

## Section 8 – Revenue and tariffs

This section contains 31 tables that analyse Scottish Water’s core revenue in granular constituent components. There are three parts within the section:

- revenue summaries (Tables 1 and 2)
- retail revenue (Tables 3 to 8, 20 and 21)
- wholesale revenue (Tables 9 to 19 and 22 to 31).

This section links closely with Section 7: Finance and includes inputs to the financial model. Scottish Water should therefore pay particularly close attention to ensure that these Sections are consistent.

### Revenue summaries (Tables 1 and 2)

This part contains two tables that summarise Scottish Water’s total core revenue.

Table 1 summarises total revenue into a hierarchal structure as set out in Annex 1 of this guidance. The following definitions apply:

**Retail:** revenue to Scottish Water directly from the end customer. Eg household charges and standpipes.

**Wholesale:** revenue to Scottish Water from Licensed providers. Eg Trade effluent charges.

**Primary:** revenue to Scottish Water from Primary services (those that are continuously provided automatically) eg water supply.

**Non-primary:** revenue to Scottish Water from non-primary services (those that are provided on request) eg Septic Tank de-sludging.

**Charges Scheme:** revenue to Scottish Water for any services provided at charges under the charges scheme.

**Schedule 3:** revenue to Scottish Water for any services provided at charges levied under Schedule 3 of the Water Services etc. (Scotland) Act 2005.

Table 2 also provides a summary of Scottish Water’s revenue. It breaks revenue down in two ways:

- **Tariff baskets:** which are the level that price limits are set and are consistent with the Commission’s methodology for the 2010-14 review; and
- **Revenue Groupings:** which are used to analyse cross-subsidy and are consistent with<sup>1</sup> “*Analysis of cost / revenue balance in water and sewerage charges*” (Frontier Economics, September 2007), which is available on the Commission’s website.

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<sup>1</sup> Table 18 and 19 are included in revenue groups 3 and 7 respectively. During the 2006-10 period these services have been re-classified as primary services. However, these would not have been classified as primary revenue in Frontier’s report. A minor adjustment will have to be made for this.

Annex 2 of this guidance sets out which (if any) tariff basket and revenue grouping Tables 3 to 31 fall into.

## **Retail revenue (Tables 3 to 8; 20 and 21)**

### **Introduction**

In this part, Scottish Water should set out the retail revenue that it expects to receive directly from customers for 2007-08 to 2017-18.

Scottish Water should do so in such a manner that it considers that Ministers' Principles of Charging for the 2010-14 period are delivered in full. In the event that Ministers have not announced principles for the 2010-14 period, Scottish Water should assume that the principles for 2006-10 are continued in the manner envisaged in the Scottish Government's consultation "*Paying for Water Services 2010-14: A Consultation on the Principles of Charging for Water Services*", published November 2007.

In particular, Ministers may set principles regarding the unwinding of cross-subsidy. In the absence of specific guidance of the level of subsidy to be unwound, Scottish Water should run scenarios based on the level of cross-subsidy identified in the aforementioned Frontier Economics report. In this case, WICS would expect scenarios to include, as a minimum, unwinding all of the cross-subsidy identified and half of the cross-subsidy identified. Scottish Water may choose to run further scenarios and may also choose whether to specify a preferred position or just to state feasible alternatives.

Where the table relates to primary revenue it is set out in the following order:

- **Tariff multipliers:** the unit (eg consumption) by which the tariff is multiplied to generate revenue.
- **Tariffs:** the annual tariff (unit rate charge) for the service (eg annual meter fixed charges); and
- **Revenue:** the product of the tariff multiplier and the tariff.

Where the table relates to non-primary revenue it asks only for a projection of revenue by service.

### **Tariff multipliers**

Scottish Water should set out the actual tariff multipliers for 2007-08 and forecast these to 2017-18.

Where a tariff multiplier can change throughout a year (eg volume) the projected annual value should be input. Where a tariff multiplier is static for the year (eg meter size) the mid-year value (end of period 6) should be input. The period 6 (median) value is assumed to be a close proxy for the average. Scottish Water should state in its commentary any instances where it feels that this is not the case.

In forecasting tariff multipliers, Scottish Water should ensure it includes:

- projections of the underlying growth of the customer base; and
- the effects (over and above the underlying growth) of alleviating development constraints as required by Scottish Ministers' Objectives for the 2010-14 period.

