

## Strategic Review of Charges 2010-14: Summary of discussions at stakeholder workshop 7 on Scottish Water's operating costs

Held on Thursday 30 August in Edinburgh

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Present from the office of the Water Industry Commission

Alan Sutherland	Chief Executive
Katherine Russell	Director of Corporate Affairs
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
Alan Scott	Scottish Water
Bryan Wallis	Water UK

Waterwatch Scotland staff and Panel members present

Ian Smith	Convener
Gary Womersley	Head of Corporate Services
Kath Purdie	Administration Officer
Jim Black	Principal Customer Support Officer
Marion Munro	Information Officer
David Chisholm	Panel Member
David Hughes Hallett	Panel Member
John Sawkins	Panel Member
Susan Walker	Panel Member
Jack Lord	Panel Member
Helen Millar	Panel Member
Tom McClements	Panel Member
Liz Breckenridge	Panel Member
Len Scoullar	Panel Member
James Sharp	Panel Member
Willie Anderson	Panel Member
Stephanie Taylor	Panel Member
Heather Brash	Panel Member
Donald Nicholson	Panel Member
Bobby Hunter	Panel Member
George Eunson	Panel Member

## Opening remarks

Stakeholders were welcomed to this seventh workshop for the 2010-14 price review. It was explained that this workshop, which followed the publication of Volume 3 of the Commission's methodology consultation for the review, would focus on how the Commission should approach assessing an allowance for Scottish Water's operating costs. The workshop was being held at the Waterwatch Scotland away day. The Chief Executive of WICS expressed his thanks to the Convener of Waterwatch.

The workshop was designed to assist stakeholders who planned to respond to the Commission's consultation. Questions were invited throughout on a range of subjects related to the price review.

The importance of a strong customer voice being heard in the price review process was emphasised. The views of customer representative organisations, in particular Waterwatch, are welcomed, and WICS has set out a number of opportunities for organisations to make these views known both formally and informally. The most important of these opportunities is that to make representations on the draft determination of charges. All views, both negative and positive, were welcomed so that they could be fed into the final determination of charges for 2010-14.

It was noted that the price review process focuses on providing value for money for customers. Ministers set objectives for the industry over a given time period (the regulatory control period). Scottish Water produces business plans that set out how it will deliver these objectives and the expenditure it requires to do so. WICS scrutinises these plans and set final caps on prices that finance Scottish Water to deliver the Ministers' objectives at the lowest overall reasonable cost.

This is designed to be a transparent process where roles and responsibilities are clearly defined. It is important that stakeholders take the opportunity to influence Ministerial objectives for the industry and ensure customer preferences are taken into account. It is also important that stakeholders scrutinise how WICS determines the financing required to deliver these objectives, and that the approach WICS takes delivers value for money for customers. Determining the amount of operating expenditure required by Scottish Water is an important part of this process. Any possible reduction in operating expenditure will have a direct impact on customers' bills.

## Key issues discussed

Volume 3 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. Do respondents agree that our approach to benchmarking Scottish Water's performance remains robust despite separation of non-household retail activities?***
- 2. Do respondents agree that we should take account of differences in the level of service and scope of activities in Scotland and in England and Wales?***

3. ***Do respondents agree with our favoured approach to setting an appropriate efficiency challenge for Scottish Water?***
4. ***Do respondents agree that our approach to assessing claims for special factors is reasonable?***

## **1. Benchmarking Scottish Water**

### *Premise for discussion*

Since the last price review, Scottish Water has created a separate entity to provide retail services to non-household customers. It is important that WICS continue to make like-for-like comparisons with the English and Welsh companies. WICS therefore need to take account of Scottish Water's change in structure in our efficiency assessment. WICS has identified two ways in which we could do this: either by deducting comparable "retail" costs from the English and Welsh companies; or adding back the operating costs incurred by Scottish Water Business Stream to Scottish Water's total operating costs.

### *Issues raised*

Attendees noted that it was important to take Scottish Water's changing circumstances into account.

One attendee questioned how the introduction of competition would affect domestic customers. It was noted that WICS has a statutory duty to ensure that the introduction of competition for non-household would not be to the detriment of Scottish Water's core function, one of which is to provide a water and sewerage service to householders. How would competition benefit household customers?

## **2. Differences in levels of service and scope of activities**

### *Premise for discussion*

When WICS use econometric models to compare Scottish Water's efficiency with the English and Welsh companies WICS assume that they offer the same range and level of service. This is because in England and Wales there is little material difference between the levels of service offered by companies. However, whilst Scottish Water is improving levels of service, according to its Overall Performance Assessment (OPA) score, its performance is still not as good as the English and Welsh companies. By taking into account this difference, that is, recognising that Scottish Water is delivering fewer outputs for its expenditure, will WICS take a more accurate view of Scottish Water's efficiency? Is it reasonable to do so?

### *Issues raised*

One attendee questioned whether the quality of information provided by Scottish Water was comparable to that provided by the English and Welsh companies. One attendee noted that in general the quality of information provided by Scottish Water was improving, but was not yet as good as in England and Wales.

