

# Directors' report and business review

## 2. Operating environment

### Our external environment

The largest of NWG's businesses, NWL, operates in the north east and south east of England. The two areas have very different economic, demographic and water resource characteristics.

In the north east there has been a gradual fall in overall water demand in recent decades as a consequence of a reduction in industrial demand for water. This trend is expected to continue for at least the next five years with a faster decline in the short term due to the impact of the economic recession. The north east compares well to the rest of the country as far as water resources are concerned and our major regional rivers can all be supported by Kielder reservoir. This provides very high security of supply for our customers.

In contrast, NWL's southern operating area is in a water scarce region that is forecast to experience further economic and population growth in the medium term. While this area has also seen a reduction in demand from heavy industry and the recession is likely to dampen housing growth in the near future, we have a current deficit, meaning supplies are not secure in a severe drought. Future growth will

intensify the pressure on the balance between supply and demand. NWL is implementing long term plans to ensure the availability of water supplies to meet both current and future demand in a region where water resources are already constrained. The project to increase the capacity of Abberton reservoir near Colchester, which has recently obtained full planning approval, coupled with ongoing demand management measures, will secure supplies to the Essex area for the foreseeable future.

The current pressures within financial markets have been well documented and the credit crunch has resulted in reduced availability of certain types of finance (such as index linked bonds). It is highly unlikely there will be a return to the exceptionally low cost of debt experienced from late 2005 to early 2007. It is not clear how long current difficult market conditions will persist. With the financing we have already put in place, we are well sheltered from the current short term volatility in the debt markets as we will not need to raise any new debt before 2011.

### Regulatory environment

As a monopoly supplier of an essential public service, the UK

### Abberton plans move forward

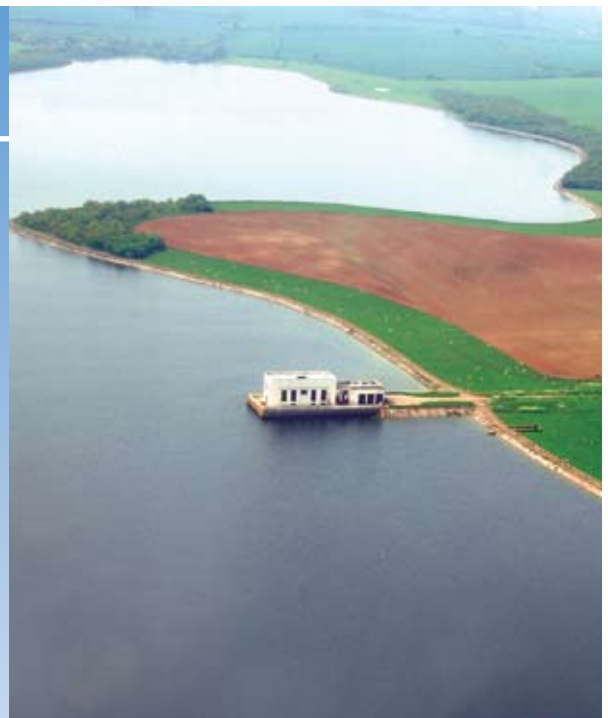
Essex is the driest county in the UK receiving on average less than 600mm of rain a year. In a dry year Essex already has a deficit of water supply to demand, making development of the Abberton scheme essential for the area. Demand for water is predicted to continue to rise, almost entirely due to a significant increase in population in the area.

This means there is a need for a long term and sustainable increase in water resources for the Essex area. We need to enlarge the existing reservoir at Abberton by 58 per cent as part of the Abberton Scheme to ensure that Essex has a secure water supply for future generations.

Planning permission has been granted to enlarge the reservoir, and build a new pumping station, a pipeline between Wormingford and the reservoir and a further pipeline between Kirtling Green and Wixoe as part of the scheme.

As well as providing a vital new water resource, the scheme has been designed to enhance the reservoir for both people and wildlife. The plan to enlarge the reservoir is the culmination of 15 years of investigation and consultation, during which over 250 locations for a new reservoir were considered.

