

Stakeholder workshop 8: Scottish Water's capital expenditure

Why is Scottish Water's capital expenditure important to customers?

Scottish Water incurs capital expenditure in two ways:

- to maintain its existing assets (its network of pipes, reservoirs and treatment works); and
- to enhance its assets to deliver service improvements.

It is important to the service that customers receive, and the wider water environment, that Scottish Water invests appropriately in its assets. However, as Scottish Water's capital expenditure accounts for almost half its annual expenditure, it can have a significant impact on customers' bills.

We have a statutory duty to determine charges caps for Scottish Water which allow it to achieve the objectives set by Ministers at the lowest overall reasonable cost. Determining an appropriate allowance for capital expenditure is an important part of this process.

Stakeholders' views at the last workshop

We held our first workshop on Scottish Water's capital expenditure on 28 June 2007. This workshop set out the main issues we were considering consulting on, and sought stakeholders' views. Discussion primarily focussed on the time period within which Scottish Water is required to deliver its investment. Other issues discussed included how much investment could be delivered efficiently and how delivery of investment could be monitored.

Attendees noted that Ministers set out the outcomes Scottish Water must deliver for customers (Ministerial objectives) over a given time period (regulatory control period). At present, regulatory control periods last for 4 years. Attendees discussed whether there would be merit in extending these periods to 8 years or longer. Some attendees welcomed the additional visibility that a longer regulatory period would provide. It was suggested that if Ministers set objectives for the industry over a longer timescale then it would provide Scottish Water with greater scope to consider long term investment needs and sustainable development issues. This may help it devise more efficient technical solutions. It was also suggested that the construction industry would also be better able to plan its contribution and ensure that it had the resources in place to respond to Scottish Water's investment plans.

Attendees noted that there are often peaks and troughs in investment over short regulatory control periods. For instance, expenditure tends to be lower in the first years of a regulatory period whilst planning and procurement takes place. It then peaks in later years as construction and delivery occurs. Attendees discussed whether there would be merit in smoothing these peaks and troughs. Some attendees welcomed such a move, and suggested that extending the control period would be the best way to do this. Other attendees questioned whether this would benefit customers in any way.

Attendees discussed if there was a limit on the amount of investment that Scottish Water could deliver efficiently. Some attendees suggested that if too much investment is made over too short a period of time, there could be a risk of over-heating the construction market, and therefore putting up construction costs. This would adversely affect Scottish Water's efficiency.

Attendees also discussed how customers could be sure that Scottish Water was delivering ministerial objectives. Attendees noted that monitoring should focus not only on how much investment was being made, but also whether it was delivering the required outcomes.

The issues we are consulting on

We published Volume 4 of our methodology consultation on 26 July 2006. We are seeking your views on the following issues:

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

Is there a limit on the amount of investment that Scottish Water can deliver efficiently? Should we advise Ministers on how much investment we believe can be delivered efficiently to assist them in formulating objectives? If so, what factors should we take into account when assessing a cap on the efficient level of investment?

- 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?***

Ministers set objectives for Scottish Water to achieve over the regulatory control period. These objectives are expressed in terms of the outcomes that must be delivered for customers and the environment. Scottish Water devises the investment it requires to deliver these outcomes - how can we be assured that this investment is appropriate, and represents value for money for customers?

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

Not only do we need to finance the investment Scottish Water requires to deliver ministers' objectives, but we also need to make an appropriate allowance for Scottish Water to maintain its existing assets. New approaches to assessing, and planning, capital maintenance requirements are being developed. However, they require an intensive amount of information about assets – how do we compensate for the fact that Scottish Water does not yet have sufficient information to implement such an approach?

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

We identified that in 4 year regulatory control periods, there can be peaks and troughs in investment. Ministers determine the length of the regulatory control period. However there are steps we can take to help ease these fluctuations, including allowing Scottish Water to make an early start on its investment programme. This may include allowing it expenditure in the previous regulatory control period to plan its investment in the next. Would such a move be effective, and is it in the interest of customers to do so?

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

An Outputs Monitoring Group (OMG) has already been formed to monitor Scottish Water's delivery of outputs during the present regulatory control period. The OMG is chaired by the Scottish Government, and consists of members from the Scottish Environment Protection Agency

(SEPA), the Drinking Water Quality Regulator (DWQR), Waterwatch Scotland and WICS. Can its role be enhanced in the next regulatory control period? If so, what information does it need from Scottish Water to improve its monitoring and how will this impact on the way Scottish Water defines how its investment proposals translate into actual outputs.