

Date: 15 February 2013

Our Ref: 130215 Consultation Response

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SHAPING THE FUTURE OF YOUR WATER AND WASTE WATER SERVICES: CONSULTATION RESPONSE

We welcome Scottish Water's consultation 'Shaping the future of your water and waste water services'. We consider this consultation to be an important element in the engagement process with customers and other stakeholders as part of the Strategic Review of Charges 2015-21.

We also consider the development of long-term (25 year) strategic projections for the industry to be an essential pre-requisite to establishing Scottish Water's near term (6 year) business plan which is due for publication in October of this year. The strategic projections will be key to ensuring a sustainable water industry in the long term.

In this response we set out our high-level views on the draft strategic projections set out in the consultation.

Keeping charges as low as possible

We welcome Scottish Water's commitment, as set out in the consultation document, to keeping charges as low as possible and affordable. The document also acknowledges that the cost of water may become a more pressing matter in the coming years.

This in our view is a key issue; customers' views on charges and what they consider affordable must take account of the wider context of the general outlook for the economy and customers' own financial circumstances. Responses to price increases (in both real and nominal terms) will be influenced by these considerations. As such, there will be times when any increase in bills (even below inflation) will be considered unacceptable by customers.

We expect Scottish Water to be mindful of this when considering the appropriate balance for customers between future prices, investment and service levels. Discussions of such matters

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with the Customer Forum will be very important in this regard. We provided more detailed information on the initial prospects for prices in our Customer Forum Note 8.

Pursuing innovations

We welcome Scottish Water's intention, outlined in the consultation document, to continue to look for and deliver productivity improvements and more sustainable solutions through innovation.

We expect Scottish Water to vigorously pursue innovative and sustainable solutions and to take advantage of best practice from within the UK and internationally. As part of the changes in our methodology approach for the next Strategic Review, we have removed all possible barriers that may previously have prevented or discouraged the company from appraising and pursuing alternative, more innovative approaches. Scottish Water is now in a position to seek out and respond in a constructive way to all possible opportunities for innovation.

Protecting customers of the core business

As the economic regulator, it is our role to protect the interests of customers of Scottish Water's core activities which involve providing water and sewerage services to homes and businesses throughout Scotland. We recognise that there may be opportunities for the company to develop new business outside of these core activities, as outlined in the Scottish Government's 'Hydro Nation' proposals. Scottish Water's consultation document includes references to such opportunities. Although we support such initiatives we would also note the importance of ensuring that the interests of customers of the core business are protected at all times.

Developing non-core business is likely to require new investment that falls into one of two distinct categories. The first is where the activity makes use of an existing asset that is owned by the core business. This would include, for example, leasing out land for a wind farm or allowing fibre optic cables to be laid within the sewerage network. The second category of investment is where Scottish Water decides to pursue an independent activity that does not rely on those assets. This would include activities such as providing training or advice and support services (as Scottish Water International has already done in Canada and Poland).

In both of these cases there will need to be very clear demarcations and no risk to customers.

In the first case, customers should be entitled to receive a payment that recognises the space or capacity that has been provided (as they paid for the assets originally). We would expect any recompense to take the form of a cash payment that reflects the going market rate. So, for example, if it is land that is being used for a wind farm, Scottish Water should be paid a fair rent for that land rather than any other form of recompense such as a share in the energy being created on the site. If a non-core activity impacts in a negative way on the assets, customers of the core business would not be expected to contribute to any costs of 'making good'.

In the second case activities should be entirely ring fenced and should not impact either positively or negatively on customers.

We would expect any income that is paid to Scottish Water as a result of the non-core use of its assets to be reallocated by Scottish Water and the Scottish Government so that it results in lower water and sewerage bills for customers.

Maintaining the health of the assets

In order to maintain customer service and provide high-quality water and sewerage services into the future, Scottish Water will need to continue to maintain the company's existing assets as they become worn out and need to be replaced. Scottish Water's draft strategic projections indicate that these costs are expected to rise due to the additional cost of refurbishing plant that was built in the past 15 to 20 years.

In broad terms, we would expect to see ongoing efficiencies that are achieved in maintaining the existing assets effectively offsetting the additional investment required in future so that investment in this area remains broadly stable in real terms. If this is not to be the case, we would expect a clear justification to be made available to customers.

Ensuring financial strength

It is in the interests of all customers that Scottish Water continues to be appropriately financed so the industry remains sustainable in the long term, with a steady investment programme and stable charges. We would certainly not wish to see a return to the 'hand to mouth' financing that was experienced by the three former water authorities, which led to disjointed investment and shocks to customers' bills. It is also important to avoid a situation where benefits are enjoyed by today's customers that will ultimately end up being paid for – either directly or indirectly – by future generations. It remains one of our key principles that decisions taken today should not disadvantage future generations.

