

Stakeholder workshop 4: Investment and quality

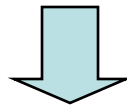
Strategic Review of Charges 2010-14: 2009 workshops
Stirling, 12 March 2009

Programme for the morning...

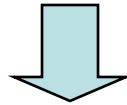
- Overview of the price review process and progress to date
- The process by which investment objectives are set
- How we propose to assess whether Scottish Water's investment programme meets these objectives at the lowest reasonable overall cost
- Some key issues for stakeholders
- Your views and questions

The price review process focuses on delivering value for money for customers. The process can be summarised in three high level steps....

1. Ministers set objectives for the industry over the regulatory control period, and define the principles of charging that must be followed.



2. Scottish Water proposes how it will deliver these objectives, and the financing it will need to do so.



3. We scrutinise Scottish Water's proposals and set final caps on prices that finance Scottish Water to deliver the Ministers' objectives at the lowest overall reasonable cost.

At the end of the process, we are able to determine the following:

1. Limits on the amount Scottish Water can charge household customers annually between 2010-14.
2. The 'default tariffs' that licensed suppliers in the newly competitive market are required to offer all business and public sector customers in Scotland.
3. Limits on the wholesale price Scottish Water can charge retail suppliers of business and public sector customers.

The final outcome is a regulatory contract setting out what Scottish Water must achieve and the financial parameters in which it must do so.

We're now reaching the final stages of the price review...

When?	What?	Why?
30 June 2009	Draft determination published	We publish our draft view on price limits – a 12 week consultation period follows.
23 September 2009	Ministers issue directions	Ministers issue formal directions to Scottish Water, revising where appropriate in the light of the draft determination.
30 November 2009	Final determination published	We publish our final view of price limits.
31 January 2010	Competition Commission appeal deadline	Scottish Water has a two month period to accept or reject our determination.

The last two weeks have been particularly important for the 2010-14 investment programme...

27 February 2009 Ministers issued draft statement on principles of charging and objectives for 2010-14 period.

Tomorrow Scottish Water submits its second draft business plan setting out how it will deliver these objectives.

In their draft statement, Ministers have set Scottish Water objectives in the following areas...

- Capital maintenance and service standards
- Strategic capacity for new developments
- Drinking water quality and water resources
- Environmental protection

In each case, Ministers have set:

- ‘priority 1’ objectives (which must be achieved and financed during 2010-14); and
- ‘priority 2’ objectives (which will only be financed if possible within a profile of broadly stable bills).

Ministers' priority 1 objectives broadly require Scottish Water to achieve the following..... (though in practice they are more detailed)

- As a minimum, ensure that standards of customer service across all areas of Scotland are maintained at March 2010 levels.
- Improve its OPA score to reach the median level of industry performance in England and Wales (in 2007-08) by 2014.
- Achieve further improvements in customer services, for example reducing customer complaints and the number of unsatisfactory intermittent discharges
- Continue to provide strategic network capacity to meet all new housing development and the domestic requirements of business
- Improve the quality, taste and odour of public drinking water.
- Achieve its 'economic level of leakage' by 2014.
- Maintain, and where necessary improve, security of water supplies

Ministers' priority 1 objectives require Scottish Water to achieve the following..... (though in practice they are more detailed)

- Improve wastewater discharges and hence receiving water quality to ensure compliance with standards and also to support the 2014 Commonwealth Games
- Fulfil all duties & obligations under the Flood Risk Management bill.
- Undertake strategic studies to understand future investment requirements for the River Clyde, Clyde Estuary and River Almond and for the new Bathing Waters Directive.

Ministers' priority 2 objectives build on priority 1 objectives, and provide additional provisions for climate change and malodour...

- Provide further improvements to services to customers to achieve 'upper quartile' OPA performance
- Specifically, make improvements relating to internal and external sewer flooding and inadequate water pressure.
- Upgrade further discharges to allow additional waters to meet the requirements of the Water Framework Directive.
- Undertake further studies to identify future investment requirements at Water of Leith, Loch Ryan, Fairlie, Loch Leven and Castle Loch.
- Establish a prioritised list of first time sewerage projects
- Carry out further work to improve the management of water resources
- Further improve the taste & odour of public drinking water.
- Commence a targeted lead pipe replacement programme
- Take steps to investigate and mitigate carbon emissions by seeking opportunities to reduce energy demand etc.
- Mitigate odour nuisance at 21 wastewater treatment works.

Scottish Water's second draft business plan will set out how it will achieve these objectives. We will scrutinise this plan, working with SEPA and DWQR, taking into account the following....

- **Deliverability:** what size of investment programme can Scottish Water reasonably be expected to deliver efficiently and within the four year regulatory period?
- **Definition:** are the outputs that the plan sets out to deliver sufficiently well defined to allow effective monitoring?
- **Ensuring effective delivery:** are the projects and solutions proposed by Scottish Water appropriate to deliver required outputs?
- **Assessing the scope for efficiency:** are Scottish Water's proposed costs consistent with efficient delivery?

When we determine how much financing to allow Scottish Water, we will also need to consider the following issues...

- **Continuity of investment between periods** – should we finance Scottish Water to make an early start on projects for 2014-18? Will this help to smooth fluctuations in investment and therefore help improve Scottish Water’s delivery efficiency or would the distraction result in a loss of focus on delivering the 2010-14 programme?
- **Uncompleted projects from previous periods** – Scottish Water is likely to have an ‘overhang’ of projects from both the 2002-06 and 2006-10 investment periods. We plan to remove any cost increases that have or will occur beyond the end of the period in which these projects should have been delivered.

Once we have considered all of these issues, we can calculate a total allowance for capital costs which we will factor into price caps. The total allowance will likely consist of the following...

Allowance for capital enhancement (Ministers' Priority 1 and, to the extent possible, Priority 2 objectives)

+

Allowance for capital maintenance (for existing and new assets)

-

Scope for efficiency (on enhancement and maintenance)

+

Allowance for completion of previous investment programmes

+

Net adjustment for phasing through early start for 2014-18 and late finish of 2010-14 investment

=

Total investment in 2010-14 period

Once the price review has been accepted, Scottish Water then needs to set about delivering objectives. Delivery is carefully monitored by the Outputs Monitoring Group (OMG)

- The OMG is a multi-stakeholder group, chaired by the Scottish Government and consisting of high-level representation from Scottish Water, SEPA, DWQR, WWS and ourselves.
- The OMG monitors delivery of the outputs required to achieve objectives to the point they are signed-off by the quality regulators.
- The group's reports highlight where there is slippage and the 'sign off' processes make sure customers receive the outputs they have paid for.
- We're working on a new, single measure of output delivery (similar to the OPA) to make Scottish Water's progress even more transparent for stakeholders.

Some key issues for stakeholders with regard to the 2010-14 investment period

- What size of investment programme can be effectively and efficiently delivered by Scottish Water?
 - The current programme is among the largest in the UK .
 - The Commission has already expressed concerns regarding late delivery of outputs.
 - Research indicates investment of no more that £500m a year
 - What impact will undelivered outputs from previous periods have on delivery?
- Leakage – Scottish Water has made progress on reducing the high levels of leakage but has missed the Commission’s targets.
 - The Commission requires leakage reduction to become an integral part of Scottish Water’s business processes.
- Customers require clarity on what they are receiving for their money
 - In the 2006-10 period we have used the “7 stage approach” to address areas of uncertainty. Does this approach remain appropriate?

We seek

- Your views and questions

**For more information on the price review please go
to:**

**[www.watercommission.co.uk/view_future_prices.
aspx](http://www.watercommission.co.uk/view_future_prices.aspx)**