

Folkestone & Dover Water Services Limited

Final Business Plan

The Company's Final Business Plan is in three parts. Part A describes our overall long term strategy. Parts B and C describe and explain the plan in detail. Each part includes relevant rationale, methodologies, analysis, proposals, tables and table commentaries. Additionally, Parts B and C include an introductory section, which details material differences between the final business plan and both the strategic direction statement and the draft business plan.

The overall structure and sections of our Final Business Plan are shown below:-

Section A The Company Strategy

- A1** The Overall Strategy
- A2** Investment Proposals 2010-2015
- A3** Financial Projections
- A4** Risk and Uncertainty
- A5** Board Endorsements

Section B The Company Environment

- B1** The post 2010 environment and the longer term
- B2** Improving efficiency
- B3** Maintaining service and serviceability
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Company Commentary

Part A The Company Strategy

Section A1 The Overall Strategy

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Company Commentary

Part A The Company Strategy

Section A1 Overall Strategy

Folkestone and Dover Water Services supplies water to the towns of Folkestone and Dover, and surrounding rural areas including Romney Marsh and Dungeness (420 square kilometres). It supplies 44 million litres of water each day to a population of approximately 158,000 people in more than 75,000 properties. The Company does not have any surface water in rivers or major reservoirs to draw on. It is entirely reliant on water stored underground in chalk and gravel aquifers.



The South-East of England is identified as an area of water stress by the Environment Agency. This means that in prolonged dry periods, or droughts, there is insufficient rainfall to recharge the aquifers and consequently there is the risk that demand for water cannot be met.

Expectations of service and environmental protection are nevertheless high.

As a result of these two factors, in March 2006, the Company was the first water company in the country to apply for and be granted “Area of Water Scarcity” status by the government.

Despite the difficulties caused by water stress, the Company has for many years provided a service to its customers which is among the best according to Ofwat’s (Water Services Regulation Authority) performance assessments.

Among the Company’s many challenges, the two that feature highest and represent its customers’ priorities are:

“ensuring a reliable supply of good quality safe drinking water”

and

“continuing to balance customers’ demand for water with the water which is available”

The Company must meet these challenges in a sustainable manner and in a way which customers can afford and are willing to pay for. Part A summarises the Company’s current performance, long-term strategy and its plan to achieve this.

Section 1.1 Service Level and Outputs since the Last Price Review

The period since 2005 has been challenging for the Company. In the period 2000 to 2005 the Company installed complex treatment processes in order to ensure continued supply of high quality water. Requiring the provision of several membrane filters and advanced technology such as reverse osmosis, these complex treatment processes were necessary because the quality of the raw water that the Company relies upon had deteriorated. The full operational and cost impact of this step-up in treatment complexity was felt in the period post 2005 and was allowed for in the Company's operating costs by Ofwat.

The "early start" capital investment programme, due for completion in November 2006, was the biggest two-year programme in the Company's history. This programme was necessary in order to improve the security of supply to consumers, by providing some extra water and greater ability to move water around our networks to where it is needed at any particular time. At the same time, the Company made the first application to the Secretary of State for EFRA, to be granted "area of water scarcity" status, to allow it to meter as many as possible of its domestic customers on a more efficient and rapid area basis.

All of this occurred during the longest, driest period in the area for over 80 years, when water resources were being stretched to meet customers' needs.

Nevertheless, the Company has maintained an uninterrupted supply of high quality drinking water to its customers and continues to score highly in customer surveys in respect of quality of service.

Section 1.1.1 Meeting Customer Demand

New Resources

In order to mitigate the risks associated with dry periods and droughts, the 'early start' programme involved:

- the construction of the Denge Security Main (approx 21km) to enable water to be transferred throughout the Company's area to the point of need, and
- the development of two new water resources, Buckland Mill and Bushy Ruff.

The programme is complete with the exception of the Bushy Ruff resource development.

Unfortunately, while the Environment Agency (EA) gave full support to the development of Bushy Ruff in the 2004 Price Review (PR04), subsequent investigation led it to decide that any abstraction there would require an equal reduction at one of the Company's other licensed boreholes within the same aquifer (i.e. no net gain in yield). Accordingly, the Company cannot proceed with the Bushy Ruff scheme. The Company has, however, been able to commission a new borehole at Cow Lane and completed the refurbishment of Dover Priory treatment works. These programmes ensure that the Company has enough water available to meet customers' demand in a dry year and that it has met its Security of Supply Index (SoSI) regulatory target of 100 in 2008/09.

Metering

The Company's strategy has been to develop a twin-track approach to balancing supply and customer demand for water. This seeks to maximise reductions from cost-beneficial demand management, while providing additional water resources to avert the risks of any remaining gap between supply and demand. As it has limited opportunity to develop new low-cost water resources, the Company had previously proposed a longer-term demand management strategy that required 90% of customers to be metered by 2015. A pre-requisite for this was to obtain statutory "Area of Water Scarcity" status to enable customers to be metered on an area rather than individual basis.

Following the grant of 'Area of Water Scarcity' status, the Company began metering on an area basis on 1st January 2007. The meter installation programme is ahead of schedule for the period. Nearly 16,000 meters have been installed. The Company now has a domestic meter penetration of 66% and we expect to exceed 70% by 2010. The Company believes that it can therefore revise its installation target to 96% by 2012. The Company received approval from Ofwat on 9th January 2009 to proceed with an accelerated metering programme as from 1 April 2009 in order to achieve this revised target.

To support the Company's strategy and develop its understanding of the benefit that metering can bring, it has begun a trial of a rising-block tariff, involving approximately 1,000 customers in Lydd. The tariff has two elements: a fixed volume to meet essential health and hygiene requirements; and additional unlimited volumes for discretionary or non-essential use. The former is at a tariff lower than the standard volumetric rate and the latter is higher than the standard. The early results of this trial will be available by autumn 2009, and will be used to inform the development of a revised tariff scheme for all customers during 2013/14.

Leakage

Reducing leakage both from the Company's own network and from customers' pipes is an important way of ensuring that more water is available for end-use by customers. The leakage reported by the Company for 2007/08 was 7.89MI/d, compared with its target of 8.20MI/d. This level is below the present 'economic level of leakage', i.e. the level at which it would be cheaper for customers if we did not attempt to reduce leakage further. That level is not an absolute and the Company continues to look closely at whether the overall advantages for customers and the environment lie in reducing leakage still further, for example, by eliminating visible leakage so far as possible, so as to remove a known irritation to customers.

Section 1.1.2 Drinking Water Quality

The Company has continued to supply water of a very high quality. The mean zonal compliance with Water Supply Regulations was 100% in 2008. This means that there were no failures of samples tested for the prescribed parameters.

Section 1.1.3 Asset Maintenance

The Company has one of the lowest below-ground asset-replacement rates in the water sector, at in excess of 300 years. Despite this, Ofwat's performance indicators suggest that the network, both trunk and distribution mains, is in a stable condition. Accordingly, the Company continued with and is achieving that replacement rate in the 2005-10 period.

Similarly, the above-ground assets are defined as being in a stable condition, using Ofwat's performance indicators. Again, the Company continued with the 2000-2005 rate of expenditure to maintain this level of service during the 2005-10 period. The rate was not achieved in the early part of the period, due to the need to divert spending to maintain operational water production at all sites during the drought. However, the Company is working to catch up with the planned pumping station and treatment works refurbishments by March 2010.

Section 1.1.4 Customer Levels of Service

The level of service being given to customers continues to be of a very high standard and one which the majority of customers are generally satisfied with. In 2007/08 the Company achieved the highest category in all the DG service level indicators.

Section 1.2 Long Term Planning – Post 2010

The Company has looked ahead to consider what the circumstances in which it operates will look like beyond 2010 and how its services will need to adapt. Customers have been consulted to ensure the Company's view of the future reflects to theirs, including service delivery priorities and willingness to pay.

Section 1.2.1 The Post 2010 Environment

There are three key issues that will dominate the Company's operating environment and influence the degree to which it is able to provide a sustainable and reliable supply of safe drinking water.

The Company operates in an area where there is likely to be **significant economic growth** and rising population. The government had already sanctioned major housing development in Ashford and the Thames Gateway and in July 2008 Dover was granted Growth Point status, indicating a minimum of 10,100 new houses by 2026. In the latest South East Plan, approximately 16,000 new houses have been allocated for the Company's operating area over the next 25 years, including those in Dover.

In 2009 the fast rail link from Folkestone to London will be operational. There is a possibility of a third nuclear power station at Dungeness and there are plans for the expansion and regeneration of Dover Port and Folkestone Harbour and the surrounding urban area in each case.

All these activities, which are not expected to be materially affected by the current economic slow-down, will inevitably increase demand for water.

The South-East is experiencing the **effect of climate change** with more erratic periods of rainfall, more intense rainfall and longer, drier periods. This change is expected to become more severe and it will reduce winter recharge of the aquifers, thus reducing the water available for supply to customers.

