Investing in and Paying for Your Water Services from 2015

An invitation to engage with the Government and to provide your views

Summer 2012
FOREWORD

Scotland is now enjoying the real benefits that have been delivered to drinking water quality, the environment and customer service since Scottish Water’s creation in 2002.

Our focus on the need to improve the quality and standards of services, our determination to keep charges affordable, and the commitment shown by our water industry has resulted in Scotland's drinking water quality, environmental performance and levels of service reaching their highest levels ever.

These are impressive achievements while holding average household charges at £324 for 2012-13, the lowest charge in the UK.

We are recognising these achievements through our Hydro Nation agenda by ensuring that the knowledge and expertise that we have gained is used to as part of our responsibility to help manage the world’s water. However, we need to ensure that we continue to make progress and, in this paper, we will examine the quality of service that Scottish Water should provide to its customers and to society as a whole, along with the charges that customers should pay for these services.

Before any decisions are made I invite you to express your views through the series of engagement workshops planned for Summer 2012 or by writing directly to us.

Alex Neil MSP
PURPOSE OF ENGAGEMENT

The availability of wholesome drinking water and the safe disposal of wastewater are crucial to public health and a clean environment. In this paper we consider the investment needs and how customers should pay for the water and wastewater services provided in the period 2015-25.

This paper does not consider any of the issues covered by the Hydro Nation Agenda or the Water Resources (Scotland) Bill. This paper concentrates on the core water and sewerage services provided by Scottish Water to its customers.

This engagement paper:
- Invites customers and stakeholders to consider the key elements of the policy framework that Ministers propose for Scottish Water over the next two regulatory periods (2015-25);
- Considers and seeks views on which parts of the policy framework may need to be reviewed; and
- Invites stakeholders and customers to attend workshops in Summer 2012 to discuss the proposed framework and to give their views as to what changes they consider are required.

This paper is in four parts:

Part 1 provides a general overview of the policy framework including an explanation of the principles underpinning charges for water services and the process for determining future quality and service standards. It explains how the industry plans to engage with customers and stakeholders in the run-up to the start of the next five-year regulatory period.

Part 2 sets out Ministers’ key policy objectives for the next regulatory period.

Part 3 sets out the principles which govern how Scottish Water charges its customers for the services that it provides. It seeks views on these principles and identifies some that may need to be refined or amended.

Part 4 sets out the process for determining the quality and standards of services for the period 2015-25 (Q&SIV) and includes, for discussion, a draft set of investment objectives that have been developed by a project team led by the Government over the past year.

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1 Members of the project team include: the Scottish Government, Scottish Water, the Water Industry Commission for Scotland, the Drinking Water Quality Regulator, Scottish Environment Protection Agency and Consumer Focus Scotland.
ENGAGEMENT ARRANGEMENTS

The Government plans to host a number of workshops across Scotland in Summer 2012. These are open to all customers and stakeholders and will be designed to promote discussions around the policy framework set out in this paper.

If you would like to be involved, please complete the respondent form at Annex A. We will contact you with details and information about the events.

Following these workshops, a summary of the issues raised will be provided to attendees and published. This may identify areas where additional work is required and, if so, will clarify how stakeholders may participate in the discussions that then follow.

Information gathered from this process will be used to advise Ministers on the policy framework that should apply to Scottish Water over the 2015-25 period.

Should you be unable to attend a workshop but wish to register written comments on any elements of the framework, please complete the relevant sections of the respondent form at Annex A. The closing date for responses is 11 September 2012. We would welcome early responses.
PART 1 – GENERAL INTRODUCTION

This section sets out the high level policy framework for water and sewerage services in Scotland. The overall purpose of the policy framework is to ensure that the water and sewerage services provided by Scottish Water continue to improve and to be efficient, responsive public services that enhance our quality of life, support sustainable economic growth and provide value for money.

The policy framework for the Scottish water industry

The policy framework comprises three sets of Ministers’ policy objectives in relation to:

- The Strategic Review of Charges process (for example key dates, length of the regulatory period and availability of Government lending),
- The Principles that should underpin charges for water services; and
- The Quality and Standards of services to be delivered in the 2015-25 period.

How does the policy framework inform the Strategic Review of Charges?

The Strategic Review of Charges is the regulatory process run by the Water Industry Commission for Scotland – Scottish Water’s economic regulator - which determines the charges payable by Scottish Water’s customers. Each Strategic Review of Charges is initiated by a letter from Ministers to the Water Industry Commission for Scotland. This sets out the policy framework and timetable which guides the Water Industry Commission for Scotland and stakeholders during the Review. The letter commissioning the Strategic Review of Charges for the next regulatory period is appended at Annex B.

The Strategic Review of Charges for 2015-20 will be the fifth undertaken in the Scottish water industry. A timetable showing the key dates for the various stages is attached at Annex C.

