

Methodology Information Paper 11: Establishing a revenue baseline

Introduction

This information paper explains how we, the Water Industry Commission, propose to establish Scottish Water's revenue base in the Strategic Review of Charges 2010-14. The Review will set charge caps that limit the average increase in customers' bills during the regulatory control period.

The overall approach

There are two main steps for establishing a revenue base for each year of the review. These are:

- establish an initial customer base: this should be the customer base where use of Scottish Water services at the applied tariffs would equal the revenue of Scottish Water; and
- forecast changes to this customer base and assess the impact of these changes on current revenue at current tariff levels.

We now discuss these in turn.

Initial customer base

In order to establish a revenue baseline, we:

- ask Scottish Water to submit detailed information about its customer base; and we
- review Scottish Water's information and seek to verify this against external information sources.

There are different charging arrangements for household and non-household customers. We therefore make different assessments for these customer groups.

Initial customer base: household customers

Household customers can be billed for their water and sewerage services in two ways. These are:

- measured basis (where a customer has a meter installed); or
- unmeasured basis (where a customer does not have a meter).

Only around 400 of the 2.2 million household customers in Scotland have a meter installed.

Customers with a meter pay their bills directly to Scottish Water. These customers pay a fixed charge based on the size of their meter connection and a volumetric rate based on how much water they consume. In its Strategic Business Plan, we will ask Scottish Water to provide information on these customers' meter size and consumption.

The overwhelming majority of household customers in Scotland pay for water and sewerage services on an unmeasured basis. Unmeasured household customers bills are based on the Council Tax band of the property.

For Council Tax purposes, properties are banded from A to H. In setting water charges, we consider the number of Band D equivalent properties. The 'Band D equivalent' is calculated by multiplying the number of customers in each category by the relevant number of ninths of a Band D bill and dividing by 9.

A number of discounts apply to unmeasured household customers. For example:

- bills for customers in receipt of disability benefits are discounted by one band from the banding of the property in which they live;
- properties with single adult occupancy receive a 25% discount;
- properties that are subject to Council Tax relief receive up to a 25% discount; and
- in limited circumstances, properties that are in effect unoccupied may receive a 50% discount.

Table 1 shows the percentage of a Band D bill paid by each band.

Table 1: Proportion of Band D bill for each customer

	Full charge	25% discount	50% discount
Band A (disabled relief)	5/9	3.75/9	2.5/9
Band A	6/9	4.5/9	3/9
Band B	7/9	5.25/9	3.5/9
Band C	8/9	6/9	4/9
Band D	9/9	6.75/9	4.5/9
Band E	11/9	8.25/9	5.5/9
Band F	13/9	9.75/9	6.5/9
Band G	15/9	11.25/9	7.5/9
Band H	18/9	13.5/9	9/9

We propose to ask Scottish Water to provide customer information at an individual band level in its Strategic Business Plan for 2007-08. We would review this information to ensure that Scottish Water's reported household

revenue is consistent with the reported numbers of customers by band and discount rate. We also propose to cross-check the household revenue information with financial information in the annual report and accounts prepared by each local authority.

If we consider that Scottish Water's information about its initial household customer base is inaccurate, we may make adjustments to set charge caps.

Initial customer base: non-household customers

Non-household customers in Scotland benefit from a competitive market for the retail element of water and sewerage services.

All non-household water and sewerage customers are billed by a retailer (and not Scottish Water) for services. Retailers may offer a range of billing arrangements to customers. These may include both fixed and volumetric tariffs. Retail competition is discussed further in Information Paper 10.

Scottish Water (the wholesaler) charges retailers on the basis of the volume of water consumed (or sewage discharged) by their customers¹. All wholesale charges that Scottish Water levies in respect of non-household customers are therefore measured.

Measured wholesale charges in respect of non-household customers currently comprise three main elements:

- an annual fixed charge for connection based on the size of their meter;
- a volumetric charge based on the volume of water customers consume and sewage they discharge; and
- a charge for surface water (and highway) drainage based on the rateable value of the property.

In the Strategic Review of Charges 2006-10, we raised concerns that the non-household customer base that Scottish Water reported may have been smaller than the actual non-household customer base. We were concerned that a 'data cleansing' exercise by Scottish Water had reduced the reported number of non-household customers from around 140,000 to 120,000. We noted that Scottish Water's information appeared inconsistent with reported non-household customer numbers from England and Wales. If Scottish Water does not bill part of its non-household revenue base, this would increase its wholesale charges in respect of the non-household customers that are billed.

In 2006, we commissioned Oxera to provide an independent estimate of the numbers of non-household water customers in Scotland. Their report (which

¹ During 2008-11 a phasing programme will operate for customers that are compulsorily metered by Scottish Water during 2006-08 where part of their consumption will be assessed from their rateable value.

is available on our website) estimated Scottish Water should have between 135,000 and 150,000 non-household customers. We therefore remain concerned that Scottish Water is not billing all of its non-household customer base.

We propose to scrutinise Scottish Water's reported non-household information carefully. We will ask Scottish Water for detailed information for 2006-07 and 2007-08, which should reconcile to Scottish Water's reported revenue. We will also compare this information to other regulatory information on the customer base, including the Annual Return.

If we consider that Scottish Water's information about its initial non-household customer base is inaccurate, we may make adjustments to set charge caps.

Under the competition framework, the CMA will be responsible for maintaining an accurate record of non-household customers. Retailers will have an incentive to identify customers not presently being billed, as they will be able to offer services to these customers and earn a return.

We propose to use information supplied by the CMA in reaching our conclusions about the baseline for non-household customers.

Forecasting changes to the initial customer base

Once we have established an initial customer baseline, we need to forecast this for each year of the review.

In the Strategic Review of Charges 2006-10, we distinguished between the underlying growth in the customer base and growth that would come about as a result of investment to alleviate development constraints. We propose to use the same method at the Strategic Review of Charges 2010-14.

Background changes

The customer base is slowly increasing. For example, housing in Scotland tends to grow at a relatively constant and predictable rate that is a function of changes in population and demographics. We will analyse underlying trends in the customer base and propose to use this information to inform our judgements about the future customer base.

We will ask Scottish Water to set out its view on changes to the customer base in its business plan.

At the last review, Scottish Water claimed that there would be a large decline in the volumes consumed by larger customers. We allowed for a smaller decline in volumes consumed by larger customers in the charge caps. We will only allow for such a change if it can be justified through analysis of historical trends.

We recognise that alleviating development constraints in some areas may reduce growth in other areas where network capacity has not been an issue. This is because developers may be able to exercise greater choice about the location of a development. We therefore propose to reduce by half the underlying growth rate in those years where development constraints are being released.

Releasing development constraints

We propose to reflect the required outcome of investment to relieve development constraints in our forecast of Scottish Water's future customer base.

In the Strategic Review of Charges 2006-10, we assumed that there would be a two-year time lag between the investment in alleviating development constraints and the premises becoming a billable customer. We propose to take a similar approach at the 2010-14 Review.

Summary

At the next review, we will place considerable emphasis on defining an accurate initial customer base. We propose to forecast future customer numbers, which take into account both underlying growth and the Ministerial objectives.

Related Documents

'The Strategic Review of Charges 2006-10: The draft determination', Volume 7, Section 4 'Charges and their impact on customers', Water Industry Commissioner for Scotland, June 2005.

'The Strategic Review of Charges 2006-10: The final determination', Water Industry Commission for Scotland, November 2005.