Climate change may also result in more flooding and lead to greater variability in the quality of the water in the underground sources. It is expected that weather extremes will worsen over the next 25 years and therefore assets and resources will need to be more resilient.

Additional water resource will be needed to provide flexibility in supply in these more volatile conditions.

The Company expects that **environmental standards** will tighten and increase in number, and public expectations will also rise. A review of abstraction licences under the Habitats Directive and Alleviation of Low Flows Project has recently been completed for three water sources and a new set of investigations is being identified by the Environment Agency's Restoring Sustainable Abstraction (RSA) programme and the Water Framework Directive (WFD). The latter is a major piece of European legislation aimed at improving the quality of water in our rivers and keeping them clean.

At best, the tightening of environmental standards would confirm existing abstraction licences but more likely it will reduce the volume of water available for supply to customers in what is recognised as a water-stressed and over-abstracted area.

The Company's ability to meet the area's water needs is reliant on the natural environment. This is under stress from a number of sources and the Company has a part to play in ensuring its protection and enhancement where appropriate. It is expected that environmental aspirations in the Company's area will rise over the next 25 years and the task of providing an economical water supply must reflect and contribute to achieving them.

These challenges should be seen against the likelihood that customers will be better off in 25 years' time – if the growth rates of the last decades are maintained, their income will on average be about twice as large in real terms. Unless something changes, this is likely to mean a continuing trend towards larger houses and accompanying forms of consumption, as well as a greater ability to pay for the services customers want from the Company.

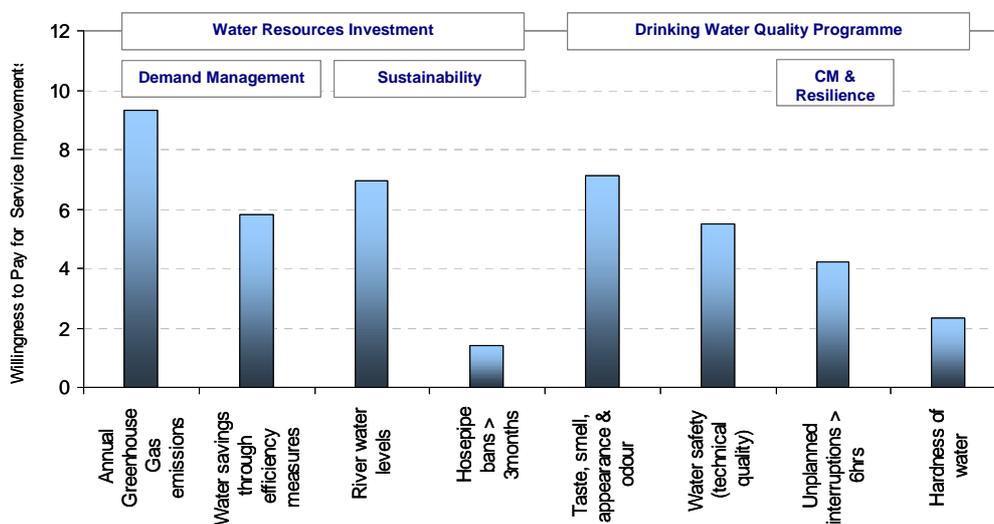
A further issue that could have a significant impact on the Company in the future is the introduction of further competition in the water industry. It is expected that accounting separation will be required and that the ability to choose supplier will be extended to all non-households. There are particular risks here for the Company because of the proportion of demand attributable to a small number of large commercial users. It is also likely that abstraction licence trading will be introduced.

Section 1.2.2 Understanding Customers' Needs

The Company has been more pro-active in consulting with and seeking the views of its customers, particularly in respect of customer service, level of service and their willingness to pay. Several distinct processes have been used and their results have informed both the Company's Strategic Direction Statement and this Business Plan.

The analysis of customer feedback confirms that their overriding priority is to receive “a reliable supply of good quality drinking water”. There is also increasing evidence that they require this to be achieved in an environmentally friendly manner. This is best demonstrated by the Willingness to Pay survey¹ conclusions that indicate consumers are prepared to pay most for a reduction in CO₂ emissions, protection of river water levels and water savings measures. The feedback also indicates that there is a reluctance, or lower priority, to improving service levels for what are regarded as the normal activities of water companies such as customer service, reducing leakage and the frequency of hosepipe bans. This indicates that in general the majority of consumers are satisfied with the service they are receiving.

Willingness to pay, £/customer



The Company’s draft Water Resource Management Plan was published in April 2008 and set out how it proposes to maintain sufficient water supplies to meet customers’ demand during the period 2010 to 2035. Public consultation has been undertaken and feedback incorporated into the Company’s Statement of Response to DEFRA. Changes made to the dWRMP in the light of the consultation have been taken into account in this Business Plan.

DEFRA published its water strategy for England, “Future Water”, in February 2008, which the Company’s strategy is aligned to and complements in many areas, including metering, per capita consumption and sustainability.

In November 2008, the Company procured a further independent survey of its customers to enable it to consider whether customers’ priorities had changed and to ascertain a more up-to-date view of their willingness to pay for the service being proposed. At the same time Ofwat, on behalf of other stakeholders, procured a national survey of customers, including over 200 within the Company’s area. Both surveys concluded that there was a high level of support for the Company’s proposals with over half of customers willing to pay more.

¹ The Willingness to Pay survey was undertaken in September 2007 and sampled 400 customers

The Company has worked closely with other regulators to consider their views and gain their support for its proposals. It has held two further quadripartite meetings with the Consumer Council for Water, Drinking Water Inspectorate and the Environment Agency. The first on the 23rd January 2009 was to discuss changes to the proposed capital investment requirements and the second on 24th February 2009 to discuss the issues that were driving price increases in this Business Plan.

Section 1.2.3 Strategic Direction Statement



The Company's vision

"To be a sustainable water supplier, exceeding stakeholder expectations through continuous improvement"

Customer priorities have been taken into account in the development of the six themes detailed in the Strategic Direction Statement and their respective targets. These are

- Theme 1 – Achieving a Sustainable Use of Water
- Theme 2 – Safeguarding Drinking Water Quality
- Theme 3 – Ensuring a Reliable Supply of Water
- Theme 4 – Mitigating Climate Change Impacts
- Theme 5 – Enhancing Customer Service
- Theme 6 – Financing our Future

This document sets out the Company's intended direction for the next 25 years and sets the context for this business plan.

Section 1.3 Business Plan 2010-2015

The Company's approach to the preparation of the business plan is more fully described in the Board endorsement in Section A5.

Throughout the business planning process, the Company has consulted customers and stakeholders and taken their views and concerns into account. Since submission of the draft business plan, further surveys have been conducted, including Ofwat's "Valuing Customers" and the findings have been incorporated into the final business plan.

Clearly, the current recession will put significant financial pressure on customers, including the ability of some of them to pay for water and we have borne this in mind in finalising the plan. The need to balance affordability and investment has led to several significant changes since the submission of the draft plan for the 2010-2015 period.

In order to provide the service that customers have indicated to be their priority and secure the long-term aspirations of the Company in an affordable manner, the targets and main activities proposed during the 2010-2015 period have been aligned with the six themes of the Strategic Direction Statement and are as follows.

Section 1.3.1 Achieving a Sustainable Use of Water

To have access to sufficient water to meet consumers' demands having regard for the water resource situation in south-east Kent and taking into account the need to protect the environment.

The objective is to maintain an adequate surplus of available water, such that in a dry year the Company will be able to meet customers' demand for water. This will be achieved through the continuation of the Company's "twin track" approach of developing new water resources in parallel with managing demand.

The Company operates in one of the driest parts of England and has limited access to good-quality raw water. Studies undertaken for the Water Resource Management Plan indicate that the next significant new water resources will come from the development of a desalination plant, or in the much longer term a regional reservoir. Consequently, the emphasis during this period will be on demand management activities because they are more cost effective. Desalination is currently an expensive energy-intensive solution.

Accordingly, the key targets are:

- Achieve a Security of Supply Index (SoSI) score of 100 by 2010 and maintain it thereafter – this will require access to sufficient water to maintain supply, even in dry periods, across the whole area. This was achieved in 2008/09.
- Meter all customers' supplies that can be by 2012 – estimated to be 96%. The acceleration in 2009/10 has been approved by Ofwat as a 'log up' in the current period.
- Reduce average daily consumption per person to 120 litres by 2015 – currently 140 litres for metered households.

The Company proposes to introduce in 2013 a socially-responsible stepped tariff for all customers as a low-cost way to incentivise customers to avoid unnecessary use of water, thereby reducing overall demand; this is currently being trialled in Lydd. In doing this, the Company recognises the need to be sensitive to issues of affordability that may affect some customers and will work to ensure appropriate safeguards are built into services offered.

Demand management through the period will include a continuation of the leakage strategy followed in the current period. This is part of a 10-year plan to achieve a Sustainable Economic Level of Leakage (SELL) and is supported by "least cost" modelling and by customers.

The Company will seek to extend beyond 2015 its current right to receive regional water resources through the existing bulk supply agreements with South East Water and Southern Water.