Performance since 2002

Scotland is enjoying the real benefits that have been delivered to drinking water quality, the environment and customer service since Scottish Water’s creation in 2002. As a result of the Scottish Government’s focus on the need to improve the quality and standards of services, the determination to keep charges affordable and the commitment shown by the Scottish water industry, drinking water quality, environmental performance and levels of service are at their highest levels ever.

- Between 2002 and 2010 standards of service improved by 76%. As a result, service levels are now comparable to those in England and Wales.
Leakage measures implemented in the period 2006-10 have saved 400 million litres of water a day – enough to supply half of Scotland’s households every day.

Additional capacity has been provided to cater for all new developments.

Drinking Water Quality is at its highest level of compliance – In 2010, 99.83% of samples tested met the required standards.

Scotland’s environment has been improved – 264 unsatisfactory discharges were improved, 400 properties were connected to public sewerage and 42 Wastewater Treatment works were upgraded.

Further details on the improvements delivered in 2006-10 are available in a report “Investing in Scotland's water industry: Improvements delivered in 2006-10”.

The Water Industry Commission for Scotland has also reviewed Scottish Water’s performance. It has identified that robust quality and economic regulation together with Scottish Water’s determination to outperform the targets now means that:

- Over the eight years from 2002 to 2010, Scottish Water has generated around £1 billion of net savings in operational costs. Operational costs are now some 35% lower than they were in 2002 whilst, at the same time, substantial improvements in levels of service to customers have been delivered. (In the same period, operating costs have increased by 13% for the water industry in England and Wales).

- Over the eight years from 2002 to 2010, Scottish Water has delivered the required capital programme for £2 billion less than originally forecast; and

- Average household charges at £324 for 2012-13 are £52 less than the average in England and Wales and the lowest in Great Britain.

Looking to the future, it is important to build on these achievements and to ensure that the policy framework supports Scottish Water’s vision to be: “Scotland’s most valued and trusted business, one that we can all be proud of.”

Who does what?

Scottish Water is a public corporation, accountable to Scottish Ministers and through them to the Scottish Parliament, and is regulated by three independent regulators:

The Water Industry Commission for Scotland is the economic regulator and is responsible for determining customer charges necessary to deliver Ministers’ Objectives at the lowest overall reasonable cost.

The Drinking Water Quality Regulator is responsible for ensuring that Scottish Water supplies drinking water to customers that complies with drinking water quality regulations.

The Scottish Environment Protection Agency is responsible for ensuring that Scottish Water treats and then discharges wastewater in accordance with environmental legislation.
The standards and performance of water services in Scotland is also scrutinised by Consumer Focus Scotland and the Scottish Public Services Ombudsman.

Consumer Focus Scotland is responsible for representing customer views.

http://www.consumerfocus.org.uk/scotland/

The Scottish Public Services Ombudsman is the final stage for handling complaints about public services in Scotland.

http://www.spso.org.uk/

Scottish Water’s progress in delivering the improvements specified by Ministers is monitored by the Output Monitoring Group. This group was established by Ministers and brings together Scottish Water, its regulators, customer representatives and the Government. Its quarterly progress reports are published on the Scottish Government website


4 See: http://www.scotland.gov.uk/Topics/Business-Industry/waterindustryscot/publications/deliveryprogress
**Why engage now?**

In past regulatory periods, the Scottish Government has consulted early on ‘Investing in Water Services 2006-14’ and on ‘Paying for Water Services 2006-10’ to gather stakeholders’ initial views on priorities to inform the Strategic Review of Charges process. It wishes to continue with this approach for setting investment priorities and for paying for water services for the period 2015-25 to ensure that the policy framework takes full account of the views and concerns of customers and stakeholders.

In setting the timetable for the Review, as set out in Annex C, the Government will be mindful of the analyses of data gathered from previous regulatory periods and assessments made by the Water Industry Commission for Scotland on Scottish Water’s performance which have shown that the early definition of the key elements of the framework helps to maximise the efficiency of delivery of the investment programme. Early definition also ensures that Scottish Water can plan delivery so that peaks and troughs of investment are minimised.

Consistent with this approach, the Government wants to engage with customers and stakeholders on priorities for the period 2015-25 with a particular focus on the first five years. It wishes to invite them to workshops to discuss the policy framework. In particular to seek views on:

- **The Principles of Charging for water services** and to establish whether the items highlighted in Part 3 of this paper as those requiring further discussion are correct and to establish who should be involved in future discussions; and
- **Ministers’ Investment Objectives**, to establish that the broad proposals for the draft objectives as set out in Part 4 of this are appropriate. Views will also be sought on the manner in which the improvements to services should be prioritised.

