

Charging for trade effluent: Our conclusions from the consultation



**Water Industry Commission for Scotland
Ochil House
Springkerse Business Park
Stirling
FK7 7XE**

**Telephone: 01786 430200
Fax: 01786 462018
Email: enquiries@watercommission.co.uk
www.watercommission.co.uk**

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Contents

1. Introduction.....	3
2. Framework.....	5
3. Responses to consultation questions	8
4. Summary and next steps	12

1. Introduction

The Water Services etc. (Scotland) Act 2005 established the Water Industry Commission and gave us powers to regulate Scottish Water's trade effluent charges. Previously, Scottish Water set its trade effluent charges and customers could only appeal these to Scottish Ministers.

During the 2002-06 regulatory control period, Scottish Water operated two separate capping arrangements which limited increases in bills for trade effluent:

- a harmonisation cap: where quality and quantity parameters remained the same, the year-on-year increase was limited to 15%;and
- a treatment cap: customers in locations where treatment was upgraded or provided for the first time were subject to a 100% cap.

As a result of these arrangements, nearly 900 customers are currently paying less than the published tariffs, with several paying considerably below.

We are concerned that the low tariffs that Scottish Water charges some customers may breach:

- competition law: Scottish Water may be showing undue discrimination for or against various customer groups; and
- European State Aid rules: some of the bills that Scottish Water charges may be below cost, and, as such, could be viewed as a State subsidy.

In June 2006, we issued a consultation paper inviting views on how we could phase changes in charges so that all trade effluent customers pay the published charges. The exception to this would be those customers who have separately negotiated special agreements with Scottish Water. We proposed transition arrangements whereby:

- there is a 'grace year' so that customers can plan for changes in their bills;
- there is then a transition period of three years, during which time all customers move from their current rates to published rates; and
- customers move onto published rates in equal monetary amounts.

We received 14 responses to the consultation¹. Most people responded to the specific consultation questions. Some respondents also included general comments on the trade effluent charging framework. We have considered

¹ One respondent indicated no comments. Two respondents commented on initial proposals prior to the formal consultation; we have considered these comments as part of this response.

these when formulating our final position on these issues. All of the responses are available on request.

We would like to thank all those who took the time to read and comment on our consultation.

2. Framework

We received a number of helpful comments from interested parties on the overall framework for trade effluent charging. We also took the opportunity to review our powers and have come to the conclusion that we can use them more effectively to improve communication with customers.

This section sets out the broad framework for trade effluent charging. We consider the following issues:

- ensuring a level playing field;
- Scottish Water's current charging formula;
- special agreements; and
- communication with customers.

Ensuring a level playing field

Respondents generally agreed that it was important to ensure a 'level playing field' between customers.

A respondent noted:

"The current charging arrangements are unsatisfactory and must be changed so that there is a level playing field."

Notwithstanding concerns about Scottish Water's current charging formula, respondents generally agreed that this means that all customers should pay transparent, published rates.

Scottish Water's response indicated that it has revised trade effluent consents. As a result, the capped bills of some customers are closer to published charges. Scottish Water also submitted up-to-date information about the number of affected customers. It shows that:

- there are slightly fewer customers affected than we indicated in our consultation (870, compared with 912); and
- the financial value of the discounts is less than we indicated (£2.1 million, compared with £4.1 million).

This means that the average affected customer will now see their bill increase from around £9,800 to around £12,200. However, there is large variation around this average and some customers will still see substantial increases in their bills. Figure 2.1 summarises the effect on the 870 customers.

Figure 2.1: Increases required so that all customers pay the published rates²

		Required £ increase to reach full rates						Total
		£0	£0– £200	£200– £500	£500– £1,000	£1,000– £10,000	Above £10,000	
Required % increase to reach full rates	0%	935	-	-	-	-	-	935
	0–25%	-	295	70	42	69	6	482
	25–50%	-	46	21	19	44	8	138
	50–100%	-	26	22	22	43	11	124
	100–500%	-	17	19	15	39	9	99
	Above 500%	-	6	4	6	9	2	27
	Total	935	390	136	104	204	36	1,805

Scottish Water’s current charging formula

Many respondents raised concerns about Scottish Water’s current charging arrangements for trade effluent.