Explanations of both of these assumptions should be set out in the Commentary. Scottish Water should summarise the key aspects of its forecast charges affecting households. It should identify and substantiate changes in the customer base, cross-referencing with evidence provided in other parts of the business plan and providing further evidence as appropriate. Scottish Water also should include an explanation of any material year-on-year variances in any of the input assumptions.

Scottish Water should ensure that its projections of volumes and properties are consistent with:

- Section 3: base assumptions on properties, volumes and population; and
- Appendix D: Supply/Demand.

The Strategic Review process will be conducted against a backdrop of a potential move by the Scottish Government to a Local Income Tax for Council services. This may impact on the joint billing and collection arrangements for unmeasured household water and wastewater services and the tariff arrangements thereof. In the absence of any further specific guidance from either the Scottish Government or the Commission, Scottish Water should assume that the current charging arrangements (including tariffs) continue indefinitely. If Scottish Water wishes to analyse the impact of alternative unmeasured household tariff arrangements on its business, it should use the free-form submission requested in Section 10 to do this.

### **Tariffs**

Scottish Water should enter 2007-08 actual tariffs. It should also project tariffs for each year to 2017-18, using the financial model. Scottish Water should input all tariffs in projected outturn prices, consistent with the inflation assumptions in the financial model.

The financial model projects revenue assuming uniform tariff increases across all tariffs within a revenue group. If Scottish Water wishes to analyse the impact of rebalancing tariffs within a revenue group, it should input these alternative tariffs in this Section<sup>2</sup> and explain in the commentary how these are equivalent to the financial model tariffs.

### **Revenue**

Where a table relates to primary revenue, the revenue is calculated automatically as the product of tariff multipliers and tariffs.

Where a table relates to non-primary revenue, the revenue should be input in projected outturn prices, consistent with the assumptions in the financial model. In doing this, Scottish Water should explain in its commentary the impact of:

- any demand forecasts for the service;
- any relative change in price due to changes in the cost of providing a service (eg greater efficiency); and

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<sup>2</sup> Note that the submitted version(s) of the Financial Model will still contain tariffs projected using uniform percentage increases across revenue groups.

- any relative change in price due to the unwinding of cross-subsidy.

### **Guidance to Reporter**

The Reporter should:

- confirm or otherwise that the base year information is consistent with other published / audited information, and, where appropriate, billing records;
- scrutinise, and provide an assessment of any explanations provided by Scottish Water for discrepancies;
- comment on the material assumptions employed by Scottish Water;
- scrutinise, and provide an assessment of the basis presented by Scottish Water for assumptions of the number of properties, discount status and demand;
- comment on the match between demand forecasts and the information in Appendix D – Supply/Demand;
- comment on the basis for the assumptions employed in forecasting large user/industrial demands
- provide an assessment of any explanations provided by Scottish Water where discrepancies are identified with other parts of the plan.

### **Wholesale revenue (Tables 9 to 19 and 22 to 31)**

#### **Introduction**

In this part, Scottish Water should set out the wholesale revenue that it expects to receive from Licensed Providers for 2007-08 to 2017-18.

Scottish Water should do so in such a manner that it considers that Ministers' Principles of Charging for the 2010-14 period are delivered in full. In the event that Ministers have not announced principles for the 2010-14 period, Scottish Water should assume that the principles for 2006-10 are continued in the manner envisaged in the Scottish Government's consultation "*Paying for Water Services 2010-14: A Consultation on the Principles of Charging for Water Services*", published November 2007.

In particular, Ministers may set principles regarding the unwinding of cross-subsidy. In the absence of specific guidance of the level of subsidy to be unwound, Scottish Water should run scenarios based on the level of cross-subsidy identified in the aforementioned Frontier Economics report. In this case, WICS would expect scenarios to include, as a minimum, unwinding all of the cross-subsidy identified and half of the cross-subsidy identified. Scottish Water may choose to run further scenarios and may also choose whether to specify a preferred position or just to state feasible alternatives.

Where the table relates to primary charges scheme revenue, it is set out in the following order:

- **Tariff multipliers:** the unit (eg consumption) by which the tariff is multiplied to generate revenue.
- **Tariffs:** the annual tariff (unit rate charge) for the service (eg annual meter fixed charges); and
- **Revenue:** the product of the tariff multiplier and the tariff.

