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THE BOARD'S OVERVIEW

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2001/02 REVIEW OF ACHIEVEMENTS

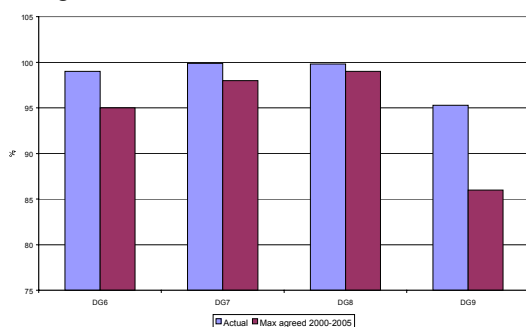
This Return reports on the second year of the five-year price control following the 1999 determination of price limits. During 2001/02 United Utilities Water has:

- continued the largest water industry investment programme in England and Wales to deliver regulatory outputs supported by the DWI and EA, dealing with the impact of foot and mouth;
- restructured our approach to the delivery of the AMP3 investment programme;
- invested to maintain serviceability to customers reflected in our Levels of Service performance;
- improved water quality with 99.8% compliance;
- accelerated programmes and invested in areas impacting adversely on customers, e.g. internal flooding and odour abatement.
- introduced risk management processes to manage the risk to customers and the environment.

Further achievements during 2001/02 were:

Customer Service

- Improving customer service performance ahead of the targets set out in the Monitoring Plan agreed with Ofwat at the last Price Review.



- UU has updated all its literature to enhance customer understanding as part of its rebranding exercise and made it available on its website.
- Retaining our Chartermark and IIP status.

Outputs and Performance

- Reaching agreement with the EA and DWI about the priorities for the sewerage and water quality programmes taking into account the impact of foot and mouth.
- Delivering all agreed outputs in 2001/02
- Retaining the highest category for five of the eight DG measures (summarised in Table 1)

Investment

- Maintaining asset serviceability from the previous year across all serviceability categories.
- Completing £409m investment, including £184m delivering Quality outputs.
- Accelerated the sewer-flooding programme allowed in price limits and investing in odour


abatement to meet customer demand, this being a major output.

Environment and Quality

- EA survey concludes the region's rivers are at their cleanest for two centuries and best ever bathing water quality results for the North West coast with an 89% pass rate against EU standards.
- Achieving our leakage target.
- Cryptosporidium incidents are at their lowest level since the mid 1980's. UU has invested to manage aqueduct ingress, complete surface drainage projects and erect fencing around aqueducts to exclude stock.
- Retaining ISO9001 for Quality and ROSPA award for our safety performance.
- Winning the "Premier Award for companies for Environmental Improvement."

Business in the Community

- Managing the provision of utility services for the Commonwealth Games and ensuring our investment programmes do not impact on the games.
- Winning the Utility Industry Achievement award 2001 for Community Initiative with a project utilising the skills and facilities of the environment education centres and aimed at disaffected youths.

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KEY OUTPUTS AND SERVICE DELIVERY


1. The Final Determination of price limits required UU to:
 - maintain service at levels already achieved by 31 March 2000;
 - deliver the quality outputs agreed with the DWI and EA;
 - install meters in response to customer requests; and
 - enhance customer service by resolving 560 sewer-flooding problems by 2005.

2. During 2001/02 we have:
 - maintained services on all but two levels of service (Table 1);
 - delivered all quality outputs following changes agreed with the DWI and EA, including those arising from foot and mouth, and are on target to deliver the agreed programme for AMP3;
 - installed meters at customer request, improving our standard of service from last year with less than 1% fitted outside the guaranteed service level;
 - enhanced customer service by advancing the sewer flooding programme in agreement with the CSC, and responding to customer and community pressure to improve odour abatement at key works;
 - developed an integrated internal control structure to develop and promote formal risk management throughout the business. Supporting processes are in place to implement effectively the strategy of managing the risk to customers and the environment. These measures will contribute substantially to achieving improvements to customer service and delivering efficiencies. An example of this is the significant project underway to assess the risks associated with UU's population of impounding reservoirs, the largest in the country. We expect this to have significant benefits in establishing the risk associated with a given maintenance regime.

