

## **Methodology Information Paper 21: Ofwat's approach to assessing capital maintenance requirements.**

### **Introduction**

This information paper sets out Ofwat's overall approach to assessing capital maintenance expenditure and whether it can be applied to Scottish Water.

### **Ofwat's approach**

Ofwat employs a four-stage approach linked to the UKWIR common framework<sup>1</sup> for capital maintenance planning.

The four stages of Ofwat's approach are:

- Stage A: Maintaining serviceability to customers to date. Ofwat assesses the companies' current serviceability to customers and examines previous expenditure to maintain this level of serviceability.
- Stage B: Is the future period different? Ofwat asks the companies to set out how they expect future investment and serviceability trends to change in the future and to provide reasons for their judgements.
- Stage C: Scope for improvements in efficiency. Ofwat uses cost-base and econometric techniques to assess the potential for the companies to improve their efficiency.
- Stage D: Impact of the enhancement programmes. Ofwat takes account of the overlaps between the companies' quality enhancement programmes and their capital maintenance plans.

### **Could the Commission adopt the same approach?**

We consider that there is currently insufficient information available in Scotland to implement Ofwat's approach to assessing the appropriate level of capital maintenance to allow for. In particular, there is insufficient historical information on the levels of capital maintenance expenditure and the performance of the network to allow the use of an UKWIR common framework approach to price setting.

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<sup>1</sup> This is an industry-standard, forward-looking risk-based approach to capital maintenance that Ofwat first used in setting prices for 2005-10. The approach requires a large amount of reliable information about companies' costs and their asset bases, collected for a number of years.

We allowed for £15 million in the Strategic Review of Charges 2006-10 for Scottish Water to improve its information in this area. We are working with Scottish Water to ensure that the relevant information is identified and collected with accuracy. Despite Scottish Water's much increased focus on improving its information about the serviceability to customers of its assets, it is likely to be at least 6 to 8 years before we are in a position to apply the UKWIR Common Framework approach.

We set out our proposed approach for the 2010-14 review in Information Paper 22 'Our proposed approach to determining the appropriate level of capital maintenance expenditure to allow for.'

### **Related Documents**

Ofwat, "Future Water and Sewerage Charges 2005-10: The Final Determination", November 2004, Chapter 11.