During the period, the Company will continue to identify and develop longer-term water resources options and will participate in further studies with South East and Southern Water to identify options for improving the environmental status of the Little Stour river. However, no allowance has been made for any reduction of abstraction licences under the Water Framework Directive, Habitats Directive or Alleviation of Low Flows project, as these are not yet known.

The Company's strategy is innovative and sustainable, promotes least-cost solutions and reduces carbon emissions. Significantly, it aligns with the views of our customers that water conservation is important and that metering is the fairest way of paying for water.

Section 1.3.2 Safeguarding Drinking Water Quality

All of our consumers have access at their tap to good quality, safe and wholesome water that is aesthetically pleasing and enjoyable to drink.

The Company has a good track record of providing customers with high quality drinking water. In order to continue to provide water that meets the standards set down in the Water Supply Regulations, the Company has agreed two projects with the Drinking Water Inspectorate for the 2010-2015 period.

The first is the provision of additional treatment at the Denge Water Treatment Works, where there is deteriorating raw water quality (attributable to iron, manganese and turbidity). The second is for a systematic mains-flushing programme in the Denge water supply zone. Both are necessary to avoid major discolouration events.

The Company is also proposing a series of measures to ensure that its sites comply with the various Advice Notes issued by DEFRA under the Security and Emergency Measures Directive.

Following the summer floods of 2007, in common with other water companies, the Company has reviewed the resilience of its infrastructure to extreme weather events. Its sites are generally well located or protected, but the Company has identified six sites where further reinforcement work is necessary to protect them from flooding. The Company proposes to deal with these sites during the 2010-2015 period.

Section 1.3.3 Ensuring a Reliable Supply of Water

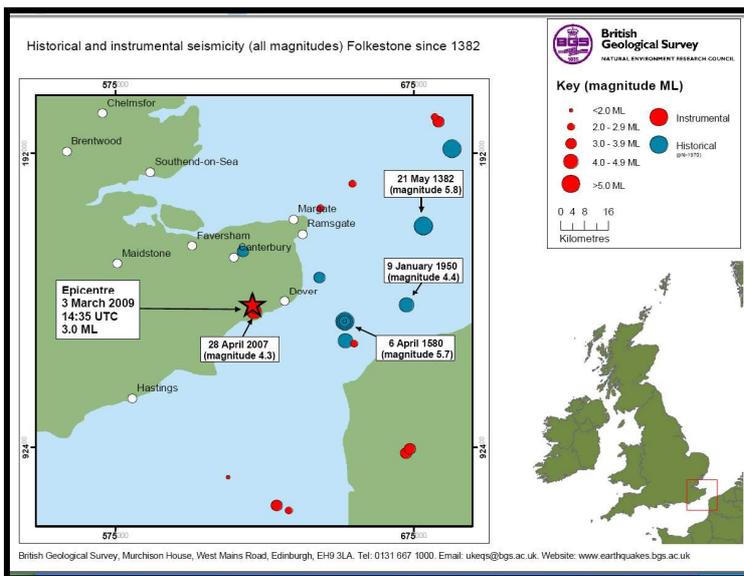
Customers have a reliable and continuous supply of drinking water at their tap.

Consumers are very clear in their desire for an uninterrupted and reliable supply of high quality drinking water through their taps. In the willingness to pay survey, they indicated that they would be prepared to pay more to maintain the current level of unplanned interruptions. Unplanned interruptions are a consequence of deteriorating assets (i.e. pipes and treatment works). Currently both pipes and treatment works are considered "stable" in Ofwat's serviceability assessment.

The rate at which the Company is currently renewing pipes is the lowest in the water industry at in excess of 300 years and the burst frequency is also among the lowest. However, the detailed assessments undertaken by the Company suggest that, unless the renewal rate is increased, there will be a deterioration, with more frequent bursts and therefore more unplanned interruptions.

The draft Business Plan included an increase in the replacement rate to 1 in 200 years for the pipe network. This level of renewal is still among the slowest in the water industry. The Company considers that in the longer term an accelerated rate is essential to maintaining stable condition. However, in recognition of the low likelihood of immediate rapid deterioration and the financial pressures facing many of our customers over the next few years, the Company has decided to continue with current rates of renewal for the next five year period. It believes however that it will be essential to increase the renewal rate in 2015-20 and thereafter to a sustained 5Km/year.

The Company has undertaken an assessment of all of its trunk mains on the basis of the likelihood and consequence of failure. This identified the need to replace or duplicate three trunk mains and these costs were included in the draft Business Plan. Failure of these trunk mains would lead to a very significant number of customers being without water.



Following submission of the draft Business Plan, further investigations have been carried out. These have identified an alternative, lower cost, solution for one of the mains (TP28). This solution removes the considerable risk to service that the loss of this main would have, recognising that it sits in a geological fault plane which has been subject to two earth tremors in the last two years (i.e. April 2007 and March 2009). The location of these are shown in the figure A.

Figure A

In 2000-2005, the Company invested significantly in membrane filtration water treatment technology to treat all water at risk of water quality failure due to cryptosporidium. Approximately 70% of water put into supply now undergoes this form of treatment. These membranes have a short life and will need to be replaced during the period. The maintenance of these and other above-ground assets is essential to ensure reliability of supply and maintain levels of service.

The Company has assessed the risk and consequence of failure of its other key infrastructure. This has highlighted the need to duplicate the Hills Reservoir. This project was included in the Company's last price limits submission, but rejected by Ofwat due to insufficient supporting evidence. The project is again included with more robust evidence in support of it. In the event of a failure of the Hills Reservoir a significant number of properties would be without water for an extended period.

Section 1.3.4 Mitigating Climate Change Impacts

A company that operates in a responsible manner to mitigate climate change through its own actions and those of its contractors, suppliers and customers.

The Company is working with its customers and suppliers to reduce emissions and help reduce the severity of its climate change impacts.

Government is setting longer term targets for cutting CO₂ emissions in the UK (60% by 2050). However, in line with customers' stated preferences, the Company has set its own targets of:

- a 1% per annum reduction in energy use from carbon sources up to 2020; and
- use of a minimum of 20% renewable energy by 2020.

The Company's strategy over the next five years is consistent with this. Through demand management activity, the Company expects to reduce energy requirements by pumping less water into supply. The capital maintenance programme will continuously look at the efficiency of existing assets and the opportunities to replace inefficient plant with new more energy-efficient plant and technology.

Customer engagement and socially responsible tariffs will also contribute towards achieving these targets during the period. As customers use less water in response to the Company's encouragement, they are likely to make consequential reductions in their own energy use. These savings have not been included in the Company's calculations.

Section 1.3.5 Enhancing Customer Service

Trusted by our customers to provide a service that exceeds expectation at a cost which they are willing to pay.

Customers have not indicated a willingness to pay more for improved levels of service. Given the overall performance of the Company, in particular the customer service levels achieved over recent years and customers' perception of the service provided, this is perhaps not surprising. Taking customers' views into account and considering the other significant pressures for investment, the Company does not propose any enhancement to existing service levels for the coming period. It is the intention to maintain current levels of service.

"Customer experience" is an area, however, where the Company will make improvements. Specifically, during the period 2010-2015, the Company intends to:

- develop billing literature which gives greater clarity and information relevant to customers' own use of water

- increase the frequency with which customers receive a bill based upon actual meter readings from two to four each year. This will coincide with the introduction of new company-wide tariff(s)
- ensure that both telephony and internet facilities provide effective routes for customers to contact the Company, including to enable them to manage their accounts, and vice versa
- promote a “right first time” culture within the Company, so that customers do not feel that they have to come back repeatedly to get a clear answer to their queries
- develop a wider range of services for offer to both domestic and non-domestic customers

The Company will continue to use quantitative customer feedback to assess the level of satisfaction customers have with the services provided.

Section 1.3.6 Financing our Future

To achieve our vision in a manner that allows a fair return to investors at a cost that customers are willing to pay.

The Company has a very clear strategy on charging. It believes that the fairest way for customers is for bills to be based on the amount of water they use. Over 80% of customers agree with us and this has been taken into account in deciding to accelerate the compulsory metering programme so as to ensure that by 2012 all customers who can be metered receive a bill based upon volume used.

Customer debt has been increasing in recent years with significant deterioration in the second half of 2008. Current economic forecasts suggest that there will be further deterioration over the coming two or three years. Where there is genuine hardship, the Company will continue to offer support as it does currently through the WaterSure scheme, the EOS Charitable Trust and other appropriate mechanisms. The Company does not believe that it is the responsibility of water companies to offer social tariffs to address ‘water poverty’ and has no plans to introduce them. The Consumer Council for Water undertook national customer research and its findings suggest that most customers do not wish there to be any cross-subsidy to assist those less able to pay. Their research also supports the Company’s position that ‘water poverty’ should be a matter for government to deal with through the social benefits and taxation system.

