLE		STABLE	STABLE
D	Carbon Accounting						
16	Carbon emissions' produced in providing the service	ktonnes/yr			32.0	32.0	
17	Other GHG emissions (as CO2e) produced in providing the service	ktonnes/yr			1.0	1.0	

A3.3 Table A2 – Current performance and planned outputs

A3.3.1 Section A – Service performance

Line 1: DG2 properties at risk of receiving low pressure

Since 1992/3, the Company has consistently reduced the numbers of properties receiving pressure below the reference level through improvements to the mains infrastructure and better operational management. From 1999, it has been possible to monitor the distribution system across the entire company area using the district metering system. This has allowed more accurate identification and reporting of areas suffering from low pressure. Subsequently, the Company has also introduced improved reporting procedures and verified each of the properties included on the register. As a result of the verification work, the number of properties on the register reported in JR08 reduced slightly. The Company envisages maintaining the properties at risk at this level throughout the forthcoming planning period.

Line 2: DG3 supply interruptions (overall performance score)

The Company's target is that no property should be without water for more than 12 hours except in circumstances outside of the Company's control. Since 1999, the Company has introduced improved monitoring and reporting procedures. Performance data is obtained from the company's Supply Interruption Database reporting and monitoring system.

It is the Company's intention to maintain its high standard of service in this area. However, as noted in Parts B3 and B6 this is often outside of the Company's control due to the circumstances it faces when dealing with some burst mains. Whilst the reported DG3 score for 2008/09 (approximately 4.2 - unaudited) is considered to be an exceptional spike, it illustrates how sensitive this measure can be. It also raises the question of whether this measure is a reasonable basis on which to determine company comparative performance.

Line 3: DG6 % billing contacts dealt with within 5 days

The information regarding DG6 is obtained direct from the company's billing database. The Company expects to maintain its current performance rating which is in the highest band. It is noted that performance in the 2008/09 report year is slightly lower than normal, although it will still be categorised as 'good' based on the level of service criteria applied by Ofwat. The reason for the slight drop in performance was associated with a malfunction on the Company's website which was upgraded during the year. The malfunction has now been remedied and contacts received via this route are now being received as normal.

Line 4: DG7 % written complaints dealt with within 10 days

All written complaints are recorded together with all other forms of complaints in the Company's customer contact database.

The Company receives relatively few written complaints. In order to achieve a high performance level it is important that the company deals with them all in an efficient manner, as the failure to respond to a single letter has a notable effect on the level of service provided. The Company believes that the systems it has in place to address written complaints enable it to operate in the top category for this level of service indicator. It expects to maintain this high performance rating throughout the AMP5 period.

It is noted that performance in the 2008/09 report year is slightly lower than normal, although it will still be categorised as 'good' based on the level of service criteria applied by Ofwat. The reason for the slight drop in performance was associated with a malfunction on the Company's website which was upgraded during the year. The malfunction has now been remedied and contacts received via this route are now being received as normal.

Line 5: DG8 % metered customers receiving bill based on a meter reading

The numbers being achieved by the Company place it in the top category for this level of service indicator. Meters are read on a continuous basis throughout the year. Larger users are read each month, and smaller and domestic users are read at 6 monthly intervals. Accounts are issued on the same basis. Where it has not been possible to read a meter, particular emphasis is given to accessing the meter for the subsequent read. With this approach the Company is able to achieve the level of service that places it in the highest band. It intends to maintain this performance throughout the AMP5 period.

Line 6: DG9 % calls abandoned

The Company reported in JR08 a significant increase in abandoned calls. This was mainly due to the increase in calls received and changes made during the report year to call handling practices as well as the increasing use of the automated freephone bill payment service (APS).

The Company introduced a change management approach during 2007/08 which dramatically reduced the number of calls to conventional lines becoming abandoned. However, it continues to classify a greater proportion of calls to the APS as abandoned in accordance with Ofwat guidance, and there is no evidence that this will change in the future. Hence, the Company has included a predicted performance in AMP5 consistent with typical observed values for its conventional voice and APS lines.