Customer Service

3. During 2001/02 UU's service performance has been maintained at the current high level or improved on most DG measures. We maintain our high level of performance on the DG6 to DG9 customer service measures. On DG5 we are reporting a decrease in the number of properties that have experienced internal flooding in the report year, even with the above average rainfall during the autumn and winter. This is as a direct result of UU advancing the programme agreed at the Price Review in 1999 to address customers concerns about sewer flooding. Our comparative assessment remains average.

4. We have improved our Drinking Water Quality OPI score from 98.73% in 2000/01 to 99.46% in 2001/02. This significant improvement is as a direct result of the

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programmes in place to address water quality issues and is reflected in our water quality improving to an all time high of 99.8% compliance.


5. In 2001/02 UU discovered a number of pressure problems on one part of the network that had not previously been recorded. Although this adversely affects the reported DG2 performance, 99.94% of the connected properties have seen no change in performance. We intend to resolve these pressure problems during 2002/03 to restore our above average status for DG2. As these are historic problems, they do not imply a deterioration in serviceability.
6. DG5 other causes has shown a slight deterioration this year. This coupled with an improving industry average has resulted in a “below average” assessment. Targeted investment in this area is expected to improve the situation in 2002/03.
7. Table 1 below compares the 2001/02 levels of service performance with both the forecast contained in our Monitoring Plan and last year. It shows that customer service has in all but two cases been maintained since 2000/01. On five of the measures we are rated in the top assessment banding reflecting our ongoing commitment to service to customers.

Table 1: Levels of Service Performance 2001/02

Measure	Performance		
	2001/02 Actual (✓ = highest band)	Monitoring Plan Commitment	Change on 2000/01
DG2: Water pressure	Average	Above average	↓
DG3: Supply interruptions	Good ✓	Good	↔
DG5: Overloaded Sewers	Average	Average	↔
DG5: Other Causes	Below average	Average	↓
DG6: Billing Contacts	Good ✓	Acceptable	↔
DG7: Written Complaints	Good ✓	Good	↔
DG8: Meter Reading	Good ✓	Good	↔
DG9: Telephone Contact	Acceptable ✓	Acceptable	↔

Quality Enhancement Programmes

8. UU delivered all quality enhancement outputs currently agreed with the DWI and EA. Detailed revisions to the programmes have been driven by changes to the quality drivers and the impact of foot and mouth.
9. The foot and mouth outbreak has resulted in a revised programme being agreed with the DWI for the water quality programme and agreement with the EA in most areas for the wastewater quality programme. A revised strategy for delivering the UID programme has been agreed but the wastewater treatment works programme is still under discussion. Changes in the UID programme were agreed following substantial investigation and modelling work by UU. Table 2 below summarises cumulative progress against the key quality outputs currently agreed with the EA and the DWI and the original programme agreed in Price Limits. UU is delivering environmental benefits ahead of the agreed programme.

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10. Foot and mouth has continued to impact heavily on the disposal of sludge, increasing operating costs and business risk, and reducing revenues from farmers.

Table 2: Key Quality Outputs included in the 1999 Determination


Programmes	Units	Cumulative Performance to 31 March 2002	Revised Cumulative Target agreed with EA and DWI	AMP3 Cumulative Target 31 March 2002
Water Service				
NW40 Distribution System	Km	1615	1600	1600
WTW	Nr	12	10	4
Sewerage Service				
Other Quality Drivers	Nr works	19	20	12
Sewerage Service				
UIDs removed	Nr	139	134	155

Serviceability

11. Wastewater infrastructure serviceability has seen a slight deterioration in sewer collapses and pollution incidents since last year. However, the improvements in DG5 properties flooded (capacity) and the trend in the other measures retains a stable serviceability assessment.
12. Last year Ofwat assessed UU's wastewater non-infrastructure performance as "uncertain", due to the impact of two large works failing consent and the impact on the population equivalent affected. This year there has been a reduction in the number of works failing consent but a failure at a single large works has increased the population equivalent affected. On this basis the trend in wastewater non-infrastructure serviceability remains uncertain.
13. UU has been active in recent studies developing serviceability measures, which will underpin the principles set out in MD161. UU was one of four companies collaborating with Ofwat and the DWI in developing improved water quality serviceability measures. UU is also currently trialing the UKWIR capital maintenance framework.

