

Communicating output and cost effectiveness

This is the fifth in a series of Initial Decision Papers that the Water Industry Commission will publish during the Strategic Review of Charges 2021-27. The Commission will issue initial, revised and final Decision Papers. These Initial Decision Papers set out, for customers and other stakeholders, the Commission's current views on important matters relating to the Strategic Review of Charges 2021-27. They will provide the Commission's views on:

- Strategic issues facing the industry that will impact levels of service beyond the next regulatory control period;
- The prospects for customers' charges during the next regulatory control period;
- Issues that directly and materially impact the charges that customers will pay in the next regulatory control period;
- The potential for Scottish Water to engage even more effectively with its customers; and
- The approach to the Strategic Review of Charges 2021-27.

The Commission has adopted the principles of Ethical Based Regulation and intends to conduct a transparent and collaborative price review¹, taking account of all the evidence currently available to it in coming to the views set out in these Initial Decision Papers.

In line with the Cooperation Agreement signed with Scottish Water and Citizens Advice Scotland, the Commission would be minded to adopt a business plan that is consistent with the Commission's Final Decision Papers and agreed with the Customer Forum as its Draft Determination.

This fifth Initial Decision Paper discusses an approach that Scottish Water could take to communicate its cost effectiveness to customers and communities. The Commission wants to see evidence that Scottish Water is setting itself an appropriately challenging target for improving its communication of its cost effectiveness – it is not wedded to any particular mechanism.

Key messages

Scottish Water will likely have to invest more in the next regulatory control period. Consequently, customers' charges may have to increase modestly. It will be increasingly important that Scottish Water explains to customers, communities and other stakeholders that it has considered the full range of potential solutions.

This will likely require increased dialogue with local communities and other stakeholders about the issues to be addressed and their potential solutions. Scottish Water should only define a project when an appraisal has been completed and money allocated.

Appraisals should be made available to stakeholders. Scottish Water could prepare an overview of all the issues that it faces and potential solutions to facilitate its dialogue with customers, communities and stakeholders. This builds upon and extends the scope of the Service Improvement Reports that Scottish Water prepared for the Customer Forum during the last Price Review.

Scottish Water should develop further its understanding of the condition of its assets and the local costs of serving customers and communities. Such an understanding will be critical to developing full trust in Scottish Water's approach to improving levels of service.

¹ Innovation and Collaboration: future proofing the water industry for customers; published on 10 April 2017 and available on our website.

Introduction

As we have explained in previous Commission Initial Decision Papers, meeting the continuing requirement of improving the quality of our environment and drinking water – along with tackling the newer challenges of improving resilience and systematically addressing capital maintenance – are likely to require Scottish Water to deliver a larger programme of capital expenditure. This will be a challenge: both in terms of its size and scope.

In recent years, charges for households have increased at less than the rate of Consumer Price Inflation (CPI). Looking forward, it may be more difficult to limit increases to CPI. Scottish Water will accordingly have to become more pro-active in explaining what it is doing and why.

Definition of the Capital Programme

Scottish Water works with stakeholders to produce a 'Technical Expression', which has historically listed all the capital enhancement projects that it plans to complete during a regulatory control period. Inevitably, some of these projects have been little more than needs identified by Scottish Water in the course of its asset management activities. Significant effort is still required to decide how best to provide a solution and to consider the cost effectiveness of the range of viable solutions.

This lack of definition of some projects has, on occasion, adversely impacted Scottish Water. There can be challenges in finding solutions, communities can form a view that there has been insufficient consultation (they consider that Scottish Water already has an answer to which they are committed) and there can be difficulties in achieving planning permission or purchasing land which impact on the best solution.

We consider that this uncertainty does not serve the customer interest well. Scottish Water should consider carefully at what point it defines the scope of an individual project. There is little point in monitoring the progress of projects until such time as they are well defined and budgets have been approved.

Communicating with customers, communities and stakeholders

Scottish Water could consider creating a clearer separation between the confirmation of a 'defined need' – where there is an agreed requirement to deliver a solution, but the best solution has not yet been identified – and the confirmation of an agreed solution. Excluding from the 'Technical Expression' defined needs which have not yet developed into projects, would give Scottish Water more time and space to liaise with customers and communities about how these needs will be met. It should also allow for more collaboration with the Quality Regulators and, hopefully, more innovative solutions being trialled.

Scottish Water should be well prepared to work with local communities and its customers. It can build on the Service Improvement Reports that it developed for its discussions with the Customer Forum during the Strategic Review of Charges 2015-21. Customers and communities will want to understand the potential options that are available and feel that they have been involved in how their needs are met. It could then be important to demonstrate that the selected option does represent value for money. Scottish Water could consider publishing a short form, yet sufficiently detailed, appraisal of the options that were practical.

Improving asset integrity

Scottish Water operates an asset base with an estimated replacement cost of more than £60 Billion. There are 48,000 km of water mains, 50,000 km of sewers, 244 water treatment plants and 580 sewage works. There are many smaller assets – many of which play a crucial role in ensuring that customers receive the level of service that they expect. Given that the water mains and sewers are underground and the assets cover the length and breadth of Scotland, it is difficult to maintain an accurate view of their current performance. Understanding the condition of the asset (its physical integrity) is even more difficult. Perhaps the single most difficult challenge is to understand the full range of possible failure modes of these assets and their implications for the service that customers enjoy.

5

Strategic Review of Charges 2021-2027

Initial Decision Paper 5:

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Scottish Water has made good progress in recent years in identifying some of the resilience challenges that it faces. It recognises that it needs to go further. Customers are likely to be much less tolerant of service failures than they may have been even a decade ago.

In our view Scottish Water should set out a clear plan for developing its knowledge of its assets and report on progress. Such openness could reasonably be expected to build trust with customers and communities.