The Company does not agree with the rules for the classification of abandoned calls on the APS as it is not measuring a failure of the Company's systems or performance.

Line 7: DG9 % calls receiving the engaged tone

Information regarding calls receiving the engaged tone is obtained from the Company's Symposium Express Call Centre reporting software, its Datapulse Call Logger system and from data generated by its specific service providers, BT and Fluency. The figures reported are for calls received during normal working hours to the Company's five principal advertised customer contact (PACC) points.

Line 8: Security of supply index (dry year annual average – planned levels of service)

The Company has adequate resources to meet dry year annual average demand for the period of the Plan. No additional resources are required, and hence the SOSI remains at 100 for the AMP5 period.

Line 9: Security of supply index (critical index)

The Company currently has deficit in resources to meet critical period (peak week) demands in both water resource zones. Phase 1 uprating of Bough Beech treatment works minimises this deficit by 2010. Phase 2 of the uprating of Bough Beech water treatment works is planned to commence in 2010, and should provide sufficient peak deployable output to meet peak demands for the next 25 years. Therefore the SOSI will be 100 by 2015.

A3.3.2 Section B – Quality & environment compliance**Line 10: % distribution input covered by section 19 undertakings at water treatment works****Line 11: % distribution input not affected by section 19 undertakings or temporary relaxations or Authorised Departures**

The Company had no undertakings, temporary relaxation or authorised departures in place for water treatment works at the end of the last report year. As noted in Part B4, the DWI confirmed on 24 March 2009 that the Company should now submit an undertaking in respect of the activities proposed to facilitate compliance with the pesticide Metaldehyde at Bough Beech Water Treatment Works. Our proposals to implement catchment management solutions in the AMP5 period, including consultant-led communication programmes to agronomists and end-users of Metaldehyde, individual farm visits, extensive operational monitoring and contributions to national research into loss pathways, have already received DWI support. Bough Beech Water Treatment Works provides approximately 15% of water into supply.

Line 12: % of properties in water supply zones affected by section 19 undertakings in distribution or Authorised Departures

The Company had no undertakings or authorised departures in place for the distribution system at the end of the last report year and does not anticipate the need to have any in place in 2014/15.

Line 13: % mean zonal compliance with drinking water regulations

The Company anticipates that from 2008/09, the mean zonal compliance will reduce from 99.99% as a consequence of failures of the PCV for the pesticide Metaldehyde at the Bough Beech water treatment works supply point. The Company expects to agree an undertaking for Metaldehyde with the DWI (see Line 10 above), but it has been assumed that improvements in pesticide compliance will not have been achieved by the end of the period due to the unpredictable performance of catchment management measures. There is no risk to public health from these pesticide failures. The projected level of performance at 2014/15 of 99.93% also takes into consideration the anticipated increased failure rate for lead, following the introduction of the revised lead standard in December 2013.

A3.3.3 Section C – Serviceability to customers (maintaining asset systems fit for purpose)**Line 14: Below ground assets assessment – infrastructure pipelines**

The Company appointed Tynemarch to undertake a Common Framework compliant forward-looking analysis of capital maintenance requirements for its infrastructure assets. Their report is given in Supporting Information B3-2. The schemes selected are all deemed to be cost beneficial in that they are the most cost effective solution to achieving STABLE serviceability for the periods up to AMP9.

Line 15: Surface assets assessment (non infrastructure)

The Company appointed Tynemarch to undertake a Common Framework compliant forward-looking analysis of capital maintenance requirements for its non-infrastructure assets. Their report is given in Supporting Information B3-3. The schemes selected are all deemed to be cost beneficial in that they are the most cost effective solution to achieving STABLE serviceability for the periods up to AMP9.

A3.3.4 Section D – Carbon Accounting**Line 16: Carbon emissions produced in providing the service in 2014-15****Line 17: Other GHG emissions (as CO₂e) produced in providing the service in 2014-15**

Operational carbon emissions have been calculated from data prepared for using the UKWIR Carbon Accounting Methodology Working Draft tool for 2007-2008. The emissions calculated using the UKWIR tool have been increased pro-rata from an actual 151.5MI/d DI in 2007/2008 to the predicted 164.7MI/d in 2014/2015. The NPV calculations assume that operational GHG emissions remain constant until the end of the time horizon in 2050. No further increases in operational emissions have been included as it is considered likely that there will be improvements in efficiency leading to reduced emissions per MI supplied.

