

Part B1 – The Post 2010 Environment**Summary Report by REPORTER**

As at DBP, Thames has prepared a four-part submission for Section B1 which presents detailed discussion of its achievements to date, an assessment of the post-2010 environment, an overview of risks & uncertainties and a discussion on achieving the right balance for customers and the environment. We confirm that the structure and content accords with Ofwat guidance.

There is no specific Reporter guidance for Part B1 but our audit plan indicated we would highlight the principal changes between DBP and FBP. We have reviewed the content of the Company's report in the light of our knowledge of the SDS, DBP, other parts of FBP and JR08 to confirm its consistency. Formal audit of data presented in the Company submission is outside the Reporters scope and in this section we provide a brief commentary on Thames' report, highlighting areas of regulatory interest for PR09.

We confirm that the strategy summarised by Thames in Part B1 represents the latest available information and is consistent with that used elsewhere in FBP.

Achievements to date compared with earlier plans

Since DBP, Thames has updated its performance data and provided revised forecasts to 2010. Thames has outlined progress since its inception against a range of measures covering statutory obligations, regulatory performance and investment.

The section includes a more detailed review of AMP4 performance and 2010 forecasts versus the FD04 target, together with summary reports of progress against two key business-driven targets; *'operating in an open and transparent manner that builds credibility and trust with stakeholders'* and *'achieving efficiencies in operating costs and capital investment'*; against which Thames, under the new management impetus has excelled.

Thames concludes by highlighting the improvements to performance and efficiency that it has achieved during AMP4, particularly since December 2006 as evidenced by June Return data. We observe that this is a creditable record and note the impact of new management focus has been instrumental.

Assessment of the Post 2010 Environment for the Company

Thames identifies the key challenge, post-2010, is delivering the strategic vision described in its Strategic Direction Statement in the light of environmental, political, regulatory and economic changes which will impact

on its future operating environment. The Company has outlined how the deteriorating economic position and more uncertain outlook have affected its business and impacted on plans for AMP5.

The Company has identified that economic circumstances have radically changed over the 8 months since DBP. Thames has noted that at the time of preparing DBP economic forecasters envisaged a *'slowdown in growth'*, whereas eight months later at FBP Thames' reports that *'we find ourselves in the midst of a recession, but we are also facing deflation for the first time in the industry's history'*.

The Company has taken account of reports from HM Treasury, Bank of England and PwC to assess the impact on its business and concludes that *'the effect of the economic downturn will continue to be felt through the remainder of AMP4 and the early years of AMP5'*.

This significant change in the economy since DBP, has drastically affected Thames' future plans to the extent that for FBP revised projections for inflation, housing development and population forecasts, bad debt, revenue, energy prices, interest rates and the cost of capital have been necessary. In each of these areas, Thames has taken professional advice and has set out in B1 the key planning assumptions for FBP.

We concur with Thames' apprehension and share the concerns about planning and projecting long-term business performance in the current economic climate. We note the regularity that revised economic forecasts are released and that there is still no consensus over the length, depth and reach of the recession or the timing and pace of recovery.

At the time of DBP, Thames noted uncertainties relating to the environmental framework and identified potential new legislation or re-interpreted existing legislation which would drive 'significant costs' if brought in during AMP5.

For FBP, Thames has extended the list to include: EPA liability for 'deposits of sewage' and the impact of legislation for private sewers. In FBP, Thames has proposed a Relevant Change of Circumstance mechanism for:

- Water Framework Directive
- EU Infractions
- Drinking Water Directive
- EPA liability for deposits of sewage
- Groundwater Directive;

and following guidance from Ofwat to exclude costs from its plan a Notified Item for:

- Adoption of Private Sewers

The Company has adopted a similar approach to potential uncertainties relating to sustainability and climate change . *(Text Redacted)*

At DBP, Thames identified skills gaps in the water sector as a potential future issue and for FBP has drawn on research (by Energy & Utility Skills) funded by Water UK to evaluate current and future skills needed in the UK water industry. Skills modelling, specific to Thames indicates a substantial staff recruitment and development need over the coming AMP periods, and Thames notes that investment in skills was recently approved by Ofgem in the energy sector, although we observe that current downsizing and rising unemployment may partially mitigate this requirement.

The Company has included comments on the impact of the development of competition emanating from the initial findings of the Cave Review, which it considers will drive both costs and benefits. Thames notes that many details of the competitive market are dependent on a large number of decisions yet to be taken.

Managing Key Risks and Uncertainties

Thames has described its operational risk management procedures, provided an overview of its implementation of the UKWir AMPAP to enhance its asset management capability and summarised its risk management procedures. We have confirmed these are widely used in Thames and that it operates formal risk registers to actively minimise overall risk exposure - particularly in large engineering projects such as the Thames Tideway and Upper Thames Reservoir, both of which are highlighted in the commentary.

The Company has included a list of Notified Items which is similar but reduced to that included in DBP. The FBP has excluded: BWB charges (under arbitration) and energy (for which it has proposed a risk-sharing mechanism). We consider these issues are significant and need to be addressed in the Periodic Review process. We also note that many are common across the industry and not unique to Thames.

Achieving the Right Balance for Customers and the Environment

The Company has been particularly proactive in seeking the views of customers (both domestic and business), environmental groups and other stakeholders' at all key stages of development of its SDS, DBP and FBP. The results of Customer research have been used to define strategy and to inform the willingness to pay for changes in service standards which in turn informs cost benefits analysis of the future programmes. Audit of the customer research is outside the Reporter's remit but we have confirmed it has been peer-reviewed by leading experts where it has been highly commended. We

confirmed that the strategic findings have been properly translated into company strategy.

The Company has described the eight-step approach used for development of FBP, the application of which we have confirmed in the various components. This has resulted in a significant refinement of DBP and provides a strategic framework within which FBP has been developed and in response to the challenges posed by the economic downturn.

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