



Scottish Council for
Development and Industry

POLICY SUBMISSION

WATER INDUSTRY COMMISSION FOR SCOTLAND

THE STRATEGIC REVIEW OF CHARGES 2010-14:
THE DRAFT DETERMINATION

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SCDI is an independent and inclusive economic development network which seeks to influence and inspire government and key stakeholders with our ambitious vision to create shared sustainable economic prosperity for Scotland.

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Strategic Review of Water Charges 2010-14: The Draft Determination

1. SCDI is an independent membership network that strengthens Scotland's competitiveness by influencing Government policies to encourage sustainable economic prosperity. SCDI's membership includes businesses, trades unions, local authorities, educational institutions, the voluntary sector and faith groups.

Introduction

2. The provision of affordable and high-quality water services is vital for the Scottish Government's overarching purpose for the public sector of increasing sustainable economic growth. With a legacy of underinvestment, substantial funding for maintenance and enhancement is required. The costs to businesses of water services can be critical in economic downturn when margins are being squeezed. A high and increasing level of efficiency in Scottish Water is therefore essential in maximising investment, and SCDI welcomes the progress which it has made.
3. SCDI has endorsed the maintenance of the Principles of Charging, including: full cost recovery; stable and affordable charges; financial sustainability and the level of Ministers' lending to Scottish Water; harmonised charges; cost reflective charges; phasing of increases; paying for increased local capacity; and future charging arrangements for non-household customers. Each is discussed below.

Financial Sustainability and the Level of Minister's Lending to Scottish Water

4. The financial sustainability and success of these proposals is based on increased customer numbers and revenue for Scottish Water. The forecast also relies on a number of properties being brought into the market which are currently not being charged. It is explained in the Draft Determination that prudent assumptions have been made about growth that are at the lower end of recently observed trends. Even so, in the current economic conditions, these forecasts may be challenging. In the light of these uncertainties, sensitivities should be built into the Final Determination of Charges in order to protect investment should they not be met.
5. The Scottish Government's Draft Budget has proposed that Scottish Water would retain borrowing powers roughly in line with those in the Draft Determination. However, the Foreword to the Draft Determination highlights that in future the Scottish Government may no longer be able to offer Scottish Water the full flexibility in the timing of its borrowing that was available in the last regulatory control period. If this is the case, using the Scottish Futures Trust as a vehicle for providing finance to Scottish Water or allowing Scottish Water to borrow commercially is recommended. Public investment in water infrastructure creates economic, social and environmental benefits and, under the existing model, it should continue to be a high priority for the public purse. SCDI considers that should this model prove unsustainable in funding the Scottish Government's objectives, within tightening public expenditure limits and economically and

socially acceptable charges, other external funding streams should be explored. The focus in this debate should be how to support sustainable economic growth.

Stable and Affordable Charges

6. Provision of clean water and sanitation should be affordable for all in society and the proposals in the Draft Determination of Charges to continue with the stable charging regime coupled with geographic harmonisation is an excellent basis on which certainty for the business and domestic consumer can be ensured. There will be falls in charges in real terms over the 5 year pricing period and the introduction of a competitive market into water services should 'compete away' Licensed Providers' margins, benefiting non-household customers even further.

Cost Reflectivity

7. SCDI supported the principle of cost reflectivity and continues to view this as the most sensible approach to charging for water services alongside full cost-recovery. SCDI strongly supports the principle that any significant increases in charge levels should be phased in gradually, but, however this is undertaken, the funding for Scottish Water must be maintained. Guidance as to the definition of a significant increase and the reasons for any increase should also be provided.
8. SCDI notes that a timetable for implementing area based charging for surface drainage for non-household customers is not included in the Draft Determination. This is a concern because Licensed Providers were scheduled to contact all final customers this year with information which may have included an implied whole charge and it is proposed that the new scheme will be introduced from 2010. Furthermore, no mention is made in the Draft Determination of a revision of charging principles to make volumetric charges a larger proportion of revenue.

Unwinding Of Cross-Subsidies Between Customers

9. SCDI has welcomed the research into cross-subsidisation and is pleased to see that action is being taken to address the identified £44 million a year of subsidy from non-domestic to domestic water customers. However, it is still of significant concern that further research has identified that Scottish water still "over-recovers" £25 million a year from non-household customers. SCDI believes that the cost recovery imbalances between SMEs and large companies on the water side and within non-household sewerage charges require to be addressed.
10. The Draft Determination does not make it clear what impact unwinding of Trade Effluent subsidies may have on individual businesses or set out the period for changes to be phased in. Significant increases in bills for treating trade effluent could encourage customers to go off-network and establish their own treatment operation. It must be ensured that increases in charges are in proportion to the service provided and do not encourage customers to move to alternative trade effluent treatment provision. SCDI continues to support a gradualist approach to eliminating these cross-subsidies in the least disruptive manner to customers.