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Table A4

Final Business Plan 2009

Sutton and East Surrey Water plc
Water service - Key activity projections

Line description		Units	Activity in AMP5 period relating to base service	Activity in AMP5 period relating to enhancements	Total planned activity in AMP5 period	Profile of activity	Total planned activity in AMP6 period
A		Key activity projections - water resources					
1	Length of raw water aqueducts refurbished	km	0.9	0.0	0.9	S	4.2
2	Work on dams & impounding reservoirs	nr	1	0	0	P*1,2	0
3	Capital investment in aqueducts, dams & impounding reservoirs	£m	1.152	0.000	1.152	F	0.906
B		Key activity projections - water treatment					
4	Number of refurbished or new treatment works	nr	3	1	3	F	1
5	MI/day of refurbished or new treatment works	MI/d	174.00	25.00	199.00	F	371.00
6	Capital investment in refurbished or new treatment works	£m	29.433	13.430	42.863	F	23.057
C		Key activity projections - water distribution					
7	Length of mains renewed	km	134.3	0.0	134.3	S	161.7
8	Length of mains relined	km	0.0	0.0	0.0	S	0.0
9	Length of new mains	km	0.0	83.6	83.6	S	73.7
10	Number of refurbished or new district meters & pressure control valves	nr	450	0	450	S	450
11	Capital investment in underground water distribution activity (incl investment in meters reported in Block E of this table)	£m	28.650	27.909	56.559	S	64.284
12	Number of refurbished or new pumping stations	nr	0	2	2	P*2,3	0
13	Capital investment in refurbished or new pumping stations	£m	5.267	3.078	8.345	P*2,3	25.939
14	Number of refurbished or new service reservoirs	nr	0	0	0	S	0
15	Capital investment in refurbished or new service reservoirs	£m	1.534	0.000	1.534	S	2.965
D		Key activity projections - management & general					
16	Offices, labs, depots, workshops	m ²	0.0	0.0	0.0		0.0
17	Capital investment in offices, labs, depots, workshops and vehicles	£m	7.450	2.803	10.253	P*2,3	8.997
18	Capital investment in instrumentation, control and automation (ICA), telemetry & computers	£m		0.000	0.000		
E		Key activity projections - metering performance					
19	Number of household meters renewed	nr			23,904	S	50,358
20	Optional meters: households	nr			8,400	S	5,687
21	Selective meters: households	nr			23,540	S	51,175
22	Percentage of households metered (at the end of the period)	%			48%	S	71%
F		Total - water service					
23	Total capital investment in the water service	£m	73.486	47.220	120.706		126.148

A3.4 Table A4 – Key activity projections

A3.4.1 Section A – Key activity projections – water resources

Line 1: Length of raw water aqueducts refurbished

Replacement of the raw water main from Bough Beech reservoir to Bough Beech Water treatment works is proposed in 2010/15 as part of the upgrade proposed at that site.

Line 2: Work on dams & impounding reservoirs

No substantive work is proposed on the company's one raw water storage reservoir, Bough Beech.

Line 3: Capital investment in aqueducts, dams and impounding reservoirs

Total capital investment on items described in lines 1 and 2.

A3.4.2 Section B – Key activity projections – water treatment

Line 4: Number of refurbished or new treatment works

Substantive work at Bough Beech water treatment works (Phase 2 upgrading and refurbishment) split between maintenance and supply/demand, and maintenance at Elmer and Woodmansterne water treatment works.

Line 5: MI/day of refurbished or new treatment works

Base is the combined current capacity of Bough Beech, Elmer and Woodmansterne water treatment works at the start of the AMP5 period. Enhancement is the proposed 25 MI/d increase in the capacity of Bough Beech water treatment works.

Line 6: Capital investment in refurbished or new treatment works

Total capital investment at all water treatment works.