The Company will continue to lobby government for legislative change to provide the tools to ensure that all customers pay for the water they use. This will also include the use of devices such as trickle-flow meters to encourage those that choose not to pay, but can afford to, to do so.

Section 1.4 Achieving the Right Balance for Customers

Section 1.4.1 Price Limits 2010-2015

The Company strategy has the views of customers and other stakeholders at its heart. It reflects their desire for a “sustainable” and “reliable supply of high quality drinking water”. It also recognises the current financial difficulties that many of our customers will be facing.

Sections A2, A3 and A4 provide the details which have been used to determine the price limits and therefore the impact on customers' bills, as shown in the table below:

	2010-11	2011-12	2012-13	2013-14	2014-15	Average
"k"	12.5	5.9	2.4	6	-0.8	5.2
Average Unmeasured Household Bill (£)	246.23	262.60				
Average Measured Household Bill (£)	172.16	181.17	185.10	195.27	193.92	185.52

The proposals translate into increases in prices in real terms in the first four years of the period to 2015 as detailed in the table. The average for unmeasured bills from 2012-2013 onwards is not given as by then all households will be measured or on a domestic assessed tariff because their property cannot be metered. The table details the average bill in real terms (i.e. without inflation).

The effect of the price limits is to take the average measured household bill from £152.85 in 2010 to £193.92 in 2015. This equates to an average measured household increase of £41.07 over the five year period.

A major influence of 'k' is the rebalancing of bills to reflect lower water usage. There are several factors which have influenced this in the period 2005-2010, including the effects of the drought, wetter summers and the current economic situation. However, the Company believe the metering of customers and customers response to the Company's water efficiency campaigning is also having a more permanent effect. This is forecast to continue into the 2010-2015 period if the target per capita consumption targets are achieved. As most of the Company's costs are fixed and do not vary with consumption, average bills need to increase to ensure that the Company can meet the costs of running its business. This re-balancing drives a first year price increase of 3.7% and 4.6% in the remaining years of the period.

Section 1.4.2 Customer Benefits

The Company recognises the implications of such increases for household expenditure. But it believes that, even with these increases, the service that customers receive will still, at 1p per 8 litres of tap water, represent excellent value compared with other household requirements like food and heating. On a weekly basis the average charge would increase from £2.94 to £3.73 over the 5-year period.

Research shows that the Company's customers are willing to pay more for improvements in service that they value. In return for these price increases customers will benefit from:

- access to water without the expense of a major regional water resource scheme
- avoidance of more disruptions to supply through replacement of ageing or deteriorating infrastructure and through duplication of key assets
- resilience to climate change, flood and security risks

- fairer charging for water usage through metering
- reduced CO₂ emissions from the water service
- more frequent meter reading and improved billing to give better information to customers and enable them to manage their own consumption and water bills.

Section 1.4.3 Cost Benefits

Effective asset management ensures that the minimum amount of investment is made to deliver the target level of output performance at an acceptable and agreed level of risk, thus maximising the return on the asset base and providing best value for customers.

In line with industry standards, the Company has developed an investment approach for delivery of its Business Plan that uses cost benefit analysis. This approach has been established for all areas of major investment and links requirements with priorities of the business, customers and the regulators in order to demonstrate effective asset management.

This process has been used to test whether the proposed investments are cost-beneficial to customers in the longer term. In particular, the following areas of expenditure have been investigated:

- Trunk Main Renewals
- Maintenance of Above Ground Assets
- Hill Reservoir Duplication
- Water Quality Programme

The review has shown all of the above to be cost beneficial.

The Company has developed a least-cost solution for analysis of its supply/demand investment programme. This is due to the difficulties associated with assessing the benefits of 'drought orders' and 'compulsory essential use restrictions'.

Also, solutions have been developed to comply with the Advice Notes which are issued under the Security and Emergency Measures Directive. These have not been the subject of the cost benefit analysis.

Section 1.4.4 Local Factors Affecting Price Limits

The Company is concerned about the impact that above inflation price increases have on customers' bills and their ability to pay. It continues to analyse investment proposals and operating practices to identify further efficiencies that can off-set necessary increases in bills. However, it is important to understand the operational background and local challenges that this Company faces which all contribute towards higher costs and thus customer bills.

These are summarised as:

- “Area of Water Scarcity” – the Company operates in an area which is among the driest in the UK and has access to groundwater sources only. Therefore, it operates many sources that are below economically-viable thresholds and promotes water supply and demand management schemes that would not be cost effective for other companies.
- Complexity of Treatment – nearly 70% of water put into supply is treated using high cost, short-life membrane technology.
- High Number of Small Treatment Works – these incur disproportionately higher operating costs (i.e. power, water quality sampling).
- Ageing Infrastructure – currently the lowest pipe network renewal rate in the industry.
- Fixed costs – the size of the Company means that its fixed costs represent a higher than average proportion of total costs. This in effect doubles the size of savings required to achieve efficiency targets set by Ofwat (see Section B2).
- Sub Regional Costs – it has been demonstrated through disaggregation that Kent is a more expensive sub-region than neighbouring counties in the Southern Region for the provision of water supply.

It is absolutely essential to recognise these local factors, which affect the cost of operation for the Company, when assessing its relative efficiency. These special factors are detailed in Section B2 of this Business Plan and amount to £1.76m per annum. The Company believes that the acceptance of its special factors would move it to Band B (upper) in Ofwat’s relative efficiency ranking. This would result in a 2.5% catch-up efficiency target.

Section A2 Investment Proposals 2010 - 2015

In order to achieve the strategic objectives set down in the Strategic Direction Statement and Section 1 of this Business Plan, the Company is proposing the following expenditure profiles, pre-efficiency:

£m	2010-11	2011-12	2012-13	2013-14	2014-15	Total
Operating Expenditure	8.710	8.794	8.908	9.079	9.091	44,582
Capital Expenditure						
Supply Demand	2,195	1,953	387	267	222	5,024
• Drinking Water Quality	1,753	1,753	130	130	130	3,895
• Security and Resilience	105	628	1,151	838	838	3,559
• Enhanced Service Levels (flooding & Denge Cleaning)	34	115	228	835	0	1,212
• Maintenance Infrastructure	1,188	2,298	3,293	2,540	1,216	10,535
• Maintenance Non-Infrastructure	3,260	5,754	5,204	1,911	1,929	18,057
Gross Capital Expenditure	8,535	12,500	10,393	6,520	4,334	42,282
Total Expenditure	17,245	21,294	19,301	15,599	13,425	86,864

Note: All prices are 2007/08

The costs have been established predominantly by using a bottom up approach. Wherever possible, unit costs have been used to develop the operating and capital expenditure programme. The unit costs are activity or project-based, and are, wherever possible, derived from actual expenditure representing local circumstances.

Section 2.1 Operating Expenditure

Operating expenditure will rise from an estimated £8.710m in 2010/11 to £9.091m in 2014/15. This is a consequence of increases in current (or base) operating expenditure and the introduction of new activities associated with the capital expenditure programme. In particular the current expenditure has been increased to allow for significantly higher employer contributions to the pension schemes, higher business rates and abstraction charges. New operating costs will also be incurred, associated with increased frequency and volume of meter readings and more treatment processes at some works.

Section 2.2 Capital Expenditure

In order to reduce the impact of price increases on customers, the investment programme (£42.3m) is smaller than was submitted in the draft Business Plan. However, the Company believes that it reflects the priorities of customers and is necessary to achieve its strategic objectives. Cost estimates have been thoroughly scrutinised since the draft submission and are considered to be accurate and robust. The main elements of the proposed investment programme are as follows:

Supply Demand

This is the expenditure required to 'Achieve a Sustainable Use of Water' through development of new resources or managing demand for water.

Of the £5.0m, approximately £3.5m is to pay for accelerating the metering programme to ensure that all properties that can be are metered by 2012. New water resources are not required in the next two asset management periods and accordingly there will be no further resource development studies until 2015-2020. The Company will continue to input into studies undertaken by South East Water and Southern Water Services, investigating potential regional water resources. The remainder is for expenditure to trial an AMR (Automated Meter Reading System), leakage reduction, and the provision of new mains and connections.

Drinking Water Quality

The proposals include £3.2m for additional iron and manganese removal at the Denge Water Treatment Works (WTW), necessary due to a deteriorating raw water quality. The remainder, £0.7m, is to fund options assessments under the National Environment Programme to determine associated investment requirements for future periods.

Security and Resilience

£3.6m of expenditure, is to provide security to the Company's operational sites, including its control systems. It also includes equipment that would be necessary in an emergency to ensure self-sufficiency in the Company's response.

Enhanced Service Levels

Following feedback from Ofwat, this Final Business Plan includes £1.2m of expenditure associated with Enhanced Service Levels. This is £1.0m for the systematic flushing of network mains in the Denge water supply zone to prevent significant discolouration events. This expenditure is explicitly linked to the additional treatment to be provided at Denge WTW. Both are necessary to prevent future discolouration events. Also included is £0.2m to improve the resilience of six treatment works to overland flooding. Both investments are shown to be cost beneficial.