UU's position for 2001/02 and that achieved for 2000/01 are summarised below:

	Water		Wastewater	
	2001/02	2000/01	2001/02	2000/01
Infrastructure	Improving	Improving	Stable	Stable
Non-infrastructure	Stable	Stable	Uncertain	Uncertain

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FINANCIAL PERFORMANCE MEASURES

Profitability

1. HC profit before tax for 2001/02 was £238 million.

Dividends

2. UU's dividend policy must not impair the ability of the business to finance its functions. In 2001/2, the directors have continued to take a prudent approach to dividend distribution with ordinary dividends to the parent company remaining close to constant in real terms.

Treasury Policy

3. Operating within policies approved by the board, the treasury function does not act as a profit centre and does not undertake any speculative trading activity. We ensure sufficient funding is available to meet foreseeable needs and maintain reasonable headroom for contingencies. Long-term borrowings are structured or hedged to match earnings, which are largely in sterling, indexed to inflation and subject to regulatory price reviews every five years. Exposure to interest rate movements for the following 12 months is largely eliminated at the start of each financial year using short term hedges. The credit quality of counter parties and individual aggregate exposures are reviewed annually. The restructuring changes in the industry have required UU to maintain significant headroom by pre-funding in debt capital markets and from committed bank lines.


Financial Ratios

4. Table 3 below shows the key financial ratios in 2001/02. This continues to show the impact of the significant change to the balance sheet assumed by Ofwat in price limits, despite the initial capex investment being lower than anticipated.

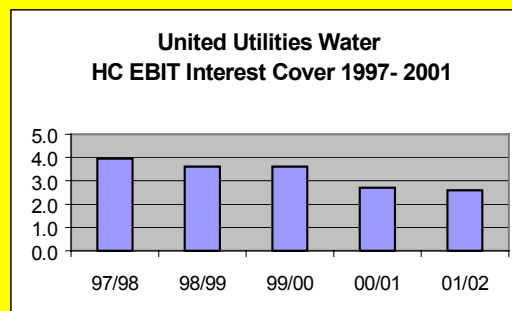
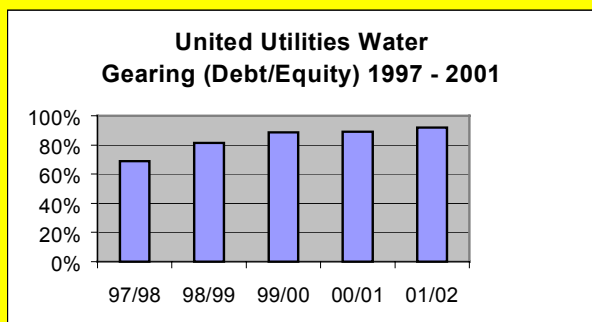
Table 3: UUW PLC Financial Ratios


	31 March 2002
HC EBIT Interest Cover	2.6 times
HC Dividend Cover	1.0 times
CC Return on RCV (post-tax)*	5.8 %
Debt : Equity Ratio	97%
Net Debt	£2,252 million

Note: * Based on Average RCV for 2001/02

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5. UU has come to an agreed position with Ofwat regarding the RCV and now believes that this reflects the final determination position.
6. The trends in gearing and interest cover since 1997/98 are shown in the graphs below.