A3.4.3 Section C – Key activity projections – water distribution

Line 7: Length of mains renewed

The mains renewals programme has been determined from the Common Framework models generated by the Company as part of its Capital Maintenance submission.

The proposed mains renewals programme for AMP5 and AMP6 to maintain stable serviceability are summarised in Table A3-1 below. The anticipated AMP4 outturn programme is also given for comparison purposes. The programme for AMP5 is significantly smaller than the programme in AMP4 especially after rehabilitation is taken into account. Modelling indicates that the mains replacement rate will have to increase again in AMP6.

	AMP4		AMP5		AMP6	
	Length (km)	Cost (£m)	Length (km)	Cost (£m)	Length (km)	Cost (£m)
Replace (Structural)	140.0	23.6	134.3	26.8	161.7	28.9
Replace (WQ)	34.4	6.0	0	0	22.5	4.2
Reline	64.0	3.5	0	0	17.5	1.0
Total		33.1		26.8		28.9

Table A3-1 – Proposed mains renewals programme (07/08 prices)

The Company predicts a similar programme in AMP7 to that it has indicated above for AMP6.

The Company is not proposing any enhancement driven mains renewals work in the AMP5 period.

Line 8: Length of mains relined

The Company is not planning to undertake any relining works during the AMP5 period.

The Company has indicated in the Table that it will also not carry out any relining works in the AMP6 period. However, it is not possible to establish precisely whether any such works will be necessary, and hence the Company will reassess this situation for its PR14 submission.

Line 9: Length of new mains

The length of new mains includes mains extensions on building sites and reinforcements made to the network during the period.

The mains extensions on building sites have been determined from an average of the last 5 years activity. Although the current economic situation might result in a reduction in new mains laid in the short term, it is unlikely to affect the longer term average for new mains laid by the Company.

The mains reinforcements include the lengths of trunk mains being laid to enable the transfer of the enhanced output from Bough Beech WTW as described in Section A1.5.3.2.

Line 10: Number of refurbished or new district meters & pressure control valves

The Company has a comprehensive district metering system that provides night flow data from which leakage estimates are derived for over 98% of properties connected to the mains network. Approximately 60% of these properties are also served by pressure reducing valves (PRV), which maintain stable pressures throughout the relevant parts of the network.

Previously these areas would have experienced either high pressure or high fluctuations in pressure. The Company attributes a significant part of its success in controlling its burst rate and always meeting its leakage target on the effectiveness of its District Meter and PRV arrangements.

The apparatus used to record data or control pressure has a relatively short life and all items need to be replaced in either AMP5 or AMP6.

Line 11: Capital investment in underground water distribution activity (including investment in meters reported in Block E of this table)

As detailed in the line description, this line incorporates all the items in the previous lines as well as the significant investment in domestic water meters described in section B5.2.4.3.

Line 12: Number of refurbished or new pumping stations

Two booster pumping stations, Buckland and Outwood, are to be uprated as part of the distribution system improvements linked to the Bough Beech scheme. They are included as enhancements. In addition, the high lift pumping station at Bough Beech water treatment works is to be uprated. Work at Bough Beech has been included in lines 4, 5 and 6 and not included in lines 12 or 13 to avoid double counting.

There is no substantive maintenance non-infrastructure at pumping stations except for the high lift pumping station at Bough Beech water treatment works which has been included in lines 4, 5 and 6. The total column therefore equals two number.

Line 13: Capital investment in refurbished or new pumping stations

With reference to the commentary on line 12, the capital expenditure allocated to maintenance non-infrastructure is the sum of work on all of the Company's 2 intake, 50 source, and 26 distribution (booster) pumping stations. The enhancement expenditure is for the uprating of the booster pumping stations at Buckland and Outwood. It excludes the expenditure at Bough Beech high lift pumping station which is included in line 6.

Line 14: Number of refurbished or new service reservoirs

Line 15: Capital investment in refurbished or new service reservoirs

No substantive work is planned at individual service reservoirs or water towers and therefore the number in line 14 is zero. The total capital expenditure on the entire maintenance programme for all of the Company's 33 service reservoirs and 6 water towers has been reported in line 15.