Maintenance Infrastructure

This expenditure is necessary to replace and renew underground assets such as trunk mains, distribution mains and communication pipes. Of the £10.5m proposed expenditure, £5.2m is to replace 3km/annum of distribution mains, which equates to approximately 0.45% of the water supply network. This will still be among the lowest rates in the country and below the 5km/annum that engineering models have indicated are necessary to prevent deteriorating serviceability. However, the Company has taken a pragmatic approach to the output of engineering models when considering investment requirements for its pipe network. There is no compelling evidence to suggest that serviceability will deteriorate rapidly during the AMP5 period and therefore it is proposed to maintain the current renewal rate of 3km/year until 2015. This is considered to be the lowest level that will maintain serviceability.

Of the remaining expenditure, £3.9m is for the duplication of trunk mains TP03, TP04 and for a network reinforcement to provide a reliable alternative supply of water in the event of a failure of TP28. In these cases, the result of failure would be a very significant number of properties (up to 24% of customers) without water. The risk to TP28 is highlighted by the two earthquakes in the last two years.

Maintenance Non-Infrastructure

Of the £18.1m planned expenditure, £10.0m is necessary to replace and renew above-ground assets such as service reservoirs, pumping stations, water treatment works and meters. This is a slight increase from the current period and reflects the need for an increased level of reservoir refurbishment activity. A further £3.4m is necessary to renew and replace other assets used to run the business such as vehicles, computer systems, telemetry and offices. The remaining £4.6m is required to construct a second cell at Hills Reservoir so that the existing reservoir can be extensively refurbished without risk to customers of large-scale interruption in supply and to facilitate maintenance on the first cell.

New operating expenditure resulting from the capital expenditure amounts to a cumulative £0.8m, by the end of 2015.

Section 2.3 Delivery of Investment Proposals

The planned level of investment is a significant step up from that in the current period.

Meter installations in the current period are being undertaken by an “in-house” team who have delivered outputs in excess of those planned and more cost effectively now that they are being installed on a zonal basis. This has increased resilience to operational failure and it is proposed to enlarge this team to deliver the accelerated installation programme in 2009-2012.

In preparation for AMP5, the Company has increased the size and experience of its in-house Capital Investment and Asset Management team. It has also established closer and improved links with delivery partners that have demonstrable track records in the water industry.

The establishment of these arrangements now will give contractors a clearer picture of the work to be done and lead-in time to ensure physical delivery but also cost effective delivery of the planned programme.

The Company's performance during the current investment period, plus the steps it has taken in preparation for AMP5, provide confidence that it will achieve the proposed outputs.

Clearly a significant risk to delivery will arise from competing demand for construction, resources, specifically utilities and infrastructure industries resources led by the 2012 Olympics, neighbouring water company investment programmes, and the establishment of development growth points in Dover, Ashford and the Thames Gateway. This is also likely to have a significant impact upon costs and this has been reflected in the Company's Cost Base submission as part of the Business Plan.

Section A3 Financial Projections

The Company's Final Business Plan incorporates the overall strategic objectives as detailed in its Strategic Direction Statement. These include the statutory duty to supply wholesome water to meet customers' demand, and commitments to minimising environmental impact and delivering a service that meets the expectation of customers.

Section 3.1 Effect on Prices

Customers have expressed a desire for the Company to provide a "reliable supply of high quality drinking water" and a willingness to pay for this to be achieved in an environmentally sensitive or "sustainable" manner.

The Company's Business Plan seeks to recover only the revenues necessary to allow it to carry out its appointed function and satisfy customer priorities. This will require a 26% increase in prices over 5-years, or an £8.21 per year increase for the average measured customer.

The current severe recession has had a marked impact on the local and regional economy with both domestic and non-household demand and income decreasing during 2008/09. Consequently, demand forecasts have been revised for 2010-15 and we are predicting lower income compared to our draft Business Plan. This has had a negative impact upon 'k' and adds to the revenue shortfall in addition to that resulting from the Company's proposed demand reductions.

Section 3.2 The Efficiency Target

The Company has carefully examined all areas of its operation to identify efficiencies, using a bottom up approach. This has identified specific efficiencies that will be achieved in the early years of the period. In the latter years, where it is difficult to foresee what efficiency might be available, assumptions have been used based upon historic data.

The Company has also considered carefully the report on efficiencies which First Economics prepared for Water UK. First Economics concluded that the most efficient companies can expect opex to increase by RPI + 0.0 to 0.75% and capex to increase by RPI + 1 to 2%. This is because expected productivity improvements are likely to be offset by input price inflation.

Having considered all of the evidence, the Company believes that the scope for on-going efficiencies is at the higher end of those concluded by First Economics. Therefore it has assumed zero on-going efficiency through the period 2010-2015 for operating expenditure. With respect to "catch-up" efficiency the Company believes that, after Ofwat's assessment of the latest special factors submission (see B2), it will be in Band B (upper) for operational costs. Accordingly a "catch up" efficiency of 2.5% cumulative has been proposed for the period 2010-2015.

The level of efficiency proposed is intended to enable the Company to continue to provide the high levels of service that customers enjoy. The Company believes that this pragmatic approach strikes a balance between customers' and shareholders' interests.

With respect to capital maintenance efficiency, the Company is already at the frontier and fully expects prices to increase in line with the First Economic findings. However, the Company accepts there is a need to balance customer affordability with investment requirements - hence its target of 0%.

Section 3.3 Infrastructure Renewable Charge (IRC)

The IRC is the accounting charge which reflects the investment needed to replace and renew the underground network of pipes. Ofwat has recommended that companies should calculate the IRC by averaging the next 15 years of Infrastructure Renewal Expenditure (IRE). If the Company were to apply Ofwat's IRC methodology this would result in an IRC substantially greater than IRE during 2010-2015. The Company has taken the view that this would be unfair to customers. Because IRC is a component of required revenue, this approach would result in customers paying in AMP5 for work that would not be conducted by the Company until AMP6 or AMP7. The Company has therefore chosen to take the average of IRE in the 15 year period 2004 to 2018. This choice gives us a total IRC for AMP5 that is roughly equivalent to the IRE in the period. The Company believes that this pragmatic approach is the fairest way to balance the interest of the Company and the interests of our customers.

Section 3.4 Current Cost Depreciation and Broad Equivalence

As part of the business planning process the Company has undertaken a detailed survey of its assets to assess their condition, performance and remaining useful lives. This has allowed the assets to be re-valued and current cost depreciation projected.

The Company Strategy achieves "broad equivalence" to within the 5% tolerance limit over the 28 year review period as explained in Section B7.

Section 3.5 Cost of Capital

The Company has relied upon industry-promoted research, undertaken by NERA, to establish the likely cost of capital and small company premium. These reports are included in the appendices of B7. Section B7 summarises the Company's views and Company-specific arguments.

Looking at all of the expert advice, including that provided by the NERA research, the Company has concluded that it will require a Weighted Average Cost of Capital (WACC) of 6.76% (post tax equity, pre tax debt).

The assessment includes a 1.1% small company premium. The need for a small company premium received strong support from equity investors in the recent Water UK Investors survey, in recognition of higher costs of capital for small companies.

For a number of other reasons, the Company believes that the small company premium is appropriate for Folkestone and Dover Water Services:

- i) The Company understands the derivation of Regulatory Capital Values (RCV's) within the industry and the important part played by the small company premium in their calculation for water only companies (WOC's). Water and Sewerage Companies (WASC's) were valued by reference to their market capitalisation immediately post privatisation. Such good evidence for WOC's was unavailable so their RCV's were set at a proportion of the indicative values used in the first price limit calculations represented comparable values to the WASC's. Clearly, that proportion of indicative value, being a proxy for market value, was influenced by the existence of a small company premium. It would transgress all principles of good regulation to disrespect, retrospectively, the fundamental basis of valuation for WOC's by failing to preserve the existence of a small company premium.
- ii) Despite having a shareholder owning 74% of the equity, the Company is licensed to operate independently. This ensures that the Company has only "arms length" relationships with other companies operated by both the majority and minority shareholders, thereby maintaining its independence as a small company.
- iii) Returns from smaller companies are more volatile due to the greater impact that operational risk can have. This Company carries significant risks associated with almost every activity (scarcity of water resources, size of capital programme, vulnerability to competition, loss of industrial customers, meter penetration, etc.). Accordingly, a higher return is expected by investors.

All of these issues are current and will remain in the foreseeable future. Therefore, the Company is clear that it should continue to receive the small company premium.

Section 3.6 Dividends

The previous section details the Company's cost of capital requirement.

The Company has a clearly defined policy, which is endorsed by the Board. The dividend should provide a return of equity in line with the allowed returned by Ofwat and having regard to dividend covers of at least 1.0.

This ensures that equity shareholders receive a return that is comparable with other similar investments and commensurate with the risk they take.

Section 3.7 Debt

The total debt is forecast to rise (in constant prices) from £26.9m in 2007/08 to £36.0m in 2014/15. The plan assumes that the Company will be able to source the new debt at interest rates equal to the cost of debt in its cost of capital calculation.

