

PRINCIPLES OF CHARGING FOR WATER SERVICES 2010-2015 STATEMENT

The following charging principles are those that Scottish Ministers expect the Water Industry Commission for Scotland (the Commission) and Scottish Water (SW) to apply during 2010-15. These are set under section 29D of the Water Industry (Scotland) Act 2002 and will guide the Commission when determining the charge limits that SW is able to set during 2010-15.

Stable charges

1. Ministers recognise the importance that customers attach to stability and certainty in charging. The Commission will publish charge limits to give customers certainty about the level of charges they will face over the regulatory period.
2. Ministers' policy is for charge caps that are affordable, stable and do not rise by more than inflation across the period. As required by Section 56A of the Water Industry (Scotland) Act 2002, Ministers have specified the Objectives Scottish Water should achieve by 2015. Ministers require the Commission to determine charges at levels which will secure the efficient delivery of an investment programme described in these Objectives. In doing so, the Commission should take account of the need to achieve continuity of investment, and the level of lending that the Government is prepared to make available to SW as set out in paragraph 13 below. Ministers invite the Commission to advise them if this requirement is inconsistent with charges that do not rise by more than inflation across the period or if it does not consider that all the Objectives can be financed within the parameters set out in this paragraph.

Full cost recovery

3. Charges should cover the full costs of providing services to customers. Public expenditure support to SW will take the form solely of lending from Ministers. In addition, customers will only be asked to meet additional costs beyond those allowed for in a charges determination, where these arise as the result of external factors beyond the influence of SW. This arrangement protects the position of customers and ensures that they do not pay twice for the same service or compensate SW for inefficiency or poor management.

Cost-reflective charges

4. Charges in general should be broadly cost-reflective - i.e. charges for given services to particular customer groups should be set to recover the cost to SW nationally of providing that service to that group as a whole. The principle of affordable charges for low income households is an exception to this which should be achieved through linking unmeasured household charges to Council Tax bands.

Phasing of increases

5. Ministers recognise that achieving stable charges in real terms could mean that some charges for individual customers will rise above inflation and others will fall. In particular this could arise in those circumstances where some tariff rebalancing is justified i.e. to correct any historic under charging where the cost to serve has been found to be greater than present charge levels.
6. Ministers wish to ensure steady progress is maintained in removing cross subsidies from charges.
7. Where charge increases are expected for individual customers as a result of a rebalancing of charges within a charges scheme, Ministers' general expectation is that the Commission will phase changes over the review period. However, they invite the Commission where they identify disproportionate impacts on customers, in light of the wider circumstances they face, to consider whether it would be appropriate to extend any transition period beyond the regulatory period.
8. While Ministers fully support the move to cost-reflective charging they recognise that the implications of the unwinding of cross subsidies may be significant for individual business customers or sectors. Ministers will study closely the evidence that emerges from the pricing review as it progresses so that if there is a disproportionate impact on the continuing competitiveness of particular sectors, they can consider what other actions outside the price review may be taken to address this.
9. Through the determination process, Ministers request that the Commission consult with SW, licensed providers and customers on the best approach to unwinding the identified cross-subsidies - recognising that the benefits to some businesses of cross-subsidies are paid for by other businesses and public sector organisations. The consultation should identify clearly the extent of the likely increase for different classes of customer.

Harmonised charges

10. A fundamental tenet of Ministers' policy regarding charges is that customers in the same group should pay at the same rate for the provision of the same service, regardless of their location, or of the actual cost of serving one such customer as against another. Section 29D (2) of the 2002 Act enshrines this principle in statute by requiring Ministers to set policy regarding charges that secures that outcome. Consequently, charges for all of SW's core services in the period must be recovered from customers on the basis of all tariffs being set at a nationally averaged rate for Scotland as a whole. This means that charges for services to particular customer groups should be set to recover the cost to SW nationally of providing that service to that group as a whole.

Financing and capital expenditure

11. Ministers believe that it is important that the capital investment programme for the 2010-15 period is no larger than can be delivered efficiently. The Commission should advise Ministers if it considers that the size of the capital programme is such that, to deliver it efficiently, charges would be required to increase by more than inflation.

12. The Government will not take a dividend from its ownership of SW and financial outperformance should be used to build up a financial reserve. It considers that SW's financial strength should be appropriate to the governance framework within which it operates.

13. The Government will continue to make finance available through lending to SW in the 2010-15 period in support of its investment programme. The Government wishes to ensure that this lending is at the lowest practicable level consistent with the principle of stable charges. Ministers will provide the amount advised by the Commission up to a maximum of £150 million per annum.

Household charges

14. Ministers confirm that, in relation to unmetered households, the present water collection arrangements and the tariff structure should continue for the period 2010-15, that is in general:

- Local Authorities will continue to bill and collect unmeasured household water and sewerage charges – Ministers will bring forward an order under section 37 of the Water Industry (Scotland) Act 2002 to secure this, and
- The bandings for household water and sewerage charges should replicate council tax bandings, with reductions on water and sewerage charges also mirroring the discounts that apply to council tax. The exceptions are that no reduction will be applied to water and sewerage charges for second homes and those households in receipt of council tax benefit but no other reductions in their water and sewerage charges will receive up to a 25% reduction. Full details of the reductions that should apply to household water and sewerage charges can be found in Annex A to this statement.