A3.4.4 Section D – Key activity projections – management & general

Line 16: Offices, labs, depots, workshops

Line 17: Capital investment in offices, labs depots, workshops and vehicles

There is no substantive work planned at individual offices, labs, depots or workshops, therefore the number in line 16 is zero. The entire capital expenditure programme has been aggregated for reporting in line 17.

The activity in AMP5 includes the overall programme for improving security in accordance with the Advice Notes received from Defra (as described in Section B4.2.8) and the Water UK Standard for Security Arrangements for Operational Assets (SSAOA) (as described in Section B4.2.9). It also includes the investment necessary to mitigate the risk of flooding at three of its water treatment works sites in accordance with the Ofwat analytical framework.

Line 18: Capital investment in instrumentation, control and automation (ICA), telemetry & computers

Investment in ICA and telemetry at Company sites has already been included in the relevant lines above.

A3.4.5 Section E – Key activity projections – metering performance

Line 19: Number of household meters renewed

The Company replaces its household meters on the basis of volume that has passed through the meter. This is because the conventional piston type meters generate friction whilst rotating and ultimately cause wear which can lead to an under-recording of the flow. On average, meters are replaced approximately every 10 years and hence the replacement programme has been determined based on this length of service. The number increases for AMP6 reflecting the increased meter programme that there has been in the current period compared to that in AMP3.

Line 20: Optional meters: household

Line 21: Selective meters: household

The number of household meters to be installed in the forthcoming two periods is consistent with the Company's Final Draft Water Resources Management Plan. The intention is to install a total of 31,940 meters in the AMP5 period on properties currently paying on an unmeasured basis. The number of customers volunteering to have a meter under the optant programme is forecast to be 1,680 per annum. The remainder of the approximately 6,400 installations per annum will be carried out as part of a selective programme on change of occupancy.

Line 22: Percentage of households metered (at the end of the period)

As a result of the Company's current programme of metering it predicts that approximately 34% of residential properties will be metered by the end of the AMP4 period. Based on the programme described above and new properties which will be automatically metered, the Company proposes to achieve 90% meter penetration by 2025.

A3.4.6 Section F – Total – water service

Line 23: Total capital investment in the water service

The sum of all items included on the Company's capital programme and presented in each of the cost lines in this table.

A3.5 Table A6 – Efficiency improvements

A3.5.1 Section A – Operating expenditure outperformance since PR2004

Line 1: Water operating expenditure outperformance

Line 2: Water outperformance as a % of regulatory expectations

Outperformance occurred in 2004/05 and 2005/06.

Line 3: Total adjusted water opex incentive revenue allowance

This only occurs in 2005/06 and hence only applies to 2010/11.

A3.5.2 Section B – Capital expenditure outperformance since PR2004

Line 7: Water service capex outperformance

Line 8: Capex outperformance as a % of regulatory expectations

The Company is forecasting a small capital expenditure outperformance arising from efficiency savings on SEMD and metering. The majority of this saving has been reallocated to other capital projects as part of the Company's promise to spend its capital allowance. For an explanation of how these figures have been derived please refer to Part B2, and Table B2.1b.

A3.5.3 Section C – Overall compounded efficiency improvements

Line 11: Operating expenditure (base service)

Line 12: Operating expenditure (enhancements)

Line 13: Capital maintenance expenditure - infrastructure

Line 14: Capital maintenance expenditure – non-infrastructure

Line 15: Capital enhancement expenditure - infrastructure

Line 16: Capital enhancement expenditure – non-infrastructure

Line 17: Capital enhancement expenditure – meters

General

The Company's approach for assessing the future scope for efficiency improvements is set out in detail in our commentary for section B2. For both operating and capital maintenance expenditure, the scope for efficiency includes an assessment of frontier shift and catch up efficiency. Based on the evidence we have received from Frontier Economics, we believe that the scope for frontier efficiency shift is limited to 0.0% pa for opex and +0.8% (i.e. increases in real terms) for capital costs. Based on an assessment by Frontier Economics, an appropriate rate for assumed catch up is 0.3% pa for both opex and capital maintenance. This is based on an application of Ofwat's existing suite of efficiency econometric models and an assessment of appropriate special factor claims. The compounded efficiency improvements reported in lines 11 to 16 all reflect this described assessment.