**How will customers’ views be sought?**

The views of customers are necessary to inform Ministers’ decisions on the investment priorities for 2015-25 and the Principles that should underpin how customers are charged for water services provided. Views will be sought in four ways:

1. Stakeholder and customer workshops planned for Summer 2012.
2. Written responses to this paper.

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5 http://www.scotland.gov.uk/Topics/Business-Industry/waterindustry/scot/SWI/Q/EditMode/on/ForceUpdate/on
6 The WICS assessment of Scottish Water’s performance for the 2006-10 may be viewed at: http://www.watercommission.co.uk/view_Performance%20reports.aspx
3. The Customer Forum - this is an exciting innovation in the regulation of the Scottish water industry. The Customer Forum will seek to secure the most appropriate outcome for customers (as a whole) in the strategic review of charges and will provide appropriate and robust challenge to proposals made.

4. Scottish Water's research - Scottish Water has an ongoing programme of customer engagement which provides direct and valuable information on the services that it provides on a day to day basis to inform its strategy and business plans.

What is the Customer Forum?

A Customer Forum has been established by Scottish Water, the Water Industry Commission for Scotland and Consumer Focus Scotland consisting of 9 board members – one chair, three business representatives and five household sector representatives (thus representing the broad split of Scottish Water’s income).

The purpose of the Customer Forum is to promote and embed the customer interest within the Strategic Review of Charges process. It will have a formal role in facilitating effective customer engagement throughout the process. This is an innovative approach which will ensure that customers’ priorities and views are formally considered in the Strategic Review of Charges.
PART 2 – KEY POLICY OBJECTIVES

In setting key policy objectives for the water industry, the Scottish Government proposes to build on the experience gained in previous regulatory periods. Through the work of the Output Monitoring Group\(^7\), which monitors the delivery of each programme, a number of lessons have been learnt on the design, timing and other important elements that contribute to a successful water industry\(^8\).

In the light of this experience and in the context of the current economic climate, the Scottish Government proposes that the following key elements should underpin the policy framework:

**Length of the Regulatory and Planning Period**

The length of the Regulatory Period, the period for which customer charges are determined, is set by Scottish Ministers. Currently, it is five years in length. The length is set in the light of views from stakeholders on the balance between the need to support the efficient operation of a long-term industry and the uncertainties surrounding planning assumptions made some years into the future.

The industry has recently indicated that it would support the increase in length of each regulatory period to six years with investment objectives being set for two regulatory periods, or twelve years. Its main arguments in favour of this proposal are that this would:

- Enable better long-term planning for the industry and its supply chain; and
- Align the investment periods with the Water Framework and Flood Risk Management Directives which are major drivers for investment.

It is proposed that the investment proposals for the first regulatory period (whether five or six years in length) would be planned in greater detail than the second. The outline proposals for the second period would be consistent with Scottish Water’s 25 year strategic projections.

To ensure a rolling programme of investment, the investment proposals for the second regulatory period will be re-examined during the first regulatory period at which time the outline proposals for a further regulatory period will be considered.

**Charges for Customers**

Charges for all customers should ensure the sustainable funding of the water industry whilst remaining affordable and broadly stable.

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Size and Nature of the Investment Programme

Overall, investment priorities must support the Scottish Government's core purpose of creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth. In particular the investment programme should be:

- Developed such that the industry’s capacity for investment is recognised and efficiency of delivery is optimised. Evidence from the delivery of previous investment programmes and independent research suggests that the programme should be limited to no more than £500m (at 2007-08 prices) per year.

- Programmed in a manner so as to avoid excessive peaks and troughs in investment. Subject to the agreement of regulators, this should include the early start and/or late finish to the 2015-20 programme.

Government Financing

Scottish Water is financed from customer charges and borrowing from Government. For planning purposes it should be assumed that borrowing by Scottish Water will be at a lower level to that available in the 2010-15 period.

Submitting your Views

Customers and stakeholders are invited to submit views, in writing or at the workshops on the appropriate length of the next regulatory period.
PART 3 – PRINCIPLES OF CHARGING

The charges that customers must pay are directly linked to the finance required to sustain Scottish Water’s operations and to deliver improvements to services. The level of charges is determined through the Strategic Review process undertaken by the Water Industry Commission for Scotland. The manner in which charges are calculated for individual customers is governed by a set of principles issued by Ministers which are known as the Principles of Charging Statement.

Views and comments from customers and stakeholders are sought on all aspects of the principles to ensure that these are appropriate and respond to the needs of customers, whilst ensuring that Scottish Water is funded properly for the services provided.

How are customers billed currently for the water services that they receive?

Households - Water and sewerage charges for households are currently collected by Local Authorities together with Council Tax. The Scottish Government considers that these arrangements are currently the most effective and efficient way to collect these charges. Charges are calculated on the basis of Council Tax Band. This means that householders in Council Tax Band H pay three times the amount paid by householders in Band A for their water and wastewater services. Specific discounts levied on Council Tax – such as the single occupant discount – are also applied, automatically, to water and sewerage charges. Council tax discounts for second homes or empty properties are not applied to water charges.