Section 3.8 Financeability

The Company strategy seeks to maintain current levels of HCA interest and dividend cover, but expects to see its level of gearing rise from 40% in 2007/08 to 53% by 2014/15.

A risk to the Company's ability to finance its operations arises from Ofwat's proposals for allowed tax. To set allowed tax at the higher of actual gearing or Ofwat's notional level of gearing would not allow the Company to finance its function, given that it operates with a gearing below Ofwat's assumed notional level.

Accordingly, the Company is requesting that Ofwat amend its proposals for this price review to allow actual gearing to be used. This would have a negligible impact in that very few companies would be affected. In the context of the current state of the global credit markets, it appears particularly timely for Ofwat to do so, otherwise their methodology might be seen as forcing water companies imprudently to increase their level of borrowing and reduce their equity capitalisation. This is quite apart from the benefit that this would have, in terms of consistency with Ofwat's policy that it is for the Boards of companies to determine the most efficient financing structure.

The Company has assumed a gearing of 40% to calculate its WACC.

Section A4 Risk and Uncertainty

The Company faces much risk and uncertainty arising from our own circumstances and the actions of others:

- **Supply Demand Balance** – the Company is following an ambitious proactive demand management approach to managing the supply demand balance. The Company has selected this approach because it believes it to be both the most cost effective and sustainable solution. This should come as no surprise, given the “Area of Water Scarcity” status granted to the Company by the Secretary of State in March 2006. However, the strategy is heavily reliant upon customers’ responding to price signals and adapting their behaviour to become more efficient in their use of water. If they fail to do so, the Company would need to bring forward capital investment to develop the next most cost effective water resource. Conversely, the Final Business Plan revenue requirement assumes a mid-range output from demand management measures (i.e. 130l/hd/d). Therefore if customers reduce consumption more than this (i.e. closer to the 120l/hd/d target), the Company will be exposed to a significant reduction in revenue that will have to met from shareholder dividend. While Ofwat has introduced the new revenue-cap price-setting mechanism, the Company believes that, due to its aggressive demand management proposals, it has potential exposure beyond that envisaged when the mechanism was introduced. This risk is far greater than any other company will face and consequently it would be unfair to expect the shareholders to meet such a shortfall until 2015-2020.
- **Reaction to Tariff Proposals** – there could be a degree of negative reaction from customers and politicians to the Company’s plan to introduce a ‘rising block’ tariff across its domestic customer base. This may be led by concern for vulnerable customer groups, such as those on low income who are less able to pay. The Company is currently trialling the tariff, which includes a mechanism to help some of those customers, and is looking at other ways in which these concerns can be dealt with. This will include further lobbying of government to accept its responsibility and deal with water poverty through the social benefits and taxation systems.
- **Availability of Water Resources** – the Company operates in an area where water resources are scarce, options are few, and the supply/demand balance is finely poised. Added to these are the potential impacts arising from climate change on aquifer recharge and raw water quality. These increase the risks to the Company significantly. Risks from the loss of existing resources, the relative failure of demand management policies, and unexpected growth are disproportionately high compared to the rest of the industry. The Company’s Water Resource Management Plan (WRMP) sets out these risks and makes allowances in deployable output and headroom assessments.
- **Operating Efficiency** – the Company is highly efficient but operates in a very difficult local environment that has many adverse cost implications, which are not recognised by Ofwat’s efficiency modelling techniques. The risk of setting an inappropriate aggressive efficiency target for a company employing less than 100 staff is self-evident. Too high a target would lead to service failure and/or failure to provide a reasonable return on capital. The Company will continue to strive for further efficiencies and has presented robust arguments in its local factors presentation in this Business Plan. (Section B2).

- Traffic Management Act – the charges associated with the implementation of this latest legislation are still particularly uncertain and unlikely to be reflected in full in the base year opex. Therefore the actual costs in the next period could be significantly different to those allowed for in base opex.
- Bad Debt – the Company continues to experience an increasing level of household customer debt. In 2007/08 alone the amount of cash collected as a proportion of money billed deteriorated by nearly 2% and in 2008/09 this is expected to total 4%. This situation has not been helped by the removal of the right to disconnect customers which, although rarely used, was a deterrent to non-payment. Whilst the Company is making every effort to collect debt, it is likely that the current and foreseeable economic climate will cause further deterioration. The Company will continue to work with the industry and government to look at how the use of ‘trickle flow’ and ‘pre-payment’ meters could be used to mitigate this.
- Loss of Large User – the Company is in the unique position of having six major commercial customers (i.e. large users) who account for nearly 25% of measured turnover, with the Company’s highest single supply being the Dungeness B nuclear power station. Clearly the loss of any of these six customers would have a significant impact on the financeability of the Company.
- Carbon Trading - The adoption of the Carbon Reduction Commitment (CRC) remains unclear and its future impact on the business will depend on three factors:
 - The value of Emissions Rights tradeable permits in the market mechanism being created;
 - The performance of industries in achieving reduction and the impact on average values;
 - The capping mechanism of tradeable permits for Emissions Rights

Water companies as regulated bodies are not fully in control of their own destiny and potentially legislation could interfere with aspirations for achieving carbon reduction.

Notwithstanding the above, what is known is that provided comparative performance is achieved the recycling of revenue from CRC will at worst introduce a cash flow cost but not a debt.

However, if industry performs well and the Company cannot maintain pace with the achievement of others, and if the capping system for tradeable permits significantly increases their value, then a penalty to the Company could result, which in financial terms could be equivalent to 10% of the value of the Emissions Rights purchased.

- Housing Growth – housing growth in the South East of England continues to be projected and some early signs that it is happening are evident (i.e. Thames Gateway and Ashford). The Channel Tunnel fast rail link (Folkestone/Ashford/London) is planned to be operational by 2009 and this is likely to increase pressure on the local market further. There is the possibility that growth could outstrip the forecasts in the WRMP and that it will require investment in new resources to be brought forward.

There is also evidence that the current buoyant construction industry in Kent and the south-east is driving construction prices higher due to skills shortages and the geographic location of the business. The full impact of the current economic slowdown is difficult to predict as many major projects are still likely to continue despite the slowdown and we believe that construction costs will remain under pressure.

- FRED 29 – adoption of FRED 29 will increase substantially the amount of corporation tax payable by the Company, well beyond the levels expected to be allowed under Ofwat's current approach to setting allowed tax.
- Earthquake –the Company's operating area has recently been affected by two earthquakes (April 2007 and March 2009) and Folkestone sits on the geological fault which gave rise to them. Such tremors can be expected to continue. The consequence of the first quake was a ground movement that has caused a horizontal fracture across one of the Company's boreholes. The estimated cost of repair is several hundreds of thousands of pounds. There is also a possibility that a change in the chalk aquifer has occurred, leading to rapid deterioration in raw water quality immediately after rainfall. This is currently being monitored and no provision for expenditure is included at this stage.

Many of the uncertainties described result in significant elements of cost within the Company's opex or impact upon revenue. The Company is expected to absorb such cost and revenue shocks. This exposes a considerable risk to the business that serves to underline the increasing difficulty that the Company faces in balancing the need for further efficiencies against its ability to finance its activities and through the higher operational risk that investors have to allow for when determining an acceptable return on capital.

In view of this the Company believes that the following, previously described issues, should be subject to notified item protection:

- i. Demand reduction by non-household customers to below 128l/hd/d on average
- ii. Traffic Management Act
- iii. Bad debt
- iv. Fred 29
- v. Loss of large user
- vi. Earthquake

Section A5 Board Endorsement

The Board is satisfied that it has submitted an integrated plan which as a whole:

- sets down and explains in a consistent and fair way its application for revised price limits, and
- takes into account all the material issues that the Company has identified will arise, or which it has reasonable grounds to expect will arise in 2010-15, or which it considers might impact beyond that period.

Roles and Responsibilities

The Board has a structure similar to that of a listed plc, with a small board comprising five non-executive directors (three of whom are considered to be independent) and one executive director (the Managing Director). They provide a range of knowledge and experience from within and outside the water industry. The Board is committed to high standards of governance and corporate responsibility.

The Board has three sub-committees (Executive Management, Remuneration and Audit). The Executive Management Committee has been responsible for overseeing the detailed preparation of the final business plan as appropriate.

The Board has had a strategic role in developing the plan, and maintained an independent overview of the assumptions and methodology used in the preparation of the final business plan, as well as challenging the material issues that are expected to arise in 2010-15. The non-executive directors, as well as the executive director and the staff team, have spent a large number of hours in helping to prepare the plan.

The Managing Director has Board level accountability for production of the business plan. He is assisted in this duty by a dedicated Project Manager and the Senior Management Team (SMT), which comprises all Heads of Department.

