

# Strategic Review of Charges 2010-14: Summary of discussions at stakeholder workshop 6 on Scottish Water's customer base and levels of service

Held on Thursday 16 August in Glasgow

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Present from the office of the Water Industry Commission

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|----------------|---------------------------|
| John Simpson   | Director of Analysis      |
| Harriet Towler | Corporate Affairs Manager |

Stakeholders present

|                  |                                |
|------------------|--------------------------------|
| Neil Hemmings    | Scottish Water                 |
| Tom May          | Scottish Water Business Stream |
| Phil Murray      | Glasgow City Council           |
| Gerard O'Loan    | NHS Scotland                   |
| Belinda Oldfield | Scottish Water                 |
| Alan Scott       | Scottish Water                 |
| Bryan Wallis     | Water UK                       |

## Opening remarks

Stakeholders were welcomed to this sixth workshop for the 2010-14 price review. It was explained that this workshop, which followed the publication of Volume 2 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. The workshop was designed to assist stakeholders who planned to respond to the Commission's consultation. Questions were invited throughout.

Attendees noted that it was 27 months until charge caps for 2010-14 would be set. During that time WICS would be consulting on both its methodology for the price review, and its draft determination of charges. The Scottish Executive would also be consulting on principles of charging and investment priorities for the 2010-14 period.

It was noted that the Commission welcomed all responses to its consultations and hoped to be able to take a balanced view of opinion. Consultation documents had been designed to consider issues at a high level to make them accessible to a wider range of stakeholders. However, the Commission welcomed any detailed responses that stakeholders may wish to submit.

## Key issues discussed

Volume 2 of the methodology consultation focuses the size of Scottish Water's customer base and the levels of service it offers. WICS seeks stakeholders and customers views on the following issues:

- 1. What are respondents' views on our approach to establishing the revenue and customer baseline for Scottish Water?**
- 2. What are respondents' views on our proposals to encourage Scottish Water to continue to improve the level of service it provides to customers**
- 3. How do respondents view the changes we are making to reflect the new competition framework?**

## **1. Revenue and customer baseline**

### *Premise for discussion*

The customer baseline that WICS assumes in its price review will impact on the level of charge caps set – if Scottish Water's customer base is larger than WICS has assumed in its calculations, then Scottish Water will gather more revenue than it needs, and charge caps will be higher than necessary. Conversely, if Scottish Water's customer base is smaller than WICS has assumed, Scottish Water will not collect enough revenue to discharge its functions, and revised charge caps may need to be set (an interim determination). When WICS set charge caps, they not only need to understand what Scottish Water's current customer baseline is, but also how it will change over the regulatory control period. This includes both household and non-household customer numbers.

Are Local Authority databases the best way of calculating the number of household customers in Scotland? Can financial information from Local Authorities be used as a check on Scottish Water's reported household revenue?

Is our proposal to calculate future changes in the revenue base by using both the level of expected 'background' growth and the release of development constraints appropriate? Is there a risk that we will either over or understate the actual base?

The creation of a Central Market Agency (CMA) for the new retail market will maintain an accurate record of non-household customers. Do respondents agree with our proposal to use information from the CMA to establish a baseline for non-household customers?

### *Issues raised*

One attendee questioned whether investing to improve the quality of customer information would be worthwhile, or if there was any way to improve Local Authority billing information.

One attendee commented that Scottish Water had carried out a considerable cleansing exercise for its data over the last four years, but that there was more work that could be done. This cleansing exercise had resulted in a decrease in non-household customer numbers by about a third over that time. However, whilst the number of customers had declined by approximately a third, the value of that customer base had not.

One attendee noted that Scottish Water's non-household customer information had transferred to Scottish Water Business Stream as part of the process to introduce retail competition. Scottish Water Business Stream was now undertaking a further data cleansing exercise. It was noted that it was in Business Stream's interest to ensure that its customer data is as accurate as possible so that all of its customers are billed. This information would be transferred to the CMA upon the opening of the competitive market.

One attendee questioned the rationale for passing this information on to the CMA. It was noted that the CMA would facilitate the transfer of customer information should they decide to change retailer in the competitive market. It was therefore important that an independent body such as the CMA managed this information. Scottish Water Business Stream and new entrants into the market would likely provide further pressure on the CMA to ensure that it maintains accurate data.