Businesses and other non-domestic properties – Most non-domestic customers are billed for water and sewerage services by reference to a meter. Surface drainage - that is the rain water collected from individual properties and a contribution to the costs of draining roads - is charged by reference to the rateable value of the premises. Licensed retail suppliers are responsible for the billing and collection of these charges.

In a Strategic Review of charges, the wholesale charges for services are set - that is the amount that it is necessary for Scottish Water, as provider of the services, to recover from the non-domestic sector. All retailers charge an additional margin to cover the costs of providing the retail service. It is possible for customers to negotiate tailored deals with their licensed retail supplier that reflect the nature and operation of their business - for example one bill for a business with multiple sites. Further information on choosing a supplier is available at http://www.scotlandontap.gov.uk/.
Principles of Charging in place for 2010-15

The Principles of Charges Statement\textsuperscript{9} for the current regulatory period (2010-15) is designed to ensure that customers pay for the services received whilst ensuring that charges remain affordable, particularly for vulnerable households. The statement was developed following a public consultation in 2008. In summary, it specifies that charges should be:

- Affordable – charges must be affordable, stable and not rise by more than the rate of inflation.
- Fully cost recoverable – charges should recover the costs to Scottish Water of running the service (i.e. there should be no Government subsidy);
- Cost reflective - charges should be broadly cost reflective such that charges for a given service to particular customer groups should be set to recover the cost to Scottish Water of providing that service to that group as a whole. The statement also identifies exceptions to this principle which are:
  - Geographic harmonisation – charges are the same irrespective of location in Scotland;
  - Household charges – these are calculated according to Council Tax band with discounts applicable for Council Tax (for example single person discount) being applied where appropriate. In addition those households on Council Tax Benefit, not in receipt of another discount, receive a reduction of up to 25%.
  - An Exemption Scheme for small voluntary organisations.

The statement also gives details on how customers should pay for roads drainage and new connections, as well as the costs of the Water Industry Commission for Scotland and Waterwatch Scotland (the latter’s functions have now been transferred to Consumer Focus Scotland and the Scottish Public Service Ombudsman).

Addressing issues of Affordability

The Scottish Government recognises that water and sewerage services are essential to every household in Scotland and that it is important that these services not only meet the expectations of customers but also remain affordable. To date issues of affordability have been tackled through geographical harmonisation, linking households charges to Council Tax bands and the availability of discounts and exemptions for specific categories of customers. Household charges are determined by council tax band and discounts are applied to families on council tax benefit - there is no equivalent discount in England and Wales. Combined with the average household charge being fourteen percent lower in Scotland, Ministers consider this ensures some of the most affordable water charges for low income families in Great Britain.

\textsuperscript{9} \url{http://www.scotland.gov.uk/Resource/Doc/917/0088612.pdf}
Going forward it will be necessary to understand whether the current measures to address affordability are broadly correct, bearing in mind that the cost of these is borne by the generality of household customers.

**Setting the Principles of Charging for 2015-20.**

Discussions and correspondence with customers and stakeholders to date would suggest that the current Principles of Charging remain broadly appropriate for the next regulatory period. However, they have identified that the details of some of the principles and other aspects of charging policy require amendment to bring them up to date or to make them more responsive to the needs of the sector.

- **The Exemption Scheme for small voluntary organisations** – the Scottish Government is committed to retaining a scheme which supports small charitable organisations with the payment of water and sewerage charges. However, it considers that aspects of the scheme require to be updated. Ministers have therefore requested that Scottish Water review the scheme, consulting with relevant stakeholders, and make recommendations as to how it can be improved within its current financial envelope. The Scottish Government has requested that this review should be completed in 2012.

- **Charging for vacant properties** – the Scottish Government is aware that the policy regarding the charging for empty properties across the household and business sectors is inconsistent. At present, owners of empty household properties are charged for water and sewerage services whereas those of empty business properties are not. The Scottish Government wishes to explore with stakeholders how charging policy should be modified so that charges for both sectors are consistent with the cost recovery principle and recognise that Scottish Water continues to incur costs associated with the maintenance of the pipe network and the drainage of roofs, car parks etc.

- **Surface drainage charging arrangements for non-domestic customers** – In the 2010-15 Principles of Charging statement Ministers announced that they had decided to defer the introduction of charging for surface drainage by reference to surface area during the current difficult economic times. They required Scottish Water to continue to develop the detail of the surface drainage charge so that the likely impact of the change can be illustrated to stakeholders and that the Commission should then consult retailers and their customers on the most appropriate way forward.
Submitting your Views

Customers and stakeholders are invited to submit views, in writing or at the workshops on whether the current Principles of Charging remain appropriate for the next regulatory period. They will also be invited to indicate whether the specific issues identified above require further discussions and, if so, who should be involved in those discussions.
PART 4 – DETERMINING THE INVESTMENT REQUIREMENTS

Scottish Ministers are required to set the investment objectives for the water industry in Scotland. It is important that these fully support the Government’s five objectives\(^\text{10}\) that underpin its core purpose - to create a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.