Small Organisation Water Services Charges Exemption Scheme

11. The decision on whether to extend the small organisation water services charges exemption scheme after April 2010 should be informed by the likely impact on the current recipients and the burden on other customers in the economic downturn. Charities with “modest financial resources” should be considered given the public benefits they supply. If the impact on recipients is regarded as too substantial, either the exemption should be continued or a phased approach taken. Scottish Water is not in a position to assess such public benefits and would need advice from the Scottish Government. The ultimate goal should be cost-reflectivity and full cost recovery but within a stable pricing environment.

Paying for Increased Local Capacity

12. Constraints on development caused by a lack of capacity within Scottish Water have previously been a major cause of frustration among local authorities, developers and local communities. SCDI is pleased that these constraints have reduced dramatically since the introduction of Q&S III. However, SCDI still hears examples of delays in the system, for example in getting Technical Approvals.
13. SCDI believes that it should not be simply left to developers to meet the cost of the additional capacity, particularly at a time when the commercial viability of projects will remain under severe pressure. Both developers and Scottish Water, in the form of new customers, will benefit from new developments. Therefore, both developers and Scottish Water should bear a proportion of the costs.
14. The initiative by Scottish Water to help housebuilders by delaying the point at which connection charges are payable until they require their first connection was a welcome step to support development and economic growth at this time.

Future Charging Arrangements For Non-Household Customers

15. The Draft Determination proposes to move Metering Activities, Trade Effluent Sampling and New Connections, Disconnections and Reconnections away from Scottish Water. These changes which would give greater control to Licensed Providers in their interactions with customers and in turn enhance their ability to champion customers’ issues. This should also mean that touch points with Scottish Water are reduced which should reduce inefficiency in the market.

Metering Activities

16. Moving metering activity away from Scottish Water could be a positive move if it facilitates the rollout of smarter metering solutions which help customers reduce consumption and save money. But it is not clear in the Draft Determination if the proposed new organisation would be responsible for policy e.g. on domestic/commercial shared properties, encouraging innovation, or meter right-sizing.

Trade Effluent Sampling

17. Allowing Licensed Providers to control trade effluent could also help customers. Licensed Providers bill customers and these changes could help both parties work much more closely together to manage effluent consents and discharges.
18. If Licensed Providers are asked to play in 'policing' non-compliance this could create some confusion because they would then not only be playing the role of customer champion. This suggests that compliance issues should remain the remit of Scottish Water alone to ensure transparency in the market place.

New Connections, Disconnections and Reconnections

19. A speedy, efficient connections process is a priority for sustainable economic growth. Experience of SCDI members with Licensed Providers for non-domestic connections has been mixed since the opening of the market in April 2008. Developers have reported delays and frustration with the system. The Draft Determination suggests that the "interfacing has not been fully effective because of lack of clarity in the Operational Code and an over reliance on Scottish Water to progress the connection process", but that performance has been improving.
20. The Draft Determination proposes to extend the role of Licensed Providers into the domestic connection market. While the intention that competition would benefit customers seeking a connection is widely appreciated, concern has also been expressed, in light of this mixed experience, about the impact on projects.
21. To create more confidence, there is a need for more clarity on the proposals, in particular reassurance that the introduction of Licensed Providers will not simply add another, time-consuming stage to the approvals and procurement process. Under these proposals, Scottish Water would still remain responsible for approving a connection point, creating a risk that delays might still occur in the process. An alternative option might be to follow the electricity market where a Licensed Provider is appointed at the point of connection. Scottish Water would run the application process and decide the outcome of the application, with customers choosing their Licensed Provider at the point of connection. Clarity would also be helpful on how the payment procedure would be affected as at present developers pay Scottish Water both Inspection and Connection charges.
22. Confidence could also be enhanced through the introduction of a 'Customer Performance Charter' to lay down timescales for responding and providing quotations or scheduling of works to ensure that minimum standards are met.
23. The changes to Reconnections and Disconnections could also provide a more efficient process for customers. Both currently suffer delays in some cases and, while the proposals need some clarification, there is potential to speed them up.

Investment Programme

24. The Draft Determination allows £258.9m less for investment across the programme than the claim from Scottish Water. This is a significant difference amounting to 8% of the total. In arriving at the Final Determination of Charges, the Water Industry Commission should not only consider Scottish Water's submissions on whether the Scottish Government's objectives can be delivered with this lower level of investment, but also if implementing such a substantial adjustment would force Scottish Water to review the entire programme with the consequential effect that construction activity is put on hold and efficiency is lost.