Construction work is due to start at the reservoir in 2010 and it is expected that the enlarged reservoir will be fully operational by 2014.



water industry operates within a demanding regulatory environment.

The Water Services Regulation Authority (Ofwat) regulates prices and levels of customer service, while the Drinking Water Inspectorate (DWI) monitors drinking water quality and the Environment Agency (EA) covers environmental protection. Customers' interests are represented by the Consumer Council for Water (CCWater).

NWL aims to maintain good working relationships with its regulators and with regional organisations, such as local authorities, which have an interest in the services it provides and can influence the company's business.

The 'Cave Review: competition and innovation in water markets' (Cave Review) published its final report in April 2009. Government has welcomed the report and intends to bring forward measures into the 'Flooding and Water Management Bill' in light of its recommendations. In our view, the vital test for any change must be 'will it improve outcomes for customers?'. While the essential characteristics of the sector mean the scope for competition is likely to be less than in other utilities, we agree that there are opportunities to expand competition beyond its current very limited level. We remain to be convinced that retail business separation would bring benefits for customers. We welcome the emphasis in the report on measures to increase innovation.

Protecting supplies to customers is a high priority. We submitted our 'Water Safety Plan' to the DWI in October 2008 and this underpins our drinking water quality proposals.

We commenced Phase I of Operator Self Monitoring in April 2009. This involves NWL taking on responsibility for sampling and analysing the final effluent at sewage treatment works for compliance purposes. This task had previously been undertaken by the EA. The transfer is consistent with the Better Regulation principles and we expect it to result in a small cost

saving. The second and final stage of the transfer will happen in January 2010.

We are pleased that the draft 'River Basin Management Plan' published by the EA for the rivers in our regions proposed an appropriate balance between challenging environmental targets and a clear evidence base for action. We support the emphasis on tackling diffuse pollution at source rather than end of pipe solutions.

NWL intends to increase the emphasis given to catchment management across its operating areas. This will help tackle emerging challenges from water soluble pesticides and also bring a range of other benefits in terms of habitat protection, biodiversity and carbon management.

### Putting customers first

As in the prior year, we have only increased our prices for 2009/10 by inflation and have not used the real increase that Ofwat's price limits allow. This is the third consecutive year in which we have not implemented the maximum price increase.

By 2010, we expect our combined water and sewerage bill in the north east to be one of the lowest in the country and, in our Essex and Suffolk regions, our water bills will compare favourably with other local suppliers.

We submitted our Final Business Plan, covering the period from April 2010 to March 2015, to Ofwat in April 2009 setting out the short term proposals to deliver our 25 year strategy published in 'Looking to the future'. Our significant investment programme will continue to deliver high levels of service to our customers and value to our stakeholders. However, within the investment programme, there is a change in emphasis from achieving new quality standards to maintaining the high standards already achieved. We will also be working to tackle the challenges posed by climate change, reducing our operational carbon emissions and improving the resilience of our assets. We believe we are well placed to deliver these objectives and propose raising prices by the minimum

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amount consistent with both maintaining safe and secure water supplies and our commitment to protect the environment.

### **Our customers**

Our relationship with our customers is vital to the success of our business.

We keep our customers informed about our activities through leaflets sent out with bills and also through an annual magazine called 'Source'. Customers also have access via our website at [www.nwl.co.uk](http://www.nwl.co.uk) and [www.eswater.co.uk](http://www.eswater.co.uk) to a range of information about our services and any supply issues.

Customers directly affected by our work receive prior notification explaining both the need for, and timing of, the work we intend to carry out. We also communicate more broadly with local communities through public meetings and written material explaining the impact of any work we are planning.

We carry out regular surveys and focus group research to understand our customers' needs, and their perceptions of our service and its value for money. Affordability and value for money are important to our customers and are, therefore, key issues for the business.

Our reputation for providing value for money and working to maintain high levels of customer satisfaction has undoubtedly helped achieve a positive response to our appeals to use water carefully.

NWG is actively involved in the business community in both of its operating areas through direct membership and involvement in the councils/boards of the CBI, Chambers of Commerce and other similar organisations.