In previous regulatory periods, the investment objectives have been issued in draft early in the Strategic Review of Charges process and confirmed, in the form of Directions to Scottish Water, in the light of cost information and consultations with stakeholders and customers.

Views and comments from customers and stakeholders are sought on all aspects of the investment priorities to ensure that these are appropriate, respond to the needs of customers and improve Scotland’s environment. In this part of the paper, we are seeking your views on the draft investment Objectives for 2015-25 and the key components of the investment programme.

Draft Objectives for 2015-25

Over the past year the Government has, together with Scottish Water, the regulators and customer representatives, worked to formulate a draft set of Ministerial Objectives for the period 2015-25. These are attached at Annex D and have been developed based on progress made to date, studies undertaken in the current regulatory period and known legislative requirements.

The draft Ministerial Objectives support the delivery of the Government’s objectives and Scottish Water’s vision to be: “Scotland’s most valued and trusted business, one that we can all be proud of.”

These focus on the need to:
1. Maintain the current asset base and deliver the standards of service expected by customers;
2. Support sustainable economic growth by providing additional capacity;
3. Protect the public’s health by improving the resilience to risks identified in the Drinking Water Safety Plans;
4. Deliver a Greener Scotland by delivering statutory requirements to improve Scotland’s environment, and.
5. Adapt to a changing climate whilst supporting the Government’s 42% carbon reduction target for 2020.

Key components of the investment programme

**Customer Service Standards** - are monitored by the Water Industry Commission for Scotland through the ‘overall performance assessment’ which encompasses aspects of service that are most

\(^{10}\) [http://www.scotland.gov.uk/About/purposestratobjs](http://www.scotland.gov.uk/About/purposestratobjs)
important to customers. To maintain service standards at current levels, Scottish Water will need to maintain its assets. Nearly half of the annual investment of £500m will need to be spent every year in this manner.

During the current regulatory period Scottish Water is required to improve standards of service such that they are comparable with the upper quartile performance achieved by the industry in England and Wales in 2007-08. Currently, Scottish Water is spending some £10m per year to deliver these improvements. Going forward it will be necessary to understand how services should improve to meet the needs and expectations of customers. Views from customers will be sought specifically on this via the work of the Customer Forum.

**Additional capacity** – is required to ensure that new developments can be connected to the public water and wastewater networks. Providing additional capacity currently costs some £40m per year.

**Drinking water quality** – significant investment has been made to improve drinking water quality over the past ten years. Whilst this has delivered year on year improvements, there remain challenges, and investment needs, to ensure that existing facilities and networks are resilient and continue to deliver consistently high quality drinking water. In the current regulatory period (2010-15), some £60m is being spent on improving drinking water quality per year.

**Environment** – significant investment has been delivered over the last 10 years to protect or improve the environment and to comply with a number of European Directives. In the current regulatory period 2010-15 more than £110m per year is being spent on this priority.

The River Basin Management Plans\(^\text{11}\) produced under the Water Framework Directive have identified that more investment is required to improve discharges and abstractions impacting on rivers, coasts and lochs which do not achieve good ecological status. Further investment may also be required in the light of new designations or tightening standards in order to protect the quality of bathing and shellfish waters.

**Climate Change Mitigation.** Electricity is necessary to deliver the high levels of treatment at water and wastewater treatment works and also to pump water and wastewater to and from customers’ properties. By 2015 Scottish Water plans to self-generate some 10% of its requirements through wind and hydro power. Further investment may be required to increase Scottish Water’s renewable generation capacity and support Scotland’s target of reducing carbon by 42% by 2020.

**Climate Change Adaptation and Flooding** - changing weather patterns mean greater extremes in weather events which will have

\(^{11}\) [http://www.sepa.org.uk/water/river_basin_planning.aspx](http://www.sepa.org.uk/water/river_basin_planning.aspx)
implications for both the quality of the raw water needed for drinking water supplies and for Scotland’s drainage systems. Joint studies with Local Authorities are already underway in urban areas which have been identified by SEPA as at a high risk of flooding. These studies are likely to identify the need for investment both for Scottish Water and Local Authorities. These measures will be included in the Flood Risk Management Plans which are due to be published in 2015.

Material Considerations

In developing the Draft Objectives, a number of issues have come to light upon which further consideration will be necessary. You are invited to submit your views in writing or at the workshops. These issues include:

**Prioritisation** - It is clear from the work done so far that the requirements identified for the next regulatory period are likely to exceed the financing available. In order to secure an affordable and manageable investment programme that can be delivered efficiently by Scottish Water, it will be necessary to consider:

- The priorities associated with various elements of the investment programme; and
- For those elements that are not driven by a legal obligation – for example customer service measures – the extent to which customers are willing to pay for them.