The responsibility for completing tables and commentaries is allocated to either the Managing Director, Head of Department, or Project Manager, as appropriate to their knowledge and area of expertise. Accordingly, they are responsible for presenting their work to the Board and various committees, the Reporter and the Auditor. They are required to resolve any queries that may arise during audit or Board challenge, and to review the information produced to verify that:

- the information is produced in accordance with Ofwat's guidance
- is reliable, accurate and complete, and;
- the material assumptions and judgements made in preparation of the information are reasonable and adequately explained in the table commentaries

and to report their assessments to the Board on these points.

The Company's systems of internal control and its processes have been properly assessed and are considered by the Board to be sufficient to fully meet its obligations for the provision of information to Ofwat.

Process for Completing the Business Plan

The preparation of the business plan is a significant piece of work and is run as a formal project similar to the June Return process. The Project Manager has followed a project plan, based upon best practice project management principles.

The project is supervised by a Steering Group, which comprises the SMT and which is chaired by the Managing Director. This group approves allocation of work and oversees project deliverables, resources and project risks. It meets fortnightly and reports on a monthly basis to the Executive Management Committee, the minutes of which are seen by the Board. It has authority to authorise actions that may be necessary to ensure the project is successful.

The Managing Director is responsible for signing off all the commentaries and the Regulatory Accountant is responsible for checking and inputting the data tables to the information capture system.

The Company has used Ofwat's Reservoir model to provide financial projections, including price limits in this final Business Plan.

Part A – Overall Strategy has been reviewed by the Board on several occasions in the course of the autumn and winter, and they have been involved in its detailed drafting. It was finally approved by the Board on 6th April 2009.

Parts B and C were reviewed by the Board subsequent to the submission of the draft business plan and they have reviewed the key changes incorporated into these parts in the final plan.

Board Involvement

The Board has been closely engaged in overseeing the production of the business plan. It was fully involved in preparing the Strategic Direction Statement which includes the Company's strategic objectives. In reaching its strategic decisions the Board was informed by the outcome of stakeholder and customer research, so it is aware of and considered their respective priorities.

The Board considered the draft business plan at its regular meetings on 4th April 2008, 20th June 2008 and at special meetings held 1st July 2008 (via teleconference), 18th July 2008, 1st August 2008, 7th August 2008 (via teleconference) and considered the final business plan at meetings on 6th February 2009, 9th March 2009 and 25th March 2009. Matters relating to the final business plan were considered at the meetings of the Audit Committee on 14th November 2008. Specifically, the Board has considered the options for capital expenditure, the interdependencies between planned activities and outputs expected, and how different options affect risk and the prices that customers pay. It has also taken into account how its business plan aligns to its Water Resource Management Plan and water quality submission to the Drinking Water Inspectorate.

The Board met with the Reporter and the Auditor on 7th August 2008 and 25th March 2009 to discuss their work on the business plan. At these times the Reporter and Auditor confirmed that there was no relevant information that had not been made available to them, although their work was not yet complete.

The Directors confirm that:

- a) so far as the Directors are aware there is no relevant information of which the Reporter or Auditor are unaware; and
- b) they have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant information and to establish that the Reporter and Auditor are aware of the information.

Through the approach described, the Board has satisfied itself that, so far as has been reasonably practicable, all information which is relevant and material to price setting has been identified.

Accordingly, we confirm that the Board of Directors of Folkestone and Dover Water Services Ltd has endorsed this Final Business Plan and considers it to be in line with the Company's Strategic Direction Statement published in December 2007, though taking account of the evolution of circumstances, relevant analysis, and customer and stakeholder comment since the Strategic Direction Statement was published.

On behalf of the Board:

David Walton
Managing Director

Paul Sabin
Chairman

Model **FBP2009-ICS**
 Versic 1.7.12
 Comp.FLK
 Table **A1**

Final Business Plan 2009

Folkestone & Dover Water Services Ltd
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	12.5	5.9	2.4	6	-0.8
2	Water service indicative "K"	nr	4	1.9	2.6					
3	Sewerage service indicative "K"	nr								
4	Proposed infrastructure charge limit - water service	£	276.81			290.00				
5	Proposed infrastructure charge limit - sewerage service	£	276.81							
6	RPI - year by year assumption	%	3.87%	4.28%	3.00%	2.50%	2.50%	2.50%	2.50%	2.50%
B Projected household bills - water service										
7	Typical unmeasured h'hold bill (base yr avg chg) - real terms	£	207.79	207.58	224.81	246.23	262.60	271.18	289.33	286.20
8	Typical measured h'hold bill (base yr avg chg) - real terms	£	149.61	154.81	152.85	172.16	181.17	185.10	195.27	193.92
9	Average h'hold bills - real terms	£	173.94	179.79	181.68	201.48	211.18	215.73	212.72	210.11
10	Average h'hold bills - nominal terms	£	173.94	187.48	195.14	221.82	238.30	249.53	252.20	255.33
C Projected household bills - sewerage service										
11	Typical unmeasured h'hold bill (base yr avg chg) - real terms	£	0	0	0	0	0	0	0	0
12	Typical measured h'hold bill (base yr avg chg) - real terms	£	0	0	0	0	0	0	0	0
13	Average h'hold bills - real terms	£	0	0	0	0	0	0	0	0
14	Average h'hold bills - nominal terms	£	0	0	0	0	0	0	0	0
D Water sales & supply/demand balance										
15	Billed water delivered	MI/d	38.04	37.64	35.81	34.67	34.02	34.12	32.54	32.60
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	52.39	52.19	52.01	51.83	51.66	51.48	51.30	51.13
18	Distribution input (dry year annual average)	MI/d	47.30	46.40	44.17	42.65	41.54	41.31	40.95	40.69
19	Total leakage	MI/d	7.89	7.70	7.46	7.17	6.98	6.98	6.99	7.00
20	Total water savings achieved or assumed from company's water efficiency	MI/d	0.06	0.06	0.06	0.07	0.07	0.07	0.07	0.07

Line description	Units	Level of performance		Level of performance by 2009-10	Level of performance by 2014-15	Level of performance by 2019-20
		2002-03	2007-08			
A Service performance						
1	DG2 properties at risk of receiving low pressure	nr	11	2		2
2	DG3 Supply interruptions (overall performance score)	nr	0.00	0.25		0
3	DG6 % billing contacts dealt with within 5 days	%	100.0%	99.8%		100.0%
4	DG7 % written complaints dealt with within 10 days	%	100.0%	99.3%		100.0%
5	DG8 % metered customer's receiving bill based on a meter reading	%	100.0%	99.9%		100.0%
6	DG9 % calls abandoned	%		1.7%		1.4%
7	DG9 % calls receiving engaged tone	%		0.0%		0.0%
8	Security of supply index (dry year annual average planned levels of service)	nr	-269	-29		100
9	Security of supply index (critical index)	nr		77		100
B Quality & environmental compliance						
10	% distribution input covered by section 19 undertakings at water treatment works	%		0.000%		0.000%
11	% distribution input not affected by section 19 undertakings or temporary releases	%	100.000%	100.000%		100.000%
12	% of properties in water supply zones affected by section 19 undertakings in any way	%		0.000%		0.000%
13	% mean zonal compliance with drinking water regulations	%		100.00%		100.00%
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			6540	6392
17	Other GHG emissions (as CO2e) produced in providing the service	ktonnes/yr			0	0

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	0.0	0.0	0.0	N/A	0.0
2	Work on dams & impounding reservoirs	nr	0	0	0	N/A	0
3	Capital investment in aqueducts, dams & impounding reservoirs	£m	0.000	0.000	0.000	N/A	
B Key activity projections - water treatment							
4	Number of refurbished or new treatment works	nr	3	1	4	P1&2	3
5	MI/day of refurbished or new treatment works	MI/d	14.57	7.20	21.77	P1&2	14.57
6	Capital investment in refurbished or new treatment works	£m	4.376	7.864	12.240	P1&2	4.523
C Key activity projections - water distribution							
7	Length of mains renewed	km	24.2	0.0	24.2	P3	45.1
8	Length of mains relined	km	0.0	0	0	N/A	0
9	Length of new mains	km	0.9	4.0	5.0	S	7.7
10	Number of refurbished or new district meters & pressure control valves	nr	0	0	0	N/A	0
11	Capital investment in underground water distribution activity (incl investme	£m	10.815	5.651	16.466	P3	18.322
12	Number of refurbished or new pumping stations	nr	1	0	1	P2&3	0
13	Capital investment in refurbished or new pumping stations	£m	3.842	0.000	3.842	P2&3	1.274
14	Number of refurbished or new service reservoirs	nr	1	0	4	P2	0
15	Capital investment in refurbished or new service reservoirs	£m	6.179	0.175	6.354	P2	1.105
D Key activity projections - management & general							
16	Offices, labs, depots, workshops	m ²	0.0	0.0	0.0	N/A	0.0
17	Capital investment in offices, labs, depots, workshops and vehicles	£m	1.502	0.000	1.502	S	1.502
18	Capital investment in instrumentation, control and automation (ICA), telem	£m	1.877	0.000	1.877	S	1.715
E Key activity projections - metering performance							
19	Number of household meters renewed	nr			4,192	R	5,305
20	Optional meters: households	nr			750	F	0
21	Selective meters: households	nr			12,450	F	0
22	Percentage of households metered (at the end of the period)	%			96%	N/A	96%
F Total - water service							
23	Total capital investment in the water service	£m	28.591	13.690	42.281		28.441