NWL has longstanding relationships with its key industrial and commercial customers in the areas it serves. The north east, in particular, has a significant industrial base and existing customers and potential investors in the region value the availability of not only high quality potable

and raw water but also access to reliable effluent treatment services.

### **Stakeholder relations**

NWG has a code of ethics, 'Our Code of Conduct', which is available on the Company's website, covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators. NWG meets its stakeholders regularly and also communicates by printed and electronic forms of communication and through the media.

### **National**

NWL is an active member of Water UK, the industry association which represents all UK water and waste water service suppliers at national and European level. It provides a very effective framework for the industry to engage with Government, regulators, stakeholder organisations and the public and helps to develop policy and improve understanding of the industry.

We also meet regularly with national, regional and local authorities and other appropriate organisations to explain NWL's activities and related issues.

### **Political**

During the year, the Group has worked with politicians of all parties, officials and opinion formers. This work has included making representations on issues which NWG feels are important to our customers and communities such as competition, adoption of private sewers, water for health, climate change, the Water Framework Directive and other legislative issues which could affect our customers.

We do not support any political party and we do not, directly or through any subsidiary, make what are commonly regarded as donations to any political party or other political organisations. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the Company and political parties and

## Castle View Enterprise Academy

We are lead sponsors for Castle View Enterprise Academy in Sunderland, which will have a business and enterprise specialism. Our aim is to use our expertise to support academic and vocational attainment and help bring lasting improvement to this community. The area contains some of the most deprived wards in the region; it relied heavily on employment in mining and shipbuilding (neither of which has been available for over 20 years). In many cases, families are experiencing third generation unemployment and ACORN classifies 61%-80% of the school catchment population as being 'struggling families'.

We have committed funding, work in kind, and many work hours from senior employees to the Academy. More importantly, when the Academy opens its doors to 850 pupils in September 2009, we are committed to supporting the new Principal to run and manage a successful school. We intend to do this through our involvement on the Academy's Trust Board, employee volunteers and community partnerships.

Our support has leveraged in £16 million of Government funding to build a state of the art new building and ICT facilities. This is the largest investment ever made in this community and will provide the young people of Castle View with excellent opportunities for a successful future.



John Cuthbert, Managing Director, and Janet Bridges, Principal Designate of Castle View Enterprise Academy, laying one of the first bricks of the Academy's new building.

Photo credit: Sunderland Echo.

political organisations. These activities include attending Party Conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. The costs associated with these activities during 2008/09 were as follows:

Name of political party	£
Conservative	4,118
Labour	8,247
Liberal Democrats	2,025
<b>Total</b>	<b>14,390</b>

Shareholder authority to permit the Company to continue with these activities until the 2010 AGM will be sought at this year's AGM.

### Our investors

Our main communication with shareholders is through the publication of the annual report and financial statements, half-yearly financial report, interim management statements and through information on the Company's website. In addition, the executive directors have regular contact with the Company's large institutional investors, as well as giving presentations to analysts and stockbrokers. During the year, the executive directors met 29 times with a range of institutional investors. Further information on NWG's shareholder relations is contained in the corporate governance report on page 53.

### Employees

Each company within the Group has developed its own employee policies, reflecting the framework set out in NWG's 'Our Code of Conduct'. These policies are tailored to specific business objectives and operating environments. Each company aims to recruit and retain the best people, with a diverse range of skills, experience and backgrounds, who are committed to making the company successful. In return, each company aims to provide opportunities and training for employees to develop their skills and capabilities to equip them to meet the challenges of their roles, while rewarding the contributions of both teams and individuals.

### Equality and diversity

The Group operates an equal opportunity policy and promotes equality of opportunity in recruitment and selection, terms and conditions of employment, and training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment on the grounds of age, gender, marital status, disability, race, ethnic or national origin, religion or sexual orientation. NWL monitors its workforce profile against the communities it operates in and aims to ensure it takes full advantage of the rich backgrounds and abilities of current and potential employees.