**Innovation** – The requirement for Scottish Water to deliver services with increasing efficiency and with a lower carbon footprint means that it needs to innovate. Traditionally the water industry has “built” its way out of difficult problems. A changing climate and limited resources mean this is no longer an option. As well as promoting the use of new technologies to deliver current services, more sustainable strategies need to be considered. Examples of areas in which innovation is already known to be possible include:

- Managing catchments so that pollution in raw drinking water is reduced rather than removing pollutants in expensive treatment processes at water treatment works;
- Removing pollutants from products at source, for example phosphates in detergents, rather than removing them at wastewater treatment works;
- Encouraging customers to reduce water demand and sewage litter; and
- Generating electricity from waste.

It will be necessary to consider how the policy framework can assist Scottish Water to adopt more innovative and sustainable approaches whilst understanding that these approaches may entail greater risks of service failure or deliver improvements over longer timescales than conventional approaches.
Submitting your Views

Customers and stakeholders are invited to submit views, in writing or at the workshops, on the issues outlined in this part of the paper. Views on whether there are any areas of improvements that have been omitted and on how the improvements should be prioritised are sought. In the light of the need to achieve improvements to services whilst reducing the use of carbon, customers and stakeholders are asked to consider the risks to service delivery, particularly where innovative approaches are adopted. At the workshops, you will also be invited to indicate whether the issues identified above require further discussions and, if so, who should be involved in those discussions.

SUMMARY AND NEXT STEPS

This paper has set out, and seeks views on, the key elements that make up the Government's policy framework in relation to Scottish Water for the next ten years. In addition, it has identified some specific aspects of the charging framework that require further consideration and has offered, for discussion in the form of Draft Objectives, an initial view on the improvements which will be required to services.

The Scottish Government is committed to ensuring that Scottish Water continues to provide the services that customers require and for which they are prepared to pay. The participation of customers and stakeholders in this engagement process is essential to ensuring this outcome. We look forward to meeting as many of you as possible at the workshops.
ANNEX A

Respondent form

INVESTING IN AND PAYING FOR YOUR WATER SERVICES FROM 2015: AN INVITATION TO ENGAGE WITH THE GOVERNMENT AND TO PROVIDE YOUR VIEWS

RESPONDENT INFORMATION FORM
Please Note this form must be returned to ensure that we handle your response appropriately.

Please ensure your response is received by 17 July 2012 if you wish to attend a workshop. If you are providing a written response this must be received by 11 September 2012. We would welcome early responses.

Responses should be sent to:

- By email to: waterindustryengagement@scotland.gsi.gov.uk
- Or by post to
  Investing in and Paying for Water Services from 2015
  Water Industry Team
  Scottish Government
  Area 1-H (North)
  Victoria Quay
  EDINBURGH
  EH6 6QQ

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3. Method of Response

I would like to attend a workshop  Yes ☐ No ☐
(workshops are likely to be held in August/September 2012)

I am providing a written response Yes ☐ No ☐
(Please see 5. Written Response – a written response may be provided instead of or in addition to attending a workshop)

4 Areas of Interest

I am interested in the following areas relating to water services:

- Key Policy Objectives ☐
- Principles of Charging ☐
- Determining the Investment Priorities ☐
- Other ☐ please specify .................................................................

5. Written Responses – Permissions

If you are providing a written response please complete the following section.

I am responding as...

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(a) Do you agree to your response being made available to the public (in Scottish Government library and/or on the Scottish Government web site)?

Please tick as appropriate ☐ Yes ☐ No

(b) Where confidentiality is not requested, we will make your responses available to the public on the following basis

Please tick ONE of the following boxes

☐ Yes, make my response, name and address all available
☐ Yes, make my response available, but not my name and address
☐ Yes, make my response and name available, but not my address

(c) The name and address of your organisation will be made available to the public (in the Scottish Government library and/or on the Scottish Government web site).

Are you content for your response to be made available?

Please tick as appropriate ☐ Yes ☐ No

(d) We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Please tick as appropriate ☐ Yes ☐ No
5. Written Responses – Questions

Key Policy Objectives

1) Do the key policy objectives provide a sound basis upon which to plan the delivery of services from 2015?

Yes □ No □

Comments

2) Do you agree that it would be beneficial to extend the regulatory period to six-years?

Yes □ No □

Comments

Principles of Charging

3) Do you agree that the current Principles of Charging remain broadly appropriate for the next regulatory period?

Yes □ No □

Comments

4) Do the specific issues identified (exemption scheme, charging for vacant properties, surface drainage charging) require further discussion and, if so, who should be involved in those discussions?

Yes □ No □

Comments

Investment Requirements

5) Do the Draft Investment Objectives included at Annex D of this paper identify all necessary improvements?

Yes □ No □

Comments
6) Do the specific issues identified (prioritisation of investment, promoting innovation) require further discussions and, if so, who should be involved in those discussions?