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Table A7

Final Business Plan 2009

Sutton and East Surrey Water plc
Water service - Expenditure projections

		AMP4				AMP5				
		2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	
Line description		Units								
A	Base service levels (£/property served)									
1	Operating expenditure to maintain current services to consumers	£/prop	94.03	95.90	102.42	106.18	110.11	112.56	114.41	114.01
2	Expenditure on pipelines, dams and aqueducts to maintain current services to consumers - "infrastructure"	£/prop	31.31	19.24	22.00	17.58	19.57	23.92	23.89	17.87
3	Expenditure on surface assets (includes abstraction, treatment, pumping and service storage) to maintain current services to consumers - "non-infrastructure"	£/prop	34.67	32.90	38.87	57.80	43.82	25.09	19.02	22.50
B	Enhanced service levels (£/property served)									
4	Additional operating expenditure for improving services to consumers	£/prop	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
5	Additional capital expenditure for improving services to consumers	£/prop	0.00	0.00	0.00	0.00	3.54	3.54	0.00	0.00
C	Supply/demand balance (£/property served)									
6	Additional operating expenditure to continue to maintain and improve the balance between the water available and the demand from consumers	£/prop	0.00	-0.18	2.06	2.65	2.81	2.97	3.25	3.36
7	Additional capital expenditure to continue to maintain and improve the balance between the water available and the demand from consumers	£/prop	12.23	14.28	14.48	31.38	42.01	27.41	25.77	12.96
D	Quality enhancements (£/property served)									
8	Additional operating expenditure to meet new environmental and water quality standards	£/prop	0.00	0.00	0.21	1.24	1.31	1.30	1.29	1.09
9	Additional capital expenditure to meet new environmental and water quality standards	£/prop	0.04	0.02	0.02	0.59	3.28	3.28	2.43	3.68
E	Enhancements - large projects (£/property served)									
10	Additional operating expenditure for large projects	£/prop	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
11	Additional capital expenditure for large projects	£/prop	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
F	Water service totals (£/property served)									
12	Total operating expenditure	£/prop	94.03	95.72	104.70	110.07	114.23	116.82	118.95	118.45
13	Total capital expenditure excluding grants and contributions	£/prop	78.25	66.44	75.37	107.34	112.23	83.24	71.10	57.02
14	Average connected properties - water (excluding empty properties)	000	266.10	268.82	270.86	272.89	275.23	277.63	280.26	282.97
G	Water service totals (£m)									
15	Total operating expenditure	£m	25.022	25.731	28.359	30.036	31.441	32.434	33.336	33.520
16	Total capital expenditure excluding grants and contributions	£m	20.822	17.860	20.414	29.291	30.888	23.110	19.927	16.135
17	Total capital grants, contributions and compensation for abstractions.	£m	0.928	0.556	0.553	0.761	0.759	0.786	0.847	0.824

A3.6 Table A7 – Expenditure projections

A3.6.1 Section A – Base service levels (£/property/served)

Line 1: Operating expenditure to maintain current services to consumers

A comprehensive review of operating costs is included in Section A1.5.2.4.

During the current period, operating costs have continued to rise above the rate of inflation. This is forecast to continue for the forthcoming period with the majority being beyond the control of the Company. Power costs have risen significantly in the past few years and have had the greatest impact on our operating costs. We believe there has been a permanent shift which in power costs will last throughout the forthcoming price review period. The other cost increases that are likely to impact on our business, such as abstraction charges, rates and traffic management charges, are determined by Government and statutory bodies.

Line 2: Expenditure on pipelines, dams and aqueducts to maintain current services to consumers – “infrastructure”

A comprehensive review of infrastructure costs is included in Section A1.5.2.2.

The Company's proposed programme to maintain its infrastructure assets in the AMP5 period is noticeably smaller than that being carried out in the current period. Expenditure is also comparatively lower. The main reason for the difference is that the Company have been unable to justify a mains renovation programme due to discolouration. It is the Company's aim to maintain its assets in a condition that delivers stable serviceability and its proposed programme is designed to achieve this.

