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RB/JP

9 October 2007

15 OCT 2007

Katherine Russell
Director of Customer Service & corporate Affairs
The Water Industry Commission for Scotland
Ochil House
Springkerse Business Park
Stirling
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Dear Madam

STRATEGIC REVIEW OF CHARGES 2010-14: METHODOLOGY – CONSULTATION

I refer to your consultation documents in respect of the above and enclose for your attention responses to the questions raised in each volume thereof. It should be noted that this response has been prepared by Officers and the comments have not been the subject of any formal review by Elected Members.

Volume 1: Financing and Governance of Scottish Water

- 1 Do respondents agree that the levels of operating risks faced by Scottish Water are broadly similar to those faced by companies south of the border? If not, how are they different and how should this be allowed for in prices?**

It is agreed that Scottish Water has broadly the same range of operational risks as companies in England & Wales. It follows therefore that customers and taxpayers should not have to share in these risks through any adjustment to the pricing mechanism and that these risks should remain the responsibility of Scottish Water.

- 2 Do respondents agree that using proper comparisons with England & Wales remains the most effective way to regulate Scottish Water? If not, how should we set prices and measure levels of service?**

It is agreed that comparison with companies in England & Wales is a suitable form of benchmarking performance, although it would be of benefit if specific factors such as deprivation, sparsity and rurality were reflected in any comparator used.

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- 3 Given that we have a duty to promote the interests of customers, are we taking sufficient steps to protect customers from unnecessary risks? If not, what other steps should we be taking?**

The overall approach set out appears to provide reasonable assurance those sufficient checks and controls are built in to the process to guard against exposure to excessive risk.

- 4 Do respondents agree with our use of the RCV, “gilts buffer” and rolling incentives?**

It is recognised that each of these tools are designed to provided and encourage operational stability and as such we would support their continued use given that further scrutiny of the RCV and the components of its calculation is proposed.

Volume 2: Customer Revenue, Levels of Service and the New Competition Framework

- 1 What are respondents views on our approach to establishing the revenue and customer baseline for the Strategic Review of Charges 2010-2014.**

The proposed work to reduce the current level of uncertainty regarding the overall number of non household customers being supplied is welcomed. This should contribute to the increased accuracy in establishing the overall revenue baseline required by Scottish Water.

- 2 What are respondents’ views on our proposals to encourage Scottish Water to continue to improve the level of service it provides to customers?**

Year on year improvement in the overall level of service delivery, within a stable price environment should remain a priority. The proposal to ensure that Scottish Water delivers a level of service comparable to that of leading companies within England & Wales should contribute to this objective. It will however be important to be able to demonstrate continued improvement in overall efficiency linked to a continued development of service quality.

- 3 How do respondents view the changes we are making to reflect the new competition framework?**

It is considered that default tariffs should ensure that no customer is in a position where they do not have access to a retail supplier. It is not clear how quality of service delivery from the retail supplier will be measured. Presumably, as the market develops, this will be demand led with consumers able to switch provider based both on price and service levels.

Volume 3: Approach to Assessing Operating Cost Efficiency

- 1 Do respondents agree that our approach to benchmarking Scottish Water’s performance remains robust despite the separation of non household retail activities in Scotland?**

It is agreed that the approach proposed remains valid. The comparison with leading water and sewerage companies in England and Wales should provide relevant comparative figures although these should be adjusted, where necessary, to reflect any factors unique to Scotland.

- 2 Do respondents agree that we should take account of differences in the level of service and scope of activities in Scotland and in England and Wales?**

Yes. It is important that identifiable differences are adjusted for within any comparison to ensure a common basis is used.

- 3 Do respondents agree with our favoured approach to setting an appropriate efficiency challenge for Scottish Water?**

Yes. The approach proposed should continue to ensure that Scottish Water continue to deliver both an improvement in service, together with a reduction in the underlying cost base.

- 4 Do respondents agree that our approach to assessing claims for special factors is reasonable?**

Yes. It is important to continue to recognise that there may be factors outwith the control of management which could influence costs. It is however equally important that Scottish Water is held to account in justifying any claim for inclusion of such factors, on an annual or rolling basis.

Volume 4 – Approach to Capital Expenditure

- 1 What are respondents views on how we propose to assess the size of investment programme that Scottish Water should be expected to deliver efficiently?**

We would be supportive of the overall approach and welcomes the need for clear identification of expected outputs from the proposed investment programme, including a robust assessment of not only the operational capacity of Scottish Water to deliver but also the wider capacity within the market place.

- 2 Do respondents have views on how we propose to define the scope of the investment programme required to deliver ministerial objectives for the water industry?**

It is agreed that the overall framework proposed should contribute to ensuring that the capital investment programme can be assessed against the overall Ministerial targets set. It is not implicit that there will be an opportunity for local authorities to influence this process, and clarification of proposals that would facilitate such consultation and involvement would be helpful.

- 3 What are respondents' views on how we propose to determine an appropriate allowance for capital expenditure?**

It is agreed that the use of available cost models, together with direct comparison with companies south of the border should support the identification of an appropriate allowance. In particular, the provision that the model will be amended to reflect special factors that are significant within a Scottish context is welcome.

- 4 **Should we consider an application by Scottish Water for an “early start” to delivering the required investment outputs for 2010-14?**

It is not unreasonable to assume that the planning process for delivering the 2010-14 outputs could start in advance of the current regulatory period ending. This should contribute to ensuring that any slippage is kept to a minimum.

- 5 **Are the methods that we propose for monitoring Scottish Water’s performance in delivering the outputs required by the regulatory contract appropriate?**

Yes the methods proposed a reviewed as being broadly acceptable in setting a framework for monitoring performance.

Yours sincerely



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