A respondent stated:

“We are concerned, however, that the published tariff arrangements for trade effluent may not offer the fairest way forward for charging arrangements. We are concerned that the modified Mogden formula used by Scottish Water to calculate trade effluent charges may not be offering an equitable alternative to the bespoke arrangements that the WICS [Water Industry Commission for Scotland] is challenging.”

We note the concerns of some customers about Scottish Water’s current charging formula. We are currently working with Scottish Water to establish the appropriate wholesale charges for it to levy on retailers (including its own retail subsidiary – Scottish Water Business Stream). As part of this process, we will consider Scottish Water’s current trade effluent charging arrangements, as well as the arguments for moving to alternative arrangements. The wholesale charges that Scottish Water will levy on retailers will be announced in summer 2007.

From April 2008, customers may be able to negotiate different charging arrangements with retailers that are better tailored to their individual circumstances.

² Scottish Water’s resubmission of information only included customers who were paying less than published rates. The number of customers currently paying published rates (0% increases) in this table is therefore an estimate.

Communication with customers

In our consultation, we envisaged using our powers to approve Scottish Water's charges scheme³ in order to make sure that it was carrying out the proposed phasing arrangements.

During the summer, we reviewed this approach and have come to the conclusion that it would be better if we use our powers to determine departures from the charges scheme for customers who presently do not pay charges scheme rates⁴.

This has the advantage that we will be able to issue individual determinations to each affected customer. This should give each affected customer a clear idea about the impact on their bills. It will also assist with the introduction of retail competition, as it should be clearer to each customer the wholesale charges they are paying. This should allow customers to seek better deals with retailers that may mitigate the impact of these increases.

However, we note Scottish Water Business Stream's representations in this respect. It states:

"We consider that an individual letter should be sent to each of the affected customers from Scottish Water Business Stream."

We will work with Scottish Water Business Stream to ensure that communication with customers is as helpful as possible. We agree that it may be beneficial if a single item of communication is sent to each affected customer by Scottish Water Business Stream.

³ Section 29A of the Water Industry (Scotland) Act 2002.

⁴ Section 29G of the Water Industry (Scotland) Act 2002 and Schedule 3 of the Water Services etc. (Scotland) Act 2005.

3. Responses to consultation questions

In this section, we outline the responses we received to the specific consultation questions.

Grace year

All respondents supported our proposal that bills to all trade effluent customers should increase in line with the charge cap for 2007-08. This means that customers who pay less than the published rate will continue to receive the same discount in 2007-08.

One respondent noted:

“We are already beginning our budgetary process for 2007 and believe that it would be unreasonable for Scottish Water to announce an increase in charges by a significant amount as late as January 2007. We therefore strongly support your proposal to allow companies a ‘grace year’.”

Some respondents argued that the grace period should be longer. However, we do not see any material benefit for customers (in terms of budgetary cycles) from increasing the grace period to beyond one year. In addition, many of the respondents who called for a longer ‘grace period’ did so because they felt that the overall time period for phasing was insufficiently long; we outline our position on this below.

Communication

We asked interested parties for their views on how changes in bills should be communicated to trade effluent customers. One respondent noted:

“Regardless of the outcome of the consultation, many customers will face significant increases to their bills and it is essential that they are made aware of this immediately, even if the actual amount and manner of this change is not finalised.”

In their responses, Scottish Water and Scottish Water Business Stream confirmed that customers who pay reduced trade effluent charges have been made aware of the full charge on their bill since 2004. This means that those who are affected by the phased increases will already be aware of the size of their eventual bill.

Respondents who commented on this issue felt that an individual letter should be sent to each affected customer. We outlined above that, following a review of our powers, we will issue an individual determination for each affected customer. We will aim to coordinate this with Scottish Water Business Stream’s communication with customers on the issue. Indeed, we consider

that it may be beneficial to customers if they receive one item of correspondence directly from Scottish Water Business Stream.

Method of increase

In the consultation, we asked interested parties whether it was preferable to have:

- equal percentage increases; or
- equal monetary increases.

We recognised that applying equal monetary increases may mean large percentage increases for the worst affected customers in the earlier years. However, we also recognised that it was monetary increases that affected customers. We therefore proposed equal monetary increases.