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We properly consider employment applications from people with disabilities and, where existing employees develop disabilities, it is our policy, wherever practicable, to support them through providing appropriate adjustments to their roles and/or effective redeployments. Our Occupational Health Physicians assist this process with professional medical advice.

### Consultation and engagement

Each company engages with its employees through a variety of means appropriate to its working environment. The importance of an inclusive and engaging management style is fully recognised and, in 2008, NWL continued to develop in this area through over 120 workshops covering all our employees. The aim was to engage employees in a dialogue on improvements to our working practices and environment and seek their views on the areas that should be covered in our 2010-15 People Plan. In March 2009, the Chartered Institute of Personnel and Development presented NWL with the Employee Engagement Award in recognition of its proactive and inclusive employee engagement activities.

### Training and development

All Group companies train and develop their employees to benefit both the company and the individual. Annual appraisals are given high priority, as

is the identification of training needs, in recognition of the importance of training and development in achieving the Group's goals and policies.

### Communication

The Group uses a wide range of communication methods including magazines, newsletters, intranet, notice boards and regular team meetings. 'Unplugged', the Group magazine, contains articles on activities and news from across the business, focusing on employees and their achievements. NWL issues all employees with a series of information booklets clearly explaining areas such as the company's mission and values, terms, conditions and benefits of employment, occupational health and wellbeing programmes and People Plan objectives.

### Disclosure (Whistleblowing)

The Group encourages open feedback and is committed to protecting employees who wish to voice concerns about behaviour or decisions that they believe to be illegal or unethical. The Audit Committee regularly reviews the Disclosure Policy.

### Health and safety

A safe working environment is given high priority across the Group. A health and safety policy is maintained and implemented at each subsidiary.

Employees celebrate their success at the northern skills awards with Kriss Akabusi.





John Cuthbert and Ceri Jones with players from the Newcastle Eagles basketball team (l-r Darius Defoe, Lynard Stewart and Reggie Jackson) supporting Children in Need.

### Employee Share Incentive Plan (SIP)

The directors believe that employee investment strengthens the ties between the Group and its employees. More than a third of employees participate in the SIP, with an interest in 0.5% of the issued share capital. The scheme provides one free matching share for every three shares bought by an employee. Shares for the SIP are purchased at market price by the Trustee and dividends are paid in cash directly to participants. There are no performance conditions attached to the SIP but free shares not held in trust for at least 12 months are forfeited. Employees participating in the SIP are given the opportunity to exercise their voting rights through the Trustee of the SIP.

### Corporate responsibility

NWL is expected to provide a secure supply of water, a basic necessity for health, and to protect or enhance the environment when we return waste to it. However, our stakeholders also expect us to:

- behave fairly and responsibly;
- use resources wisely;
- improve quality of life; and
- contribute to economic development.

We take our corporate responsibilities seriously. Our aim of balancing economic, social and environmental

priorities underpins all of our activities and is an integral part of the way we do business.

We have significant resources in our assets, land and employees and believe we have a responsibility to use these resources for the benefit of our customers, our shareholders and the wider communities we serve.

The Managing Director is directly accountable to the NWL and NWG boards for both the environment and sustainable development policies.

We have developed our own model to integrate corporate responsibility as an essential part of normal business practice in NWL. This model is published on our websites with links to our policy, action plan, key performance indicators, trend data and case studies for 25 key areas of our business.

The Corporate Responsibility Committee (CRC) is a subcommittee of the NWL board and comprises non-executive directors, management team members and senior managers from the business. The CRC maintains a strategic overview of corporate responsibility policies and issues. Within the business a Corporate Responsibility Management Group (CRMG) drives and manages our

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corporate responsibility programme both prioritising activity and facilitating reporting and monitoring.

The CRMG is supported by two regional groups and by teams of community and environmental champions drawn from across the business to ensure

communication and influence is as effective and widespread as possible. We also have specialist working groups responsible for investigating, advising on and driving change on specific projects, such as climate change, energy use, transport, waste and recycling.



NWL's corporate responsibility model.