Where the table relates to primary Schedule 3 revenue, it is set out in the following order:

- **Tariff multipliers:** measures of the unit impact (eg consumption) at the supply point that are defined consistently with the wholesale charges scheme.
- **Revenue:** the projected revenue at the supply point for the service.

Where the table relates to non-primary revenue it asks only for a projection of revenue by service.

### **Tariff multipliers**

Scottish Water should set out the actual tariff multipliers for 2007-08 and forecast these to 2017-18. In all cases, the 2007-08 actuals should be based on the structure of wholesale charges agreed with WICS to commence in April 2008. This is particularly important for trade effluent discharge point information – all information should be expressed using the Scottish Standard Strengths irrespective of the standard strengths stated in the consent.

Where a tariff multiplier can change throughout a year (eg volume) the projected annual value should be input. Where a tariff multiplier is static for the year (eg meter size) the mid-year value (end of period 6) should be input. The period 6 (median) value is assumed to be a close proxy for the average. Scottish Water should state in its commentary any instances where it feels that this is not the case.

In forecasting tariff multipliers, Scottish Water should ensure it includes:

- projections of the underlying growth of the customer base; and
- the effects (over and above the underlying growth) of alleviating development constraints as required by Scottish Ministers' Objectives for the 2010-14 period.

Explanations of both of these assumptions should be set out in the Commentary. Scottish Water should summarise the key aspects of its forecast charges affecting Licensed Providers. It should identify and substantiate changes in the revenue base, cross-referencing with evidence provided in other parts of the business plan and providing further evidence as appropriate. Scottish Water also should include an explanation of any material year-on-year variances in any of the input assumptions.

From April 2008, Scottish Water will start to phase wholesale charges at formerly unmeasured supply points to measured charges using an assessed consumption (based on the rateable value) at the site. Therefore, the tables do not include any unmeasured supply point information and refer only to assessed supply points. Scottish Water should, nevertheless, input forecast assessed and actual consumption until 2017-18 for all formerly-unmeasured supply points. This should

take account of any changes in demand expected for this group of customers. The purpose of this is to check against historical information.

Supply points that attract negative wholesale charges due to their charitable relief status are listed within the assessed charges table (tables 9 and 14). However, in the event that these supply points become chargeable during the period, they should be included within the measured charges tables (tables 10 and 15). Any phased changes for these supply points should be input by altering the input tariff multipliers such that the stated revenue remains correct. The Gross and Net tariff multiplier assumptions in this case should be stated in the commentary.

Scottish Water should include all supply points in both the assessed and actual information, irrespective of the practicality of fitting meters. Scottish Water should set out in the commentary its views on the level of the extent of unmeasurable premises. However, it is assumed that a tariff for unmeasurable customers will be developed that closely approximates consumption, Scottish Water should comment on the impact that this assumption in its commentary if it feels that the impact is material.

Scottish Ministers have set an expectation that during 2010-14, Scottish Water should change the basis of its wholesale surface drainage tariff from rateable value based to surface-area based. This effect is assumed to be revenue-neutral and we have not asked for any information on the projected area-based tariff multipliers. Instead, Scottish Water should set out in its commentary a summary-level description of its programme to measure surface areas and any information that it has on the impact that this could have.

Where a definition refers to “formerly in receipt of a LUVA” it refers to supply points where the customer (prior to the retail separation of Scottish Water) had a Large-User Volume Agreement, as per the 2003-04 to 2005-06 Schemes of Charges (and continued in the 2006-07 Charges Scheme). We expect that there should be no increase in the number of supply points that attract these rates.

Scottish Water should ensure that its projections of volumes and properties are consistent with:

- Section 3: base assumptions on properties, volumes and population; and
- Appendix D: Supply/Demand.

This is particularly important for actual consumption at formerly-unmeasured supply points.

### **Tariffs**

Scottish Water should enter 2007-08 actual tariffs. It should also project tariffs for each year to 2017-18, using the financial model. Scottish Water should input all tariffs in projected outturn prices, consistent with the inflation assumptions in the financial model.

The financial model projects revenue assuming uniform tariff increases across all tariffs within a revenue group. If Scottish Water wishes to analyse the impact of rebalancing tariffs within a revenue group, it should input these alternative tariffs in

this Section<sup>3</sup> and explain in the commentary how these are equivalent to the financial model tariffs.