Respondents expressed mixed views about their preferred method of increase. Some respondents expressed a preference for our proposal to increase charges in equal monetary amounts. However, no respondent expressed this as a particularly strong preference.

Scottish Water and Scottish Water Business Stream suggested that we should use a method based on percentage increases. However, rather than increasing all affected customers' bills over the three-year period, they suggested that we should increase these bills at 30% per year for two years, with all customers moving onto published rates in the third year.

We have reviewed this proposal and recognise that it may be beneficial as it:

- moves some customers onto published rates sooner than our proposed method; and
- is relatively straightforward.

However, having reviewed the proposal we concluded that it would result in unacceptably large changes in around 180 customers' bills in the third year. We also consider that we can further mitigate the increases to lesser-affected customers by phasing their bill increases over the full time period.

Other respondents expressed a preference for equal percentage increases. One respondent noted:

“Although the ‘equal percentage increases’ approach tends to produce a ‘back end loaded’ outcome, that would at least alleviate the difficulty of companies having to face a significant increase in the first year and would enable them to budget for heavier increases in later years”.

Some other respondents expressed similar views. We are generally persuaded by this argument and therefore agree that bills should increase in equal percentage amounts over the period⁵.

Time period

In our consultation, we proposed that, following the 'grace year', discounted trade effluent bills should take three years to reach published rates. We also presented an option where bills reached published rates over four years. However, we felt that the additional time would run a risk of breaching European State Aid and competition rules.

We received a mixed response to this proposal. Many respondents agreed with our suggestion that bills should take three years to reach published rates. However, other respondents expressed views, often in strong terms, that increases should be phased over a period of at least four years.

We have carefully considered the merits of extending the transition period. However, we do not consider that any of the respondents who asked for a longer transition period presented any new arguments. We are also persuaded by comments by Scottish Water and other stakeholders that we should minimise the burden on those customers whose bills would be higher for longer if there was a longer transition period.

We therefore consider that, following a 'grace year', charges should increase in equal percentages over three years⁶.

Improved treatment

Most respondents agreed with our proposal to use the same mechanisms to phase increases in trade effluent charges that result from increased treatment at a wastewater treatment works.

However, one respondent commented:

"We do not believe that enough information has been provided in the consultation document to answer this question. In particular, it is not clear whether this proposal is limited to the charge increases required as a result of treatment improvements put in place in the 2002-06 period or whether whenever treatment is improved in the future, trade effluent customers would have a phased increase in charges".

⁵ Bills will increase by an equal percentage amount, plus actual inflation in each year.

⁶ As the final year increase will transition customers onto published tariffs, the actual increase in the final year will depend on the outcome of the next Strategic Review of Charges, where these charges will be reviewed. As a result, the percentage increase in the last year may be greater or less than the preceding two years.

The respondent also asked for further information about the number of affected customers and the impact on these customers' bills of paying for the increased treatment.

We confirm that we will introduce the same phasing arrangements for customers receiving increased treatment of their effluent, irrespective of when this treatment is introduced. We understand that only a small number of customers are likely to be affected by this and that the effect on their bills will be in the range discussed in our consultation document.

Introduction of competition

All respondents agreed with our proposal to ensure that the introduction of competition did not affect the transitioning arrangements for trade effluent customers' bills.

4. Summary and next steps

We asked interested parties for their views on our proposed transition arrangements for moving all trade effluent customers onto paying published tariffs (except those who have separately negotiated special agreements with Scottish Water). Figure 4.1 summarises our proposed approach and the changes we have made to our proposals in light of the responses.

Figure 4.1: Transitional arrangements

	Proposed approach (June 2006)	Actual approach (December 2006)
When phased increases start	2008-09, following a 'grace year'	2008-09, following a 'grace year'
The method of charge increases	Equal monetary increases	Equal percentage increases
How long it takes to reach published rates	Three years, following grace year	Three years, following grace year

We will also introduce this method of phasing increases for customers affected by increased treatment at a treatment works.

In addition, we have improved the method of informing customers about their likely bill. We will issue individual determinations to each affected customer, informing them about the maximum charges they will pay each year. We expect to be able to communicate this to customers through Scottish Water Business Stream during 2007.