

## **Methodology Information Paper 18: Defining the baseline**

### **Introduction**

In this information paper we set out how we propose to determine the baseline for Scottish Water's capital investment programme. The baseline defines the specific outputs that Scottish Water is required to deliver if it is to meet Ministers' objectives for the industry.

### **Ensuring that the programme of investment is properly defined**

The baseline for the capital investment programme is the agreed detailed list of capital projects that Scottish Water will deliver during the next regulatory control period. This is a key part of the regulatory contract between Scottish Water and its customers. The baseline programme must be such that if Scottish Water delivers the outputs specified in the programme, it will have achieved the ministerial objectives. The baseline programme allows stakeholders to monitor Scottish Water's progress in delivering these outputs.

Investment programmes in the water industry are typically split into three main elements:

- Capital maintenance - investment to maintain the current level of service to customers by replacing worn out plant and equipment that is at the end of its useful life.
- Quality enhancement - investment to bring about improved levels of service to customers, better water quality, improved environmental performance and to address service issues such as sewer flooding.
- Investment in the supply/demand balance<sup>1</sup> - investment to meet increased demand for water resources from existing or new customers.

The level of definition that is possible for each of these three elements varies. Capital maintenance projects tend to be more difficult to define than quality and supply/demand investment projects.

### **Defining the baseline programme**

To define the baseline investment programme we are likely to require the following information:

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<sup>1</sup> Supply/demand investment includes addressing the ministerial objectives to meet growth in demand from new customers and businesses

- **A detailed list of projects**

We will require a detailed list of all of the quality enhancement projects and supply/demand projects (including contributions<sup>2</sup>) and the larger capital maintenance projects. The smaller or less well-defined capital maintenance projects will require a programme-level definition. Each investment project or programme should have:

- a unique code;
- a unique name; and
- a geographical reference (place name and water supply zone/drainage area).

- **Defined outputs for each individual project**

All projects should have pre-agreed, defined and discrete outputs. This ensures that all planned investment outputs are covered within discrete, single projects. Scottish Water's investment plan is likely to be large and complex. Stakeholders will want to ensure that projects to address a particular local need are clearly identifiable in the baseline. By requiring clear links between outputs and individual projects we should avoid overlap between projects in Scottish Water's baseline programme.

- **Clear definition of capital maintenance proposals**

All capital maintenance projects and programmes should clearly identify:

- the work proposed (its size, quantity and type);
- whether the project or programme is planned or reactive;
- the project or programme costs; and
- whether the work is being brought forward to co-ordinate the activity with work being carried out under the enhancement or supply/demand programmes.

It is possible to make savings by carrying out capital maintenance work at a site at the same time as quality improvement or supply/demand work is underway. However, in these circumstances it is important that the costs for capital maintenance are properly allocated. We have recently had discussions with Scottish Water about their guidelines for capital expenditure allocation; we will look for evidence

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<sup>2</sup> Contributions to the funding of projects can include grants and required contributions from customers

that proper policies are in place to ensure that capital maintenance expenditure is being properly recorded.

- **Definition of quality and supply/demand drivers, costs and outputs**

Quality and supply/demand projects should be clearly identified and costed. This should include:

- information about which agreed 'drivers' are generating the project;
- an allocation of costs between drivers and excluding any elements associated with capital maintenance;
- an appropriate measure of the output; and
- the number of units of that measure that the project delivers.

Examples of appropriate measures for outputs would include the volume of water delivered to customers that will become compliant with the required standard as a result of the work, or the population that will benefit from improvements at a sewage treatment works to meet environmental standards.

- **Profile of project delivery**

The timetable for project delivery should include:

- the annual projected investment spend for each project – this should include expenditure before or after the regulatory control period;
- key project milestones (for example when options have been developed, when the target cost has been agreed and when construction will reach beneficial use); and
- the expected completion date.

- **Clear links to the ministerial objectives**

The contribution that each project or programme of work will make towards meeting the ministerial objectives should be captured. This will confirm to stakeholders that delivering the agreed capital programme will ensure that ministerial objectives are met.

## Benefits from defining a detailed baseline

Defining the programme in detail in this way brings clear benefits for customers:

- It allows us and other regulators<sup>3</sup> to examine Scottish Water's proposals in detail to establish whether they meet the ministerial objectives.
- It also enables us, through a range of benchmarking and analysis techniques, to establish whether Scottish Water is delivering the objectives at the lowest reasonable overall cost.
- It enables Scottish Water's progress in delivering the required outputs to be monitored in detail.
- It provides customers with transparent information about what Scottish Water has to deliver at a local level.

We would expect Scottish Water's investment submission clearly to identify any elements of undelivered investment from the current 2006-10 investment period. We made it clear in the Strategic Review of Charges 2006-10 that customers will not pay twice for outputs that are already financed by the current settlement contract.

### Related documents

'The Strategic Review of Charges 2006-10: The draft determination', Volume 5, Water Industry Commissioner for Scotland, June 2005.

'The Strategic Review of Charges 2006-10: The final determination', Water Industry Commission for Scotland, November 2005.

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<sup>3</sup> Including SEPA, DWQR and Waterwatch Scotland