Paying for public roads drainage

15. SW household and wholesale charges should continue to include an appropriate element to recover the cost to SW of draining public roads.

Paying for increased local capacity

16. Where enhancements to the local infrastructure are required to enable new developments to be connected to the public networks, developers should meet the net cost to SW of such enhancements. The detailed aspects of the

arrangements can be found on the Scottish Government website. The Commission should continue to provide for SW to levy infrastructure charges for each new property connected to the water or sewerage infrastructure.

Surface drainage charging arrangements for non-household customers

17. To minimise disruption for customers, Ministers have decided to defer the introduction of charging for surface drainage by reference to surface area during the current difficult economic times. Scottish Water should continue to develop the detail of the surface drainage charge so that the likely impact of the change can be illustrated to stakeholders. The Commission should then consult retailers and their customers on the most appropriate way forward, informed by Scottish Water's analysis.

Exemption scheme

18. Ministers confirm that the exemption scheme is to be extended until 2015. The details of this scheme are set out in Annex B.

Paying for economic regulation and customer representation

19. Ministers confirm that the cost of economic regulation and customer representation should be covered by an annual levy on SW funded out of charge income.

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Annex A – Reductions to apply to water and sewerage charges at unmetered households

1. Reductions to water and sewerage charges at unmetered households should apply in relation to dwellings (where “dwelling” has the same meaning as in part II of the Local Government Finance Act 1992) where all the following circumstances apply:-

- a. a person is liable to pay water and/or sewerage charges under a charges scheme; and
- b. the dwelling in respect of which the charges are payable is not one to which the Council Tax (Discount for Unoccupied Dwellings) (Scotland) Regulations 2005 apply.

2. Where the dwelling is subject to a Council Tax discount under section 79 of the Local Government Finance Act 1992, the discounts to be applied to unmetered water and sewerage charges shall be the same as those applied to Council Tax charges. If there is no such discount under section 79, but a person receives council tax benefit in respect of the dwelling, the following formula should be used to calculate the level of reduction for which that dwelling is eligible.

$$R = 25 \times A/B$$

Where: R is the percentage discount to be applied to water and/or sewerage charges;
A is the amount of council tax benefit which a person receives in respect to that dwelling in that year; and
B is the council tax for which that person is liable in respect to that dwelling in that year.

3. No reduction in water charges should be applied for 2nd homes or to dwellings supplied through a water meter.

4. The Objective directions set out that SW should prepare a plan for a metering trial in the 2010-15 regulatory period. Tariffs for those households involved in such a trial may be set to further the aims of the trial.

Annex B - Exemption scheme

1. Ministers confirm that the exemption scheme is to be extended until 2015 – that is exemption to water and sewerage charges should continue to apply where:
 - The premises in respect of which an amount is due by the person under a charges scheme was, on 31 March 1999, a premises in respect of which payment of part or all of the charges due to an authority (a water or sewerage authority) for any services provided to those premises in the course of carrying out their functions was not demanded.
 - Is not at any time, in the year for which the exemption is to be applied, between 1 April 2010 and 31 March 2015: a retail outlet; or occupied by a council within the meaning of the section 2 of the Local Government etc. (Scotland) Act 1994,
 - Is not at any time, in the year for which the exemption is to be applied, between 1 April 2010 and 31 March 2015 except under an occasional permission granted under the Licensing (Scotland) Act 2005 or its predecessor, licensed under either or those Acts; and
 - The person, in the financial year immediately preceding the year for which the exemption is to be applied by Scottish Water, has a net annual income of less than £60,000 in respect to the relevant premises subject to certain permissible deductions, listed in the definition of “net annual income” in SSI 2002/167 namely any funds raised and paid over by that person as a donation to a Scottish charity as defined in section 7 of the Charities and Trustee Investment (Scotland) Act 2005 or to a body registered as a charity in England and Wales under section 3 of the Charities Act 1993 during that year; any funds raised and paid over by that person as a subscription to, or contribution towards the costs of, a parent organisation during that year; and any grant paid to that person under any enactment for purposes specified as being in connection with capital expenditure on the relevant premises during that year. The maximum level for net annual income will increase by £1,500 annually thereafter with the first such increase being applied from 1 April 2011.

2. Premises occupied by a charitable organisation (as defined in the Charities and Trustee Investment (Scotland) Act 2005) that continue to meet the other criteria as set out in paragraph 1 above will retain their exemption status if they move premises from 1 April 2010. Registered charities that moved premises from 1 April 2006 but continue to meet the other criteria as set out in paragraph 1 above should regain eligibility to exemption from 1 April 2010.

3. Likewise, registered charities (as defined in Charities and Trustee Investment (Scotland) Act 2005) who receive a premises license under the Licensing (Scotland) Act 2005 after 1 September 2009 but who had been exempt up to that date, and would have continued to be exempt except for receiving that license, should retain exemption to water and sewerage charges.