Line 3: Expenditure on surface assets (includes abstraction, treatment, pumping and service storage) to maintain current services to consumers – “non-infrastructure”

A comprehensive review of non-infrastructure costs is included in Section A1.5.2.3.

The Company's proposed programme to maintain its non-infrastructure assets in the AMP5 period is comparable to that being carried out in the current period. Expenditure also remains broadly similar. It is the Company's aim to maintain its assets in a condition that delivers stable serviceability and its proposed programme is designed to achieve this.

A3.6.2 Section B – Enhanced service levels (£/property served)

Line 4: Additional operating expenditure for improving services to consumers

No commentary required.

Line 5: Additional capital expenditure for improving services to consumers

In accordance with the information requirements, the Company has included in this section its proposed programme to mitigate the risk of flooding at three of its water treatment works sites.

A3.6.3 Section C – Supply/demand balance (£/property) served**Line 6: Additional operating expenditure to continue to maintain and improve the balance between the water available and the demand from customers**

This cost includes the cost of producing and treating more water to supply customers demand.

Line 7: Additional capital expenditure to continue to maintain and improve the balance between the water available and the demand from consumers

The cost of completing the Company's AMP4 supply/demand balance programme; in particular the metering programme and the uprating element of Phase 1 of the Bough Beech water treatment works project allocated to supply/demand. From 2010, the capital expenditure associated with the Company's metering programme, and the uprating element of Phase 2 of the Bough Beech water treatment works project

A3.6.4 Section D – Quality enhancements (£/property served)**Line 8: Additional operating expenditure to meet new environmental and water quality standards**

Includes the cost of carrying out two investigations required by the Environment Agency as part of the National Environmental Programme.

Line 9: Additional capital expenditure to meet new environmental and water quality standards

Includes the cost of implementing the Company's lead strategy associated with the reduction of the PCV for lead in 2013, and works associated with meeting defined security requirements.

A3.6.5 Section E – Enhancements – large projects (£/property served)**Line 10: Additional operating expenditure for large projects****Line 11: Additional capital expenditure for large projects**

The Company has no large projects for enhancements as defined in Part B10.

A3.6.6 Section F – Water service totals (£/property served)**Line 12: Total operating expenditure****Line 13: Total capital expenditure excluding grants and contributions**

No commentary required

Line 14: Average connected properties (excluding empty properties)

The number of connected properties consistent with JR2008, and the Company's Final Draft Water Resource Management Plan.

A3.6.7 Section G – Water service totals (£m)

Line 15: Total operating expenditure

The Company's actual operating expenditure in 2007/08 and forecast operating expenditure for 2009 to 2015. This shows an 18% real increase over the plan period and a 34% real increase since 2007/08.

Line 16: Total capital expenditure excluding grants and contributions

The Company's actual capital expenditure in 2007/08 and proposed capital expenditure for 2009 to 2015 (post efficiency).

Line 17: Forecast capital expenditure real price effect (RPE)

No commentary required.

Line 18: Total capital expenditure (2007-08 cost terms) excluding grants and contributions

As per line 16.

Line 19: Total capital grants, contributions and compensation for abstractions

None

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 Table A9PD

Final Business Plan 2009

Sutton and East Surrey Water plc
 Financial projections - Public domain

		AMP4	AMP5		
		2007-08	2010-11	2014-15	
Line description	Units				
A	Current cost profit & loss and financial indicators				
1	Turnover	£m	50	58	65
2	Operating costs	£m	24	30	34
3	Capital charges	£m	14	16	18
4	Operating profit	£m	10	13	14
5	Regulatory capital value-year end	£m	160	176	189
6	Pre tax return on regulatory capital value	%	6.3%	7.4%	7.1%

A3.7 Table A9 – Financial projections

A3.7.1 Section A – Current cost profit and loss and financial indicators

Line 1: Turnover

Turnover calculated by the Tariff basket, K factors and RPI discussed in other Parts of the Plan. The large increase occurs in 2010/11 where increased operating costs, especially power and chemicals start to impact on prices.

