

B1 THE BUSINESS ENVIRONMENT AND THE LONGER TERM

Outline

Scottish Water should expand on its assessment of the likely environment in which it will have to operate in the Q&SIII period and beyond as set down in Section 1 of the strategy.

The text should focus on explaining Scottish Water's assessment. No formal tables are required although Scottish Water may wish to draw on or refer to numerical data in other prescribed tables. This part of the submission should be divided into four sections. This structure provides a framework for Scottish Water to explain its assessment of the post 2006 environment in its own way.

The post 2006 environment

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| Section 1 | Achievements to date compared with earlier plans |
| Section 2 | Assessment of the post 2006 environment for Scottish Water |
| Section 3 | Managing the key risks and uncertainties |
| Section 4 | Achieving the right balance for customers |

Section 1: Achievements to date compared with earlier plans

In scene setting for the draft and final business plan Scottish Water should set its achievements to date into context, covering both services to customers and maintaining the integrity of its systems and assets. When setting its

achievements into context Scottish Water should refer back to previous plans under Quality and Standards I and II, amended as appropriate to reflect revenue caps set by Ministers.

Material differences between achievements and planned outputs should be explained. Material changes in Scottish Water's policy should be set down together with the reasons for the changes.

Section 2: Assessment of the post 2006 environment

Scottish Water should expand on the summary included in part A and explain in more detail its assessment of the post 2006 environment relevant to the periodic review.

Section 3: Managing the key risks and uncertainties

The key opportunities, risks and uncertainties need to be set down and their impact on the regulated business quantified. Scottish Water should explain how it intends to manage these whilst reducing the risks and uncertainties with the emphasis being on improving services to customers and delivering value for money.

Section 4: Achieving the right balance for customers

Scottish Water should set how and why it considers that its overall strategy for the Q&SIII period achieves the right balance between services and bills for customers. Section B6 looks in more detail at the improvements in service that Scottish Water plans to deliver.

Scottish Water should set out how its strategy relates to the views expressed by specific groups such as business customers or low-income customers.

Guidance for Reporters

B2 IMPROVING EFFICIENCY

Outline

In developing its draft and final business plan Scottish Water should decide on the scope for it to improve its efficiency in the next price limit period. Constraints on making the maximum use of this scope should be explained.

Scottish Water should:

- set out its views on the scope for improvements in efficiency and the evidence on which they are based
- explain how they lead to its assumptions about cost reductions from current levels that it has included in its strategy
- describe how the assumed improvements have been incorporated in the business plan expenditure projections.

These judgements should be informed by Scottish Water's view of:

- its expectation for improvements in efficiency which a frontier company may achieve
- its current efficiency or inefficiency relative to its peers within the regulated industry
- the findings of any benchmarking studies it has carried out
- the pace of improvements over the period

- the balance to be struck between customers and stakeholders that provides the right incentives to improve its efficiency still further.

Scottish Water should refer to any benchmarking studies it has conducted and explain how these and other studies have informed the assessments.

We suggest that part B2 should be divided into three sections.

Efficiency improvements

Efficiency improvements	
Section 1	Overall approach to assessing the scope for improvements in efficiency the Q&SIII period
Section 2	Water service efficiency improvements (1) Operating expenditure (2) Capital maintenance expenditure (3) Capital enhancement expenditure
Section 3	Sewerage service efficiency improvements (1) Operating expenditure (2) Capital maintenance expenditure (3) Capital enhancement expenditure

Scottish Water should make any assessments of relative efficiency using 2003-04 as the base year for both output delivery and costs incurred.

Scottish Water should explain how it intends to meet its efficiency assumptions including where they will be made. Scottish Water should confirm that its efficiency assumptions can be met, without increasing the risk of service or quality compliance failure.

Scottish Water may wish to provide details of studies undertaken both to arrive at its relative efficiency assessment and also the scope for general improvement in efficiency in the industry.

General guidance

Scottish Water should set out the basis of its efficiency assumptions (for both opex and capex) and set out the impact of its overall assumed efficiency profile as well as that for:

- Capital maintenance
- Quality enhancements
- Supply/demand
- Service delivery.

Capital efficiencies

For capital maintenance, the efficiency assessment should be made relative to the recent average historical level of expenditure. The projected efficiency should be applicable whether or not any adjustments have been made by Scottish Water to correct deteriorating trends in either serviceability or asset condition. Efficiencies may result both through a projected reduction in capital unit costs, and from a reduction in levels of renewal activity from, for example, more effective targeting of capital maintenance resulting from improved methods of risk assessment and/or better information.

For capital enhancements, the efficiency assessment should be made relative to current estimates of the projected cost of meeting quality obligations, enhancing service standards and

maintaining the supply demand balance. Efficiency improvements will therefore be relative to Scottish Water's current unit cost models used to generate the investment projections for this category of expenditure. Efficiency improvements may result from both projected reductions in capital unit costs and from anticipated adoption of new technologies and practices.

Guidance for Reporters