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Expenditure

Operating Costs

7. Operating expenditure totalled £337 million in 2001/02.
8. Operating expenditure has increased by £4.5 million over 2000/01 mainly due to an increase in quality obligations offset by rate reductions and operating efficiencies.

Investment

9. Cumulative investment for AMP3 is £792m.


KEY SUPPORTING INFORMATION

1. Table 4 below summarises the cumulative maintenance activity levels for the period April 2000 – March 2002 compared to levels in our Monitoring Plan. Overall, water maintenance is on track and wastewater is lagging due to the impacts of foot and mouth and the transition in bringing management of sewerage networks in-house. The wastewater treatment works refurbishment programme is particularly badly affected

Table 4: Capital Works Activity compared to the Monitoring Plan

Programmes	Units	Cum 2000-2002 Actual	Cum Monitoring Plan Forecast
Water Service			
WTW refurbished	Vol Ml/d	1101	233
Mains renewed/relined	Km	108	98
Sewerage Service			
Sewers renovated/replaced	Km	190	212
WwTW refurbished	Nr works	11	33

2. Water capital expenditure on base service has increased 18% relative to last year and reflects the water service outputs as detailed in Table 4. Water quality spend has also increased with the impact of the quality programmes underway during this year.
3. Wastewater capital expenditure on base service has decreased 6% from that reported in 2000/01 mainly as a result of UU bringing management of the sewerage network in-house to improve investment control. In addition, impacts of foot and mouth have delayed some maintenance work.
4. The increase in wastewater enhanced service spend reflects the increased activity in solving internal flooding problems and odour abatement.
5. Operating cost expenditure has reduced for water from 2000/01 due to ongoing efficiencies, and increased for wastewater base service and quality due to the increased costs associated with foot and mouth and new quality projects being commissioned.

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Water Balance

6. UU has achieved its leakage target for the 5th year in succession. UU achieved a leakage level of 452 Ml/d exceeding the target of 455 Ml/d, despite the difficulties presented by foot and mouth disease and a freeze-thaw event during December/January, which has resulted in a reduced performance for mains bursts. As agreed with OFWAT our leakage target is based on a robust assessment of the economic level of leakage, which is consistent with the least cost option to maintain the supply-demand balance.
7. UU continues to implement its plans to achieve a satisfactory supply-demand balance in the Carlisle and West Cumbria zones, consistent with our water availability levels of service. These improvements remain on target to be delivered before the end of the AMP3 period. UU expects to maintain the supply-demand balance and current water availability levels of service in the rest of the region during the remainder of the AMP3 period.

Metering

8. The take up rate of the free meter option (FMO) has increased since last year due to a number of promotional activities including leaflets distributed with customer bills and personalised letters to 94,000 customers informing them of the potential savings. UU will continue to raise customer awareness over the next year.


Other Key Supporting Information

9. We have continued to provide UU's enhanced customer commitments for all our customers, which in some cases exceed the Guaranteed Standards Scheme.
10. UU's bad debt policy is to write-off debt only where a customer has left a property and can no longer be traced. The provision against profits is reviewed annually, taking account of latest debt information. Revenue outstanding has consistently increased year on year by about £10 million, mainly relating to unmeasured households in areas where historically it has been difficult to collect payment. We continue to see difficulties in revenue collection as a result of the ban on disconnection of domestic properties. We are pleased to see that Ofwat acknowledges the difficulties this has created for companies but believe that this will remain a growing problem for companies in general, and UU in particular.

EFFICIENCIES

Capital Expenditure


1. Building on last year's reported initiatives, sources of capital efficiencies continue to be pursued. These include:
 - more cost-effective procurement, for example through the use of internet reverse auctions with a total value of auctions thus far of some £190m;

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- the creation of an in-house team to strengthen standardisation of UU's design policies; and
 - the recent award of three regional framework contracts to deliver the AMP3 quality investment programme, each worth up to £250m, replacing over 200 contracts that delivered AMP2.
2. Based on Ofwat's capital maintenance econometric models and an analysis of cost base information, UU believes that its 2001/02 industry comparative ranking is average for water and slightly below average for sewerage, no change on 2000/01. UU is developing special factor evidence to compensate for regional features of our operating environment which are outside management control, e.g. inherited sewers in condition grades 4 and 5.