Yes [ ] No [ ]

Comments

**Other**

7) Please include any other comments you wish to make on paying for and investing in water services from 2015 below.

Comments
13 June 2012

Dear Gordon

STRATEGIC REVIEW OF WATER CHARGES: 2015-20

I am writing to inform you of the broad arrangements that the Government wishes to be followed in the next Strategic Review of Water Charges (SRC). The Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, places duties on both the Scottish Ministers (Ministers) and the Water Industry Commission (the Commission). In particular it requires Ministers to specify the time period for the SRC and the date by which a Determination must be made.

In agreeing these arrangements Ministers wish to build on those put in place successfully for previous regulatory periods. In particular, they note the importance of a defined investment programme ahead of the start of any regulatory period which is essential to maximise efficient delivery and that sufficient time is required for the planning of such a programme.

Ministers acknowledge the benefits of planning over a longer timeframe than a single regulatory period as this provides certainty for the industry and customers as well as the supply chain. They fully endorse the Commission’s intention to require Scottish Water to prepare a 25 year strategic vision and request each five year investment plan is developed in a manner so as to support that vision.

Ministers commend the substantial improvements in efficiency made by Scottish Water over recent years and acknowledge that these have been made possible by robust comparison with the performance already achieved by water companies south of the border. Ministers accept that the Commission can no longer rely entirely on these comparisons and that the economic regulatory regime in Scotland must continue to evolve.

In evolving the regulatory mechanisms to keep Scottish Water at the forefront of efficiency levels and enable it to meet the challenges of the future, Ministers request that there is greater engagement with customers on the choices on levels of service improvement. They also request that the Commission specifically consider ways in which to facilitate much
greater innovation within the industry to meet, for example, future challenges on sustainability and climate change.

**SRC 2015-20: Ministerial Specifications**

The following sets out the specific requirements Ministers wish to be met in the next Strategic Review of Charges (SRC).

**Time period and date of publication for the Determination:**

The Commission is to undertake a Strategic Review of Charges for the five-year period 2015 to 2020, consistent with the planning horizon used in the Quality and Standards 4 process. It shall also consider the implications and advantages of moving to a six-year period as recently proposed by the Commission and Scottish Water. The Final Determination of Charges should be published by the end of November 2014. All future references to the five regulatory period in this letter should also reflect the possibility of moving to a six year period.

**Principles of Charging:**

Ministers’ policy is for charge caps that are affordable and broadly stable. This policy will underpin their Principles of Charging for the next regulatory period. Ministers will confirm the principles of charges to be applied by way of a public statement in 2014 following appropriate engagement.

**Statement of Objectives:**

Ministers will finalise their objectives in September 2014.

Ministers agree in principle with the draft Objectives attached at Annex B. They expect the Q&S4 Project Management Team and with advice from the Output Monitoring Group to engage on the draft investment objectives for 2015-20 and outline objectives for 2020-25 in summer 2012. Thereafter they expect Scottish Water and regulators to develop detailed investment plans. The details of a planning framework within which Ministers expect this to be undertaken are set out at Annex A.

Ministers recognise that the majority of the investment programme, and therefore their objectives, will be driven by statutory obligations in relation to drinking water quality and the environment. However, in calculating the funding necessary to deliver the draft objectives, it is important that full account is taken of both customers’ and Government’s priorities. It will be necessary to demonstrate how these objectives will contribute to the Government's purpose of increasing sustainable economic growth and, in particular, to Scotland's climate change targets.

Ministers note that in the 2010-15 regulatory period, the Final Determination provided for £180m to be allocated during the period to finance outputs that would be defined as a consequence of studies. In principle, Ministers are supportive of such a mechanism. However, they request that an analysis is undertaken of the effectiveness of this approach in the 2010-15 period.
Timetable

In agreeing the timetable for the SRC, Ministers ask that all parties ensure that, in keeping with good practice, sufficient time is made available to ensure appropriate consultation with the wider stakeholder group and for the Government’s own public engagement.

I look forward to receiving regular reports on the progress of the strategic review.

I am copying this letter to the Chair of Scottish Water, the Chair of Scottish Environment Protection Agency, the Drinking Water Quality Regulator for Scotland, the Chair of Consumer Focus Scotland and the Chair of the Competition Commission.

BOB IRVINE
Framework for Developing Investment Plans for Q&S4

Ministers need to be advised by the Q&S4 Project Management Team on their options and risks on investment needs going forward. The following framework is intended to help guide the work of all groups contributing to that process. Ministers will also look to the outcomes of the Scottish Water customer research and willingness to pay surveys, the evidence from the wider Scottish Water Customer Engagement and the Customer Forum’s considerations of the evidence to identify customer’s priorities for investment and to understand the standards of service expected.

Context and Process for Confirming Ministerial Objectives for Q&S4

The National Performance Framework underpins delivery of the Scottish Government's agenda which supports the outcomes-based approach to performance. At the heart of this framework is the Government's Purpose:

To focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.