Profile of Investment Between Regulatory Control Periods

25. It is clearly sensible to ensure that any investment programme is deliverable. That previous programmes have stretched Scottish Water resulting in delay and deferment of projects has caused problems for Scotland's civil engineering and development sectors, not to mention cost increases. However, it is also true that such a level of investment has provided a very steady stream of work for the civil construction sector and there is no reason why it could not be effectively delivered and managed were it to be properly planned and evenly spread over the regulatory period. SCDI understands that, in general, this situation has improved significantly, but a sharp decline in workloads has recently been highlighted in the Highlands. Overhang and early start transition periods between regulatory periods are also crucial to this smoothing of the investment profile.

26. Lengthening the regulatory period from four to five years will further improve stability and certainty in investment has been previously supported by SCDI and SCDI welcomes the planned extension. However, SCDI understands that this does not negate the need for overhang between investment programmes and that doing so in its entirety would severely reduce workloads in transition periods. It believes that there is a continuing role for limited and controlled overhang.

27. The current parallel regulatory periods north and south of the border require both areas of the UK to be competing for resources at the same time. SCDI continues to recommend that the Scottish and English programmes are moved out of step.

Climate Change and Adaptation

28. The response to the threat of climate change will be a top priority over the period 2010-14 and it is one on which the public sector will be expected to take a lead. Scottish Water is both a contributor to increasing carbon emissions and in the front line of the response. It is one of the biggest energy users and, with droughts and sudden heavy rain event modelled to become more frequent, it will also be expected to protect services. The Draft Determination accepts Scottish Water's proposals for investment likely to address the likely implications of the Flood Risk Management Bill and contains as yet undefined enhancement which could include studies of how Scottish Water could best adapt to and mitigate the potential threat of climate change. However, given the scale of the challenge, it is surprising that the Draft Determination does not discuss the issue in more detail.

29. The Climate Change (Scotland) Bill recently passed by the Scottish Parliament has set a very challenging target of reducing carbon emissions in Scotland by 42% by 2020. Every sector will need to contribute, but competing environmental priorities and demographic trends are increasing the task for Scottish Water. Its capital investment programme to deliver water and waste water services that comply with ever tighter drinking water and environmental standards had led to a one to two per cent annual rise energy demand and increased carbon emissions, and the population is generally moving towards the warmer and drier south-east. Two thirds of Scottish Water's emissions are due to the use of electricity from the grid. A higher percentage of renewable power in the electricity mix by 2020 will reduce its carbon intensity and Scottish Water has been working to increase its renewable energy use. But if the target is to be achieved, there is also a need for more energy efficiency. Scottish Water has been encouraging innovative designs and use of materials which reduce energy demand and lower carbon emissions. It is vital that the final Determination of Charges enables Scottish Water to build on this work and contribute to the sectoral targets which are being currently developed in the Scottish Government's Climate Change Delivery Action Plan.
30. SCDI understands that Scottish Water is itself at present prevented from investing in renewable energy projects because this is not regarded as in the interests of consumers so it must seek partners for them. SCDI believes that it is worth revisiting these regulations and that investment by Scottish Water in projects which show benefits might, indeed, be incentivised. Low and clean energy solutions would ultimately reduce operating costs, provide a reliable power source safeguarding services and be in the interests of future consumers.

Environmental Improvement

31. In view of the challenges created by climate change and the regeneration opportunities, the Scottish Government's National Planning Framework 2, the long term spatial strategy for Scotland's development, designates the Metropolitan Glasgow Strategic Drainage Scheme as a National Development. Substantial improvements in drainage infrastructure and water catchment management are required to reduce flood risk which stems from under-investment over decades. The development also has a key role to play in facilitating regeneration on the east side of the Glasgow conurbation. This demands a strategic approach in which drainage and catchment management measures are co-ordinated with major transport infrastructure projects such as the M74 Extension and East End Regeneration Route; the regeneration of the Clyde Gateway; and the developments of the 2014 Commonwealth Games facilities at Dalmarnock and the Glasgow and the Clyde Valley Green Network.
32. The Metropolitan Glasgow Strategic Drainage Partnership, which includes Scottish Water, has been put in place to take forward this National Development. SCDI understands that, while it has not yet secured all the funding needed for the long-term scheme, there is sufficient funding within the Draft Determination to keep it on track. This includes work to find more cost-effective solutions. Hard engineering solutions are being replaced where possible by soft engineering

solutions, such as Sustainable Drainage Systems (SUDS), which as well as addressing the drainage problem, also adds value, by increasing economic competitiveness, strengthening communities and improving biodiversity. Overall cost estimates for the scheme are reducing from their original projection, but are still considerable and the partnership must continue to be adequately resourced.

Metering

33. SCDI is encouraged by the progress which has been made in installing meters into non-household sites and welcomes the proposal in the Draft Determination of £1m a year for three years for the first trial of household metering in Scotland.

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