Operating Expenditure

3. UU has continued a £300 million programme to deliver operating cost efficiencies over the five years to 2005, arising mainly from the restructuring of the business. UU has reduced base operating expenditure by 11.6% in real terms on 1997/98 levels, after excluding exceptional items. This reduction results mainly from efficiencies arising from outsourcing, innovation and optimisation within the capital programme, rationalisation of existing assets, synergy savings arising from stream-lining operations and pursuing multi-utility benefits, green energy initiatives, and realising value from waste products. An example of such an initiative implemented this financial year is 'Selectusonline' a joint venture purchasing consortium formed to achieve best value via economies of scale. In the first year of the initiative UU (a founder member) achieved savings of around 10% a year for at least three years on contracts with a combined value of £50 million.
4. To ensure UU continues to meet compliance targets whilst seeking further efficiencies, we have introduced a system of staff designated as "licensed operators" who ensure our activities meet regulatory compliance requirements and future targets. In addition, we are in the process of bringing back in-house the wastewater network operations previously undertaken by local authorities. This will allow us to achieve greater synergies with water, and electricity, operations.
5. We estimate that UU is above average for water service opex efficiency and has improved to above average for sewerage service opex efficiency in 2001/02. However, UU continues to believe there are deficiencies in Ofwat's sewerage service efficiency models, which do not reflect the impact of additional quality related expenditure on operating costs.

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COMPETITION

1. We welcome the government's recent further statement, which indicates the likely scope of competition in the water industry.
2. We look forward to the government's subsequent consultation. We are pleased that a picture is now beginning to emerge that can be taken into account at the forthcoming price review.

Current Activities

3. UU has been a key player in the industry examining the way the competitive market might develop. This has included supporting industry-wide task forces working on the framework and processes needed to make competition work.

Inset Appointments

4. There are no applications for inset appointments in UU's area at this time but we have received some enquiries.
5. UU is investigating the potential for inset appointments at several out-of-region sites.

Common Carriage Proposals


6. UU published its Access Code in August 2000 as required by the Director General, and this will be updated and reissued shortly, taking account of Ofwat's recent guidance.
7. Through Water UK, UU has led an industry task force comparing Access Codes across the industry to establish the feasibility of a National Access Code. We welcome Ofwat's proposals for a forum to develop best practice in access codes.
8. There are no applications for common carriage in UU's area at this time. UU is pursuing common carriage options for several out-of-region industrial wholesale water partnership projects.

Competition in Providing New Water Mains and Service Pipes

9. UU has been one of the industry leaders in opening up self-lay of water mains to third parties and already allows third party contractors to undertake mains laying work. UU is submitting a revised self lay policy in line with the regulator's deadline of July 2002 to further aid competition in this area.

Competitive Services

10. Within its portfolio of regulated and non-regulated offerings, UU offers a comprehensive range of water, wastewater and billing management products/services that are specifically tailored for the business market, including:

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- national water advisor (group-wide agreements)
- water and wastewater efficiency services
- bespoke, on-site water and wastewater services
- leakage detection and repair services
- metering services
- consolidated billing and fixed date/period billing services

These services are promoted via Key Customer Managers operating regionally, Business Managers operating nationally, the UU internet site and direct mail campaigns.

11. UUW offers the following non-regulated services to its customers, through third parties: plumbing insurance; electrical wiring insurance; gas boiler maintenance; water related products (water butts etc); gas and electricity; plumbing service; and household accident insurance. Water related products and plumbing insurance are promoted through inserts with bills, the internet site and direct mail. Non-water related products are promoted separately through direct mail.

REPORT AUTHORISATION

Signed on behalf of the Directors of UUW PLC



Date: 06 September 2002

J Roberts

Chairman

United Utilities Water