		AMP3	AMP4					AMP5					
		2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	
Line description	Units												
A Operating expenditure outperformance since PR04													
1	Water operating expenditure outperformance	£m	0.566	0.703	0.452	0.157	0.000						
2	Water outperformance as a % of regulatory expectations	%	6.87%	8.22%	5.38%	1.90%	0.00%						
3	Total adjusted water opex incentive revenue allowance	£m						0.000	0.000	0.000	0.000	0.000	
4	Sewerage operating expenditure outperformance	£m	0.000	0.000	0.000	0.000	0.000						
5	Sewerage outperformance as a % of regulatory expectations	%											
6	Total adjusted sewerage opex incentive revenue allowance	£m						0.000	0.000	0.000	0.000	0.000	
B Capital expenditure outperformance since PR04													
7	Water service capex outperformance	£m	-0.531	0.229	2.649	-0.494	-0.722	-2.157					
8	Water service capex outperformance as % of regulatory expectations	%	-10.1%	2.9%	31.7%	-17.4%	-24.6%	-59.8%					
9	Sewerage service capex outperformance	£m	0.000	0.000	0.000	0.000	0.000	0.000					
10	Sewerage service capex outperformance as a % of regulatory expectations	%											
C Water service - overall compounded efficiency improvements													
11	Operating expenditure (base service)	%					0.00%	0.00%	0.50%	1.00%	1.49%	1.99%	2.48%
12	Operating expenditure (enhancements)	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
13	Capital maintenance expenditure – infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
14	Capital maintenance expenditure – non-infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
15	Capital enhancement expenditure – infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
16	Capital enhancement expenditure – non-infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
17	Capital enhancement expenditure - meters	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
D Sewerage service - overall compounded efficiency improvements													
18	Operating expenditure (base service)	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
19	Operating expenditure (enhancements)	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
20	Capital maintenance expenditure – infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
21	Capital maintenance expenditure – non-infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
22	Capital enhancement expenditure – infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
23	Capital enhancement expenditure – non-infrastructure	%					0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

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Folkestone & Dover Water Services Ltd
 Water service - Expenditure projections

Line description	Units	AMP4			AMP5					
		2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	
A Base service levels (£/property served)										
1	Operating expenditure to maintain current services to consumers	£/prop	113.37	111.91	111.80	113.33	112.89	112.49	111.76	110.85
2	Expenditure on pipelines, dams and aqueducts to maintain current services to consumers - "infra"	£/prop	10.62	20.15	22.73	15.58	30.52	43.80	33.38	15.58
3	Expenditure on surface assets (includes abstraction, treatment, pumping and service storage) t	£/prop	30.34	33.41	42.11	44.17	77.69	70.02	25.49	25.51
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	0.46	1.55	3.05	11.14	0.00
C Supply/demand balance (£/property served)										
6	Additional operating expenditure to continue to maintain and improve the balance between the w	£/prop	0.00	0.82	1.65	3.68	4.58	4.76	6.76	6.81
7	Additional capital expenditure to continue to maintain and improve the balance between the wat	£/prop	14.59	15.85	32.92	29.73	26.38	5.21	3.56	2.94
D Quality enhancements (£/property served)										
8	Additional operating expenditure to meet new environmental and water quality standards	£/prop	0.07	0.53	0.71	1.00	1.27	2.62	2.60	2.58
9	Additional capital expenditure to meet new environmental and water quality standards	£/prop	0.40	0.59	3.40	25.18	32.15	17.24	12.91	12.80
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	113.43	113.26	114.15	118.02	118.74	119.88	121.11	120.24
13	Total capital expenditure excluding grants and contributions	£/prop	55.94	70.00	101.16	115.12	168.30	139.32	86.49	56.83
14	Average connected properties - water (excluding empty properties)	000	72.25	73.30	73.55	73.80	74.06	74.31	74.96	75.61
G Water service totals (£m)										
15	Total operating expenditure	£m	8.196	8.302	8.396	8.710	8.794	8.908	9.079	9.091
16	Total capital expenditure excluding grants and contributions	£m	4.042	5.131	7.440	8.496	12.464	10.353	6.483	4.297
17	Total capital grants, contributions and compensation for abstractions.	£m	0.441	0.404	0.279	0.421	0.421	0.421	1.034	1.034

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Folkestone & Dover Water Services Ltd
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	17.606	20	22
2	Operating costs	£m	8	9	9
3	Capital charges	£m	4	6	7
4	Operating profit	£m	6	5	6
5	Regulatory capital value-year end	£m	67	66	68
6	Pre tax return on regulatory capital value	%	8.60%	8.10%	8.50%

Final Business Plan 2009

Folkestone & Dover Water Services Ltd

Water and sewerage services - Summary of justification of company investment

		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	29.52	73.000	762.000	45.420	1.000
2	Investment proposals demonstrated to be cost-beneficial	14.79	7.000	742.000	22.750	0.000
3	Investment proposals shown to be non-cost-beneficial	3.71	22.000	20.000	5.700	0.000
4	Investment proposals not assessed	11.03	45.000	0.000	16.970	1.000

Folkestone and Dover Water Services Limited - Explanation of the company's plan to deliver now and in the future

OVERALL STRATEGY FOR 2010-2015 PERIOD AND BEYOND

The Company's vision is "to be a sustainable water supplier, exceeding stakeholder expectations through continuous improvement". This has served the Company well and is the foundation for its strategy 2010-2015.

The Company strategy has customers at its heart. Extensive consultation and survey work has been undertaken to establish their priorities and willingness to pay. The conclusions from this work has been used as the focus for both the Strategic Direction Statement and the 2010-2015 Business Plan.

Overwhelmingly, customers have stated their priority to be : **"a reliable supply of good quality drinking water"**

The Company has developed six themes which each have targets and objectives that align with customers stated priorities. These are:

- Theme 1 - Achieving a Sustainable Use of Water
- Theme 2 - Safeguarding Drinking Water Quality
- Theme 3 - Ensuring a Reliable Supply of Water
- Theme 4 - Mitigating Climate Change Impacts
- Theme 5 - Enhancing Customer Service
- Theme 6 - Financing our Future

In summary the Company strategy for 2010-2015 seeks to progress ambitious demand management activities in parallel with gaining access to a greater volume of water in order to meet consumer demand; increase the level of maintenance activity to ensure no service failures of critical assets and an ageing infrastructure; and provide additional treatment where deteriorating raw water quality may affect the Company's ability to provide good quality water to some customers.

All of this will be achieved without deterioration to the high levels of service provided to customers and in accordance with all statutory and regulatory requirements

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

Maintain a supply demand balance surplus throughout the period (i.e. SoSI = 100)

Progress to full metering by 2012 (c96%) ensuring that all customers pay a bill based upon the volume of water they use

Implement an ambitious programme of demand management measures intended to reduce customers unnecessary use of water at the same time reducing carbon emissions from the Company's activity

Maintain stable condition of above and below ground assets

Make proactive investments to avoid interruptions of supply to a significant number of customers

Provide additional treatment at a key water treatment site to maintain compliance with water supply regulations

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

		Water	Sewerage
Average household bill in 2009-10		181.68	
Less	(1) past efficiency savings and outperformance		
	(2) maintaining base services		14.73
	of which	Water	Sewerage
	a) changes in revenue	1.78	
	b) changes in operating costs to maintain current services to consumers	1.73	
Plus	c) changes in costs of maintaining assets	13.27	
	d) changes in impact of taxation	(2.45)	
	e) the change in the cost of capital	0.41	
	(3) maintaining and enhancing security of supplies to all customers	8.36	8.36
	(4) the impact of improvements in services		7.42
	of which	Water	Sewerage
	a) drinking water quality	6.65	
	b) environmental improvements	0.00	
	c) Improvements in service levels	0.77	
Less	(5) scope for reduction through future efficiency improvements		(2.09)
Average household bill in 2014-15		210.11	

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)	2.6	12.5	5.9	2.4	6.0	-0.8
1 Average measured household bill	152.9	172.2	181.2	185.1	195.3	193.92
2 Average unmeasured household bill	224.8	246.23	262.60	271.18	289.33	286.20
3 Average household bill	181.7	201.48	211.18	215.73	212.72	210.11
		110.90%	104.81%	102.15%	98.60%	0.99
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	112.26	
2	Operating costs to improve services to consumers and protect the environment	7.33	
3	Cost of maintaining assets to deliver current services to consumers	76.35	
4	Cost of improving assets to deliver improvements for the environment and consumers	36.86	
		Pre tax cost of debt and post tax cost of equity basis (Vanilla)	Fully post-tax basis
5	Assumed cost of capital (%)	6.76	6.20

For further information go to: www.fdns.co.uk