As the consultation notes there will be significant pressures on the availability of government borrowing, and lower borrowing will be available than has been in the past.

We endorse the view that having certainty on financial strength is important if Scottish Water is to be in a position to finance future improvements in the most efficient and cost-effective way. For example, it should allow Scottish Water to access debt markets on reasonable terms – if Ministers decided to proceed down such a course – without bills having to increase as a result.

As part of our approach to the next Strategic Review, we are introducing changes that will allow us to ensure that Scottish Water remains financially sustainable in the long term. These include the financial tramlines, which set out, in effect, a range of financial strength for the company. We provided more detailed information on the financial tramlines in our Customer Forum Note 7.

An efficient capital programme

We welcome the work that Scottish Water has done to identify its long-term investment requirements and opportunities for efficiencies. We note too that the company expects its future capital investment requirements to be between £450 and 500 million (in 2012-13 prices).

It is important to make sure that the investment programme for the forthcoming investment period is manageable, affordable and can be delivered efficiently. As such, we endorse the Scottish Government's view that a maximum level of capital investment of between £450 and £500 million a year is likely to be most efficient.

There is strong evidence that Scottish Water has improved both its cost efficiency and delivery of capital investment over previous regulatory periods. Equally, we consider that Scottish Water should be able to make further efficiencies through more innovative solutions, a more strategic approach, and smarter procurement and delivery. These further efficiencies will allow Scottish Water to deliver both increased value for money for customers and additional water quality, environmental and customer service benefits. We provided more detailed information on the efficient use of capital expenditure in Customer Forum Note 5.

Investment in the environment

In the consultation document Scottish Water identifies some significant exclusions from the investment projections. These relate to environmental obligations which, if they were all included and came to fruition, would amount to some £17 billion in additional investment in total. Clearly this goes far beyond the maximum efficient level of investment identified above, and would have significant impacts on customers' bills, both now and in future.

We consider that investment proposals on this scale are wholly unrealistic and that Scottish Water should be using its expertise as a provider of water and sewerage services to challenge proposals where it is clear that the benefits could not justify the costs. Such an approach is a prerequisite to ensuring that any future investment proposals are soundly based.

As noted earlier, there will also be opportunities for Scottish Water to explore lower cost, more sustainable and/or innovative solutions to these potential environmental obligations. It will be important that Scottish Water agrees the approach in these areas with the environmental regulator, SEPA, and is pro-active in managing the associated financial and environmental risks.

Managing water resources

Scottish Water's consultation outlines its commitment to managing water resources efficiently. The consultation document suggests that there are a number of opportunities that exist to help Scottish Water to improve the efficiency with which it delivers water services. These include developing greater connectivity between water supply systems and continuing to reduce leaks from the water network.

In our view, Scottish Water should consider such opportunities as part of a wider, long-term strategic approach to managing water resources. This would comprise, for example, a move away from a pure assessment of the level of leakage towards a wider assessment of achieving the necessary supply/demand balance in each water zone. As part of this more strategic approach Scottish Water should identify the lowest cost solutions for delivering the required supply/demand balance. These solutions may rely on other parties, and we would expect Scottish Water to work constructively with these parties in identifying and developing such approaches.

Meeting new demand

It is important that Scottish Water's projections for the investment required to meet new demand for water and waste water services are soundly based. Along with accurate information on historical and future growth in demand, this requires a detailed understanding of the current network capability and a strategic approach to meeting new demand in the most cost-effective way. There will be opportunities to deliver new capacity through efficient procurement arrangements with third parties (where, for example, Scottish Water manages an abstraction right but does not own it).

Scottish Water's projections will impact on the investment available in other areas of the programme and will be scrutinised carefully as part of the Strategic Review process.

Reducing carbon emissions

We very much welcome Scottish Water's stated commitment to reducing its own carbon emissions. In doing so, Scottish Water will play its part in helping Scotland to achieve its carbon reduction targets. Scottish Water has, for example, identified investment of £85 million to develop further renewable energy from within its assets. In our view, customers and other stakeholders would find it helpful if Scottish Water were able to develop and publish targets for its own carbon reduction, so that progress can be monitored and reported. Similarly, there is scope for more detail on the measures Scottish Water is putting in place to achieve the proposed reduction.

Reducing flooding and pollution from blocked sewers

Scottish Water reports that more than 80% of flooding from sewers is caused by inappropriate items being disposed of in toilets and drains. The document proposes that this is tackled through encouraging proper disposal of household waste as part of the company's education programme. Given the impact on the public and the environment from this flooding and pollution it would be appropriate for Scottish Water to consider what additional customer communication measures could usefully be put in place.

We have outlined above our high-level responses to Scottish Water's draft strategic projections. We look forward to working with Scottish Water, the Customer Forum, the quality regulators and other stakeholders to deliver the Ministers' objectives for the water and sewerage industry over the forthcoming regulatory control period 2015-21 and beyond.