In setting their priorities for investment, Ministers will wish to ensure that these are aligned with the Government’s Purpose and five underpinning Strategic Objectives. In particular:

- **Size of Investment Programme** – should be planned to be between £450m and £500m per annum.

- **Planning Period** - should be planned for ten years to be delivered over two five year regulatory periods (2015-2020 and 2020-2025). Plans should also reflect the possibility of moving to a six-year period. The length of the regulatory period will be confirmed in the light of comments received from the engagement on the plans for the next regulatory period.

- **Government lending** – in the light of the consultation on the Principles of Charging for 2015-2020, Ministers will confirm the amount that government is able to lend over that 5 year period. It should be assumed that less Government lending will be available than for the period 2010-15.

- **Promoting more sustainable outcomes** - Scottish Water is vital to a sustainable Scotland. Scottish Water will continue to act in accordance with the principles of sustainable development and to work to maximise the benefit to the environment, economy & society in the delivery of its services. Scottish Water will take appropriate and cost effective steps to reduce the overall energy demands of its services, to become more energy efficient and to deliver more renewable power for the benefit of Scotland. Where possible, operational approaches should be sought and implemented wherever it is more economic to do so.

- **Delivering more efficient and effective outcomes** – the industry is reaping the rewards of allowing time for comprehensive studies of investment needs to be done ahead of decisions being taken. Ministers endorse this approach.
• **Customer involvement** - Ministers support the aspiration to increase and improve customer involvement in the setting of investment priorities to deliver the levels and quality of service they deserve for the charges they pay. They expect Scottish Water and its regulators to assist fully in the work of the Customer Forum.

• **Setting the Outputs of the Investment Programme** - Ministers Objectives will specify the outcomes they expect SW to achieve. It is for the quality regulators and customer representatives, in consultation with SW, to define the outputs required to deliver these outcomes and to do so in the timeframes set out by the Water Industry Commission for Scotland.
Timetable

<table>
<thead>
<tr>
<th>Milestone</th>
<th>Date</th>
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<tbody>
<tr>
<td>Ministers issue letter to Water Industry Commission for Scotland setting</td>
<td>13 June 2012</td>
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<tr>
<td>out policy framework for the next regulatory period</td>
<td></td>
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<tr>
<td>Engagement paper and Draft Ministerial Objectives published</td>
<td>19 June 2012</td>
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<tr>
<td>Workshops on Investment Priorities and Principles of Charging held –</td>
<td>July &amp; August 2012</td>
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<td>dates and venues to be confirmed to interested parties</td>
<td></td>
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<tr>
<td>End of Engagement period</td>
<td>11 September 2012</td>
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<tr>
<td>Summary of responses from engagement published</td>
<td>October 2012</td>
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<tr>
<td>Issues identified in engagement taken forward with stakeholders</td>
<td>October 2012 to June 2013</td>
</tr>
<tr>
<td>Scottish Water publishes its 25 Year Strategic Projections</td>
<td>October 2013</td>
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<tr>
<td>Water Industry Commission for Scotland publishes the Draft Determination</td>
<td>June 2014</td>
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<td>of Charges</td>
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<tr>
<td>Ministers publish the Final Investment Objectives for the next</td>
<td>September 2014</td>
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<tr>
<td>regulatory period</td>
<td></td>
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<tr>
<td>Water Industry Commission for Scotland publishes the Final Determination</td>
<td>November 2014</td>
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<tr>
<td>of Charges</td>
<td></td>
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<tr>
<td>New regulatory period begins</td>
<td>1 April 2015</td>
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WATER INDUSTRY

DRAFT OBJECTIVES FOR THE PERIOD 1 APRIL 2015-31 MARCH 2025

The overall purpose of these Objectives is to ensure that the focus of water and sewerage services is on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.

1. A Wealthier and Fairer Scotland
To deliver better and more efficient public services that enhance our quality of life, support sustainable economic growth and assure those that fund and rely on them that their public services are responsive, provide value for money and are continually improving, Scottish Water shall in respect of:

1.1 ASSET MAINTENANCE

Ensure that assets are maintained so that there is no overall deterioration in performance from that required to be achieved by 31 March 2015.¹

1.2 SERVICE STANDARDS OBJECTIVES

Build on the improvements made to date and continue to improve services to customers including those measures² agreed with the Customer Forum.

² Measures include internal sewer flooding, interruptions to supply, malodour, external sewer flooding, drinking water discolouration, taste and odour of drinking water supplies, customer satisfaction etc
1.3 STRATEGIC CAPACITY FOR NEW DEVELOPMENT OBJECTIVES-

(a) Identify and make provision to service demand for new ‘strategic’ capacity to meet all new housing development and the domestic requirements of commercial and industrial customers for the period 1 April 2015 to 