Line 2: Current cost operating profit

This is current cost operating profit before tax. The profit has reduced in 2009-10 due to the full impact of increased power costs with no recognition within prices (and therefore turnover) until 2010/11.

Line 3: Net interest receivable less payable

This line includes current bond interest and indexation costs. The cost of the amortisation of bond issue costs is ignored. Preference share dividends are also excluded although for accounting purposes they are treated as interest.

Line 4: Net tax on profit on ordinary activities

No comment.

Line 5: Dividends

Dividends remain constant in real terms throughout the AMP5 period until 2014/15 when some growth (2%) is considered affordable.

Line 6: Regulatory capital value – year end

This is calculated in accordance with Ofwat's methodology. It increases substantially during the period because of new investment, most notably, in Bough Beech.

Line 7: Regulatory capital value – year average

This is calculated in accordance with Ofwat's methodology. It increases substantially during the period because of new investment, most notably, in Bough Beech.

Line 8: Current cost dividend cover

No comment.

Line 9: Pre tax return on regulatory capital value

This is in accordance with our proposed 6.1% pre-tax cost of capital. There is an opex outperformance adjustment of 0.4% in 2010/11.

Line 10: Post tax return on regulatory capital value

A post tax return of 5.45% is assumed (see comments above in line 9 above).

A3.7.2 Section B – Historic cost profit & loss and financial indicators**Line 11: Operating profit**

The profit has reduced in 2009/10 due to the full impact of increased power costs with no recognition within prices (and therefore turnover) until 2010/11. The operating profit is maintained at reasonable levels in the AMP5 period.

Line 12: HC dividend cover

This ratio is quite low but it includes a significant non-cash item (bond indexation cost).

Line 13: Total net debt

This includes our bond and bank finance. However it also includes our preference shares, ignores the bond fees and deducts all our available cash so it will not reconcile with our bond covenant calculation.

Line 14: Gearing: D/R CV

This ratio is at a level that is acceptable but the calculation is inconsistent with our bond covenants due to the comments in line 13 above.

Line 15: Cash interest cover (funds from operations; gross interest)

No comment.

Line 16: Adjusted cash interest cover (funds from operation less capital charges; gross interest)

We have to prepare a plan that meets the interest cover ratios required by our bond and potential new bond finance. This ratio needs to be around 1.8x to meet these requirements.

Line 17: Debt payback (FFO / debt)

This averages around 15% during the AMP 5 period which is an acceptable level.

Line 18: Debt payback (RCF / debt)

This averages around 12% during the AMP 5 period.

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Table A10

Final Business Plan 2009

Sutton and East Surrey Water plc

Water and sewerage services - Summary of justification of company investment proposals

		Contribution to annual average household bill in 2014-15 £/year	Net present value of costs arising from investment proposals in 2010-15 £m	Net present value of benefits arising from investment proposals in 2010-15 £m	Capital expenditure proposed for 2010-15 [AMP5] £m	Operating expenditure in 2014-15 £m/year
Line description	Units					
A Water Service						
1	The total plan for the water service 2010-2015	16	113	153	121	34
2	Investment proposals demonstrated to be cost-beneficial	16	113	153	121	34
3	Investment proposals shown to be non-cost-beneficial	0	0	0	0	0
4	Investment proposals not assessed	0	0	0	0	0

A3.8 Table A10 – Summary of justification of Company investment proposals

A3.8.1 Section A – Water service

Line 1: The total plan for the water service 2010-15

This shows the financial impact (in terms of impact on bills, total costs, benefits, capex and opex) of the Company's proposed investment programme as a whole. The figures entered here have been calculated from those reported in Table C8.1 and further information regarding these can be found in the commentary in Part C8.

Line 2: Investment proposals demonstrated to be cost beneficial

As outlined in the commentary for Part C8, all of the Company's investment proposals are found to be cost beneficial. Therefore the figures entered for this line are equal to those in line 1.

Line 3: Investment proposals demonstrated to be non-cost beneficial

None.

Line 4: Investment proposals not assessed

None.