One attendee noted that climate change could impact on OPA scores in the future, for instance recent flooding events in England would likely affect the companies' OPA score. Would differences in the way climate change impacts on different regions of the UK affect the validity of making comparisons with the OPA?

One attendee noted that by decreasing leakage, Scottish Water could significantly improve its OPA score, improve its efficiency and potentially reduce its carbon footprint.

One attendee questioned if Scottish Water had yet calculated its economic level of leakage.

Another attendee questioned if Ministers had made the reduction of leakage a specific objective, or if Scottish Water's leakage targets had been set by WICS. It was noted that Ministers had set a broad objective for Scottish Water to improve. WICS had allowed additional funding as part of this objective for Scottish Water to improve its leakage performance, and had set pragmatic leakage targets for it to reach.

One attendee noted that customers generally support a reduction in leakage, but dislike the potential disturbance that can be created such as reduction in pressure, or roads being dug up.

One attendee questioned if customer preferences for improvements in service in general were taken into account in the price review process. It was suggested that conducting customer research would help to ensure that the customer voice was heard. Attendees discussed whether Waterwatch Scotland, as the customer representative, should conduct this research.

One attendee noted that customers are rarely aware of the charges they pay, until something goes wrong with their supply. It was only elderly customers, and business customers who had experienced the introduction of higher standing charges that were particularly conscious of the price they pay.

### **3. Setting an efficiency challenge**

#### *Premise for discussion*

If Scottish Water is not yet as efficient as the companies in England and Wales, should it be set further targets to improve? WICS believe it should – but by how much? WICS propose that Scottish Water should be challenged to deliver an equivalent level of service for an equivalent level of cost as the leading water and sewerage companies in England and Wales during 2007-08. This challenge does not take into account how the English and Welsh companies may improve during 2010-14, that is, it will not take Scottish Water to the frontier. However, it is a level of performance that the English and Welsh companies have demonstrated can be achieved. In the interests of customers, is this too great or too little a challenge?

#### *Issues raised*

One attendee suggested that Scottish Water aimed to be the highest scorer on the OPA measure in the UK. Scottish Water was also working to improve its Guaranteed Minimum Standards performance – would this be taken into account? Scottish Water

had also indicated its willingness for qualitative measures of service to be considered as well.

#### **4. Assessing claims for special factors**

##### *Premise for discussion*

WICS recognise that there could be differences in Scottish Water's circumstances compared with the England and Welsh companies that are beyond its control and that affect its costs. Such factors may increase or decrease costs. It is important that if WICS is to make like-for-like comparisons we take such differences into account. We propose asking Scottish Water to provide evidence of the existence and impact on costs of these 'special factors'

##### *Issues raised*

One attendee questioned how the proposed climate change bill would impact on the price review process. Would different approaches to climate change North and South of the border be regarded as a special factor. It was noted that should the bill be passed, it would be for Ministers to take account of these requirements in their objectives, and Scottish Water to set out the associated costs.

One attendee noted that climate change was an issue that the entire water industry faced. The regulatory framework would need to respond to these changes as well as the water companies.

#### **5. Wider issues discussed**

One attendee noted that since the last price review had been carried out, that there had been a change in administration – had the new Minister indicated that they would wish to change existing objectives for the industry? Another attendee noted that whilst administrations may change over a regulatory control period, industry objectives tend not to. This visibility helped the price review process, and greater visibility, that is greater clarity about objectives over a longer period, should be encouraged.

One attendee questioned whether Scottish Water took into account whole life costs when devising capital solutions to deliver Ministers' objectives. It was noted that by devising appropriate capital solutions, operating costs could be reduced, but that longer term capital solutions may need to be considered in order to do so. But more capital intensive solutions could actually increase environmental costs because modern assets often incur high energy costs and that an operating cost solution may be less environmentally damaging.

One attendee noted that it was important to find an appropriate balance between capital and operating solutions in order to deliver value for money for customers.

One attendee questioned what the Chief Executive of WICS' three key messages for Waterwatch panel members would be. The Chief Executive responded:

- That Scottish Water has made great progress with reducing its operating costs and should be congratulated. However, there is no room for complacency and there is more that can be done, particularly with regard to capital delivery.

- That competition should bring benefits to customers, and that this was already evident – in separating its retail and wholesale activities, Scottish Water had identified processes and activities that it did not need to carry out. The reduction in costs associated with not carrying out these processes would benefit both household and non-household customers.
- That the 'customer voice' is a hugely important part of the price review. Regulators, Ministers and Scottish Water need to understand if customers want to see improvements in the levels of service they receive and if they are prepared to pay higher bills to fund for these improvements. WICS in particular wants to hear if its price determination delivers for customers or not. The proposed workshops would be an opportunity for this.

**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 final stakeholder workshop will be held prior to the close of the period for consultation on the Commission's 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 26 July 2007
2. Customer revenue and levels of service	31 May 2007	10 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