

Strategic Review of Charges 2010-14: Summary of discussions at stakeholder workshop 2 on Scottish Water's customer base and levels of service

Held on Thursday 10 May in Stirling

Present from the Office of the Water Industry Commission

Alan Sutherland	Chief Executive
Katherine Russell	Director of Corporate Affairs
Suzanne Baylis	Analyst
Cesar Raffo	Analyst
Harriet Towler	Corporate Affairs Manager

Stakeholders present

Tom McClements	Waterwatch Scotland
Robert Galbraith	Freescale Semiconductors
Neil Hemings	Scottish Water
David Hughes Hallett	Waterwatch Scotland
John Kingsland	University of Aberdeen
Jim Lugton	Scottish Council for Voluntary Organisations (SCVO)
Sean McComish	Scottish Water
Belinda Oldfield	Scottish Water
Gerard O'Loan	NHS Scotland
John Struthers	Waterwatch Scotland
Bryan Wallis	Water UK

Opening remarks

Stakeholders were welcomed to this second workshop for the 2010-14 price review. It was explained that this workshop, which preceded the publication of the Commission's methodology consultation for the review, would focus on how the Commission should approach Scottish Water's customer base and levels of service.

Today's meeting coincided with the publication of Volume 1 of the methodology consultation on Scottish Water's governance and incentives. Comments from stakeholders at the workshop on 12 April on the same subject had helped influence this document. It was noted that the Commission hopes to capture the views of as many stakeholders as possible before publishing its methodology. Attendees were invited to raise questions throughout this workshop.

One attendee questioned the rationale for a four-year **regulatory control period**. It was noted that the length of regulatory control periods is decided by Ministers. It was noted that there may be some advantages to lengthening the regulatory control period, for instance providing greater continuity between investment programmes.

However, this would be a matter for the Minister to consider when commissioning the next price review.

Issues discussed

1. Scottish Water's customer base

Premise for discussion

Scottish Water's **customer base** is important to the price setting process. In any price cap regime there is an incentive for the regulated organisation to understate its customer base during the review. This is because price caps are set to allow the regulated company to recover an allowed level of revenue based on the number of customers they have. If in reality the organisation has more customers than the regulator has assumed, it will earn more revenue than has been permitted in the regulatory settlement. Inaccurate data about the customer base can also have a similar effect on the outcome of the review.

Is it possible to provide the regulated company with an incentive to declare all of its customer base? How can we predict future changes in the customer base? Will the introduction of retail competition for non-households, and a **Central Market Agency** (CMA) to hold customer information, improve the accuracy of information on the customer base?

Issues raised

Attendees were asked if it is reasonable to predict **future growth** in the customer base by taking into account ministerial objectives. Such an approach was taken at the last price review, and WICS were considering taking a similar approach at this price review. One attendee questioned whether newly built properties were being recorded by assessors, and hence being billed for water and sewerage through the council tax system. Another attendee questioned whether there were alternative methods available to calculate growth, in particular, could trend analysis be relied on? One attendee commented that Local Authorities structure plans may not be an accurate source of this information.

One attendee questioned whether a new approach would have to be taken if the council tax system were to be replaced, and what the impact of that change would be.

2. Levels of service

Premise for discussion

At the last price review WICS 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.

Should WICS set Scottish Water further **targets** using the OPA? How can WICS' use of the OPA be enhanced? Will the introduction of competition impact the use of the OPA?

Issues raised

One attendee noted that the OPA calculates a single performance score by weighting a number of measures according to the importance that customers attach to them. Therefore, an underlying assumption in using the OPA was that the **preferences** of Scottish customers were the same as the preferences of English and Welsh companies. Was it reasonable to make this assumption?

Furthermore, one attendee questioned whether the preferences of customers in Scotland had ever been properly surveyed?

One attendee noted that whilst the OPA had the advantage of providing an objective measure of levels of service, it did not give a strong indication of the quality of service provided. Could more **qualitative measures** be introduced, and was there a role for Waterwatch, as the customer representative, to carry out these assessments?