One attendee questioned whether Scottish Water, as the wholesaler, faced greater risks under this arrangement. Scottish Water had no control over non-household consumption information. This could make forecasting and planning difficult, particularly as retailers may introduce an optimism bias about the number of customers they will have and the amount of water they will consume.

One attendee noted that ministerial objectives had been used to predict growth in the customer base at the last price review, and questioned whether this approach had proved accurate. It was noted that it was too early in the price review period to determine, but that better information would be available in time for the final determination of charges.

One attendee questioned whether other Government databases could be used to verify reported customer numbers. Another attendee suggested that it would be difficult to use these databases for commercial properties, particularly as a number of businesses could be located at one property.

## **2. Levels of service and the overall performance assessment**

### *Premise for discussion*

WICS use Ofwat's overall performance assessment (OPA) as an objective means to assess Scottish Water's levels of service performance. WICS uses this information to make comparisons with England and Wales. At the last price review, WICS also used the OPA to set Scottish Water milestones to improve its levels of service.

Should WICS further incentivise improvements in levels of service by setting OPA targets again? Or does this confuse how WICS will measure Scottish Water's performance against the regulatory contract? How reasonable is WICS' proposal to ask Scottish Water to indicate the costs of improving its levels of service, and then taking this into account when we assess efficiency? How will the introduction of retail competition affect WICS' use of the OPA?

### *Issues raised*

One attendee questioned how the OPA would be affected by the introduction of competition. Would new measures be introduced to reflect the fact that Scottish Water was no longer fully vertically integrated?

One attendee questioned whether WICS intended to introduce Ofwat's assessed customer service measure, which had not been possible to use at the last review. They questioned whether this measure made the OPA more subjective as one component assessed the quality of complaints handling.

Another attendee noted that Ofwat would likely propose changes to its OPA during the next regulatory control period. Would WICS follow suit? If so, time would be needed to gather any new information required.

Attendees considered whether future OPA targets were required for Scottish Water. It was noted that Scottish Water were responding well to those set at the last review. One attendee noted that there was always the possibility of a major incident, such as a drought, which was beyond Scottish Water's control, and could seriously affect its OPA score before the next review.

Another attendee noted that it may be difficult to set further milestones as the future performance of the companies in England and Wales was uncertain – how much of a gap would exist? And if a gap existed, how much of it should be closed?

Attendees noted WICS' proposals to benchmark Scottish Water's operating cost efficiency with England and Wales, and take account of any difference in levels of service. Doing so would require Scottish Water to provide information on the expenditure it would require to improve its levels of service. One attendee questioned how much of an improvement Scottish Water would be expected to assume in its costings and to what level of detail. Would the OPA be used as a basis to measure levels of service? If so, would Scottish Water be required to cost how much it will require to improve each measure on the OPA? Will doing so take away Scottish Water's discretion to target specific measures according to its operational priorities as the companies in England and Wales do?

One attendee questioned whether requiring Scottish Water to improve its OPA score would be a specific Ministerial objective, or whether it would be set by WICS in the final determination.

### **3. Impact of the introduction of competition**

#### *Premise for discussion*

In April 2008 the new retail market for non-household customers will open. WICS will take account of this change in the next review by calculating: a charge cap for household customers; a charge cap for wholesale services; and default tariffs that new retailers must offer all customers.

At what level should WICS set default tariffs? Should efficiency gains made by Scottish Water be taken account of in default tariffs, or should competitive forces be relied on the generate cost savings for customers? Is our approach to competition appropriate?

#### *Issues raised*

One attendee questioned whether Scottish Water would be required to include information on non-household tariffs in its business plan. At the last review, Scottish Water had been required to report the likely impact of its investment proposals on

prices. Would Scottish Water be required to do so for non-household customers at this review, or would it be Scottish Water Business Stream's role to do so?

One attendee questioned if information would be required from Scottish Water Business Stream to carry out the review, and if so, when this requirement would be clarified.

Attendees questioned the proposal to allocate all efficiency improvements to the wholesale business and to take no account of efficiencies in default tariffs.

One attendee questioned whether 'customer experience' would be a factor considered by WICS in the price review. Also, would willingness to pay be considered? – are customers prepared to pay more for a better level of service. Another attendee commented that these could be issues that are considered by Ministers in their objectives for the industry.

**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](mailto: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](http://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.***

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