## **Revenue**

Where a table relates to primary revenue, the revenue is calculated automatically as the product of tariff multipliers and tariffs.

In tables 9 and 14, the revenue is calculated taking account of the phasing programme between assessed and actual consumption. It is based on the following weighting of each category of supply:

	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012 onwards</b>
<b>Assessed consumption</b>	100%	67%	33%	0%	0%
<b>Actual consumption</b>	0%	33%	67%	100%	100%

Where a table relates to non-primary revenue, the revenue should be input in projected outturn prices, consistent with the assumptions in the financial model. In doing this, Scottish Water should explain in its commentary the impact of:

- any demand forecasts for the service;
- any relative change in price due to changes in the cost of providing a service (eg greater efficiency); and
- any relative change in price due to the unwinding of cross-subsidy.

In tables relating to supply points (and discharge points) with Schedule 3 agreements, Scottish Water is requested to input the revenue (in projected nominal terms, consistent with the financial model assumptions) for each agreement. Scottish Water should identify in the commentary which agreement each numbered line refers to.

For Trade Effluent customers formerly in receipt of capped agreements, Scottish Water should input the total revenue for all such agreements. In doing so, Scottish Water should ensure that the revenue is consistent with the Commission's published consultation response on unwinding these agreements (published December 2006).

For non-primary charges, Scottish Water should include any projections of abortive or survey charges within the revenue line for that service.

## **Guidance to Reporter**

The Reporter should:

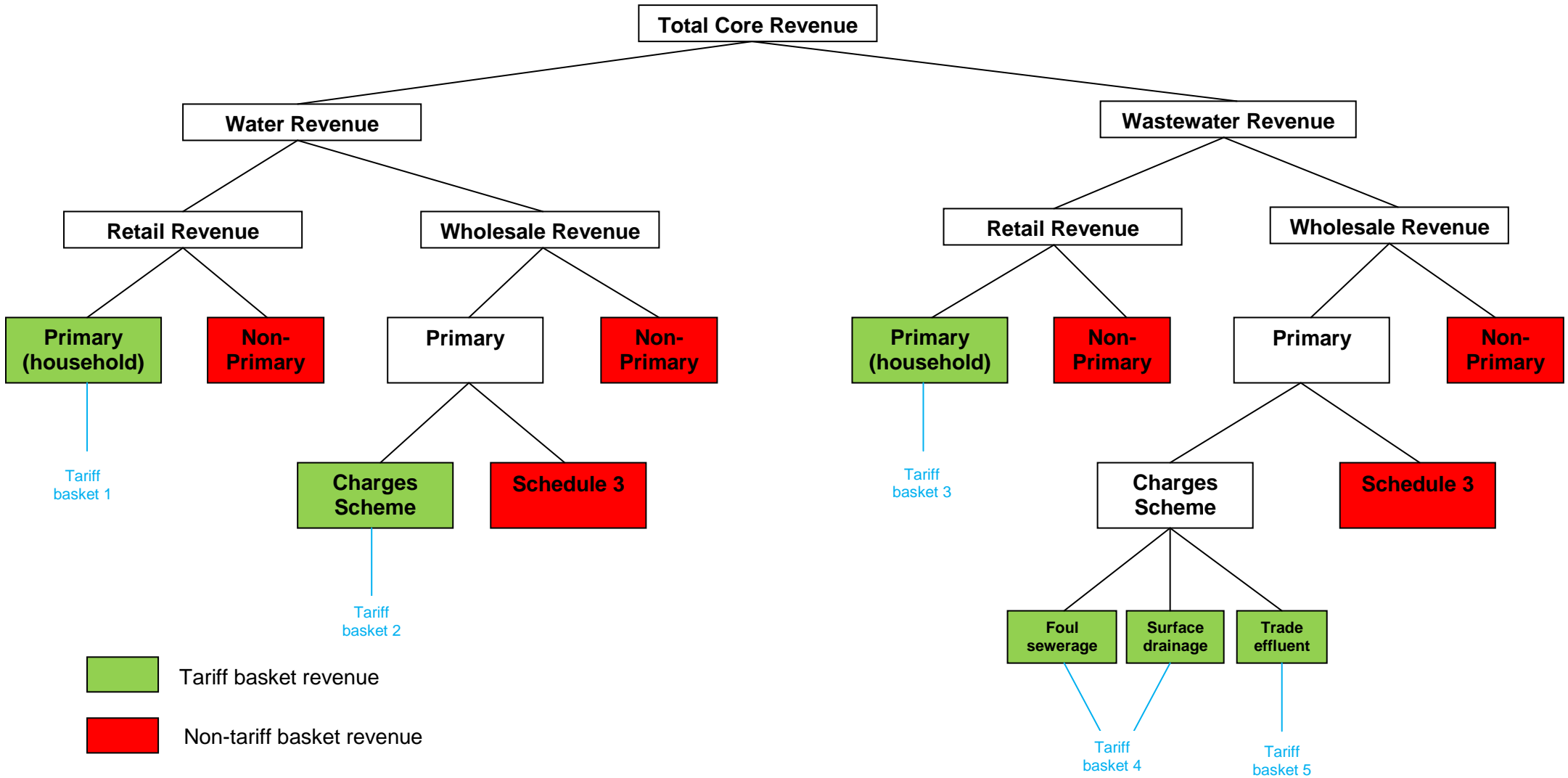
- confirm or otherwise that the base year information is consistent with other published / audited information, and, where appropriate, billing records;
- scrutinise, and provide an assessment of any explanations provided by Scottish Water for discrepancies;