One attendee questioned whether there was any evidence of levels of customer satisfaction increasing as the OPA score increases?

One attendee noted that a report by the Public Account Committee on Ofwat, published that day, had been critical of how Ofwat protects customers in England and Wales. Would this deter WICS from using Ofwat's OPA? Was it time for Ofwat to revisit its use of the OPA? Another attendee pointed out that much of this criticism related to public perception rather than reality.

Another attendee questioned whether OPA results actually reflected **customers' perceptions** of the levels of service they receive? For instance, if customers see water and sewerage companies earning high profits, imposing drought orders and allowing water to leak into the street, would having a high OPA score really convince them that they were receiving a good level of service? And to what extent are customers' views of the service they receive actually conditioned by the price they pay?

One attendee noted that the media has a stronger role than the OPA to play in forming customers' opinions about the service they receive. For instance, recent positive media coverage of Scottish Water appeared to have improved customers' perceptions of how good a service they receive.

Another attendee questioned if where customers received a lower level of service than their peers, for instance, those known to be affected by sewer flooding, this should be reflected in lower charges? Would WICS be taking account of differences in the levels of service customers receive by adjusting the cap on price they pay? If so, how could this be funded? Would it be appropriate to use the proceeds from **outperformance** of the regulatory contract?

One attendee questioned if Scottish Water's current OPA targets would be adjusted to take into account the impact of the introduction of competition.

One attendee noted a recent election manifesto pledge to give pensioners free water and sewerage services. If such a proposal was implemented, what would be the impact on Scottish Water's remaining customers –would they be required to pay more?

3. Competition

Premise for discussion

Retail competition for non-household customers will be introduced into the Scottish water industry in 2008. Customers should benefit from greater choice, lower prices and better levels of service. The introduction of competition will impact how the price review is conducted. At the 2006-10 review, in anticipation of this change, WICS calculated both **wholesale and retail charge caps**. It did so by calculating the total revenue requirement of Scottish Water as a whole, and then deducting the retail element of those costs. Should a similar approach be taken at this review?

It was also noted that there was scope under S29E of the Water Service etc (Scotland) Act 2005 to reduce wholesale charges for individual customers, providing it could be demonstrated that steps had been taken by licensed retailers to reduce the costs of wholesale supply to these customers. Such departures from the wholesale charges scheme had to be determined by the Commission. Departures would only be granted where it could be demonstrated that Scottish Water's wholesale costs of supply had been reduced.

Issues discussed

One attendee questioned whether there would be regional wholesale charges.

One attendee questioned what kind of margin a self-supplier could expect to save under the proposed regime and whether there would be onerous conditions for entry.

Another attendee questioned whether Scottish Water and its household customers would be at risk under the new competitive regime. For instance, who would bear the risk of non-payment? It was noted that retailers would be required to pre-pay Scottish Water for the services they receive.

One attendee questioned whether Scottish Water's proposed **wholesale charges scheme**, which was currently being consulted on, was consistent with the charges caps set by WICS for the period 2006-10. This attendee commented that the wholesale charge scheme proposed would result in a 20-30% increase in their charges compared with what they paid under their current Large User Volume Agreement. And, this increase did not take into account an additional retail element of cost which would be added to end charges.

One attendee questioned how the minimum level of service required by retailers would be specified in licence conditions. Would the OPA be used?

One attendee asked how the universal service obligation would be enforced.

END

The Commission attaches significant importance to stakeholder workshops and would welcome any further comments or feedback that interested parties may have. Comments should be sent to Harriet Towler (harriet.towler@watercommission.co.uk or 01786 430200).

A discussion paper, issued prior to this workshop and providing further context is available on the Commission's website at www.watercommission.co.uk.

A further two stakeholder workshops will be held prior to the publication of the Commission's consultation on the methodology for the price review.

Methodology volume	Publication date	Workshops
1. Financing Scottish Water	10 May 2007	26 July 2007
2. Customer revenue and levels of service	31 May 2007	16 August 2007
3. Operating costs	28 June 2007	31 May 2007 30 August 2007
4. Capital expenditure	26 July 2007	28 June 2007 20 September 2007