Stakeholder workshop 6: Scottish Water's revenue baseline and levels of service

Why is Scottish Water's revenue baseline and how we measure levels of service important to customers?

It is important that when we set price caps, we understand the customer base of Scottish Water - how many customers Scottish Water has, what type of customers they are and what consumption characteristics they have. This includes understanding both the customer revenue base at the outset of the review period, and forecasts of how this base will change throughout the review period. This is because under a price cap setting system, the number, type and consumption characteristics of customers that Scottish Water has can significantly affect the revenue it receives, and in turn the prices customers pay. For instance:

- If Scottish Water's customer base is larger than we have assumed in the review, then it will collect more revenue than it needs. Price caps will have been higher than may have been necessary.

- If Scottish Water's customer base is smaller than we have assumed in the review, then it will collect less revenue than it needs. This means Scottish Water may not have sufficient funds to carry out its core functions.

The levels of service provided by Scottish Water are of obvious significance to customers. On average, customers should receive a level of service that is commensurate with the price they pay. During the price setting process, we make judgements about the level of efficiency that Scottish Water should operate at (compared with what has been achieved elsewhere). When we consider efficiency, we examine both the costs that Scottish Water incurs and the levels of service it provides.

Stakeholders' views at the last workshop

We held our first workshop on Scottish Water's revenue baseline and levels of service on 10 May. This workshop set out the main issues we were considering consulting on, and sought stakeholders' views. Attendees at the workshop raised a number of issues, but discussion primarily concentrated on how we predict Scottish Water's future customer base, how levels of service can be measured, and how competition will impact on the next price review.

Attendees discussed how we could predict future changes in Scottish Water's customer base - could Ministers' objectives for future growth in Scotland be used? Attendees questioned whether other ways of predicting growth were possible, for instance by using trend analysis. Other attendees questioned whether information on Scottish Water's existing customer base was reliable, and whether potential additions to this base were accurately recorded (for instance, are newly built properties were being recorded by assessors, and hence being billed for water and sewerage through the council tax system?)

Attendees discussed our approach to measuring Scottish Water's levels of services at the last price review. They noted that WICS had set Scottish Water targets to improve its levels of service to customers, and bring its performance more into line with that of the English and Welsh water and sewerage companies. These targets were set using Ofwat's Overall Performance Assessment (OPA) which calculates a single score from a combination of different measures. Attendees questioned whether it was appropriate to make such comparisons with England and Wales, for instance, are the preferences of Scottish consumers the same as their English and Welsh counterparts? Attendees also questioned whether customer preferences had ever been surveyed in Scotland, and if so, to what extent were customers' perceptions of the service they receive influenced by the media's portrayal of it or by the price they pay? Other attendees questioned whether the OPA was still fit for purpose, and whether other means of measuring levels of service be used.

Finally, attendees discussed how the introduction of retail competition for business customers in Scotland in April 2008 would affect the price review. Attendees questioned how our comparisons between Scottish Water and the English and Welsh companies would be affected - as Scottish Water will no longer be providing retail services for business customers, can this be taken account of in our use of the OPA?

The issues we are consulting on

On 31 May we published the second volume of our methodology consultation. We posed the following questions:

What are respondents' views on our approach to establishing the revenue and customer baseline for Scottish Water?

How we establish Scottish Water's existing customer baseline and predict how it will change over time will have a direct influence on the outcome of the price review. If Scottish Water's customer base changes during the regulatory control period in a different way than predicted, there is the option to have an interim determination of prices to take account of any differences. However, this can create uncertainty for customers. We would prefer to be as accurate as possible at the outset.

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

Although Scottish Water's levels of service are improving, they still lag behind the English and Welsh companies. We have previously addressed this issue by setting both price caps and targets for Scottish Water to improve its OPA score. However, does taking such an approach make it difficult to measure Scottish Water's performance? For instance, if Scottish Water spent less than expected, but also delivered lower levels of service than expected, has Scottish Water outperformed its regulatory contract or underperformed?

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

It is important that if we make comparisons with England and Wales they are done on a fair and transparent basis. The introduction of a competitive regime in Scotland different to that in England and Wales does create differences, however we believe these differences can be taken account of by treating Scottish Water as though it is still a fully vertically integrated organisation, and then deducting retail costs. Such an approach would also allow us to calculate 'default tariffs' for the new retail market. Is this approach appropriate?