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<sup>3</sup> Note that the submitted version(s) of the Financial Model will still contain tariffs projected using uniform percentage increases across revenue groups.

- comment on the material assumptions employed by Scottish Water;
- scrutinise, and provide an assessment of the basis presented by Scottish Water for assumptions of the number of properties, discount status and demand;
- comment on the match between demand forecasts and the information in Appendix D – Supply/Demand, in particular as relates to assessed premises and the impact of the metering programme;
- comment on the basis for the assumptions employed in forecasting large user/industrial demands
- provide an assessment of any explanations provided by Scottish Water where discrepancies are identified with other parts of the plan.

Annex 1: revenue hierarchy



**Annex 2: Summary of revenue by grouping**

Table no.	Service	Retail / wholesale	Primary/ non-primary	Charging method	Tariff basket	Revenue Group
Table 3	Water	Retail	Primary	Charges Scheme	1	1
Table 4	Water	Retail	Primary	Charges Scheme	1	1
Table 5	Wastewater	Retail	Primary	Charges Scheme	3	2
Table 6	Wastewater	Retail	Primary	Charges Scheme	3	2
Table 7	Wastewater	Retail	Primary	Charges Scheme	3	2
Table 8	Wastewater	Retail	Primary	Charges Scheme	3	2
Table 9	Water	Wholesale	Primary	Charges Scheme	2	3
Table 10	Water	Wholesale	Primary	Charges Scheme	2	3
Table 11	Water	Wholesale	Primary	Charges Scheme	2	4
Table 12	Water	Wholesale	Primary	Charges Scheme	2	5
Table 13	Water	Wholesale	Primary	Charges Scheme	2	6
Table 14	Wastewater	Wholesale	Primary	Charges Scheme	4	7
Table 15	Wastewater	Wholesale	Primary	Charges Scheme	4	7
Table 16	Wastewater	Wholesale	Primary	Charges Scheme	4	8
Table 17	Wastewater	Wholesale	Primary	Charges Scheme	5	9
Table 18	Water	Wholesale	Primary	Charges Scheme	2	3
Table 19	Wastewater	Wholesale	Primary	Charges Scheme	4	7
Table 20	Water	Retail	Non-primary	Charges Scheme	X	X
Table 21	Wastewater	Retail	Non-primary	Charges Scheme	X	X
Table 22	Water	Wholesale	Primary	Sch. 3	X	3
Table 23	Water	Wholesale	Primary	Sch. 3	X	4
Table 24	Water	Wholesale	Primary	Sch. 3	X	5
Table 25	Water	Wholesale	Primary	Sch. 3	X	6
Table 26	Wastewater	Wholesale	Primary	Sch. 3	X	7
Table 27	Wastewater	Wholesale	Primary	Sch. 3	X	8
Table 28	Wastewater	Wholesale	Primary	Sch. 3	X	9
Table 29	Wastewater	Wholesale	Primary	Sch. 3	X	9
Table 30	Water	Wholesale	Non-primary	Charges Scheme	X	X
Table 31	Wastewater	Wholesale	Non-primary	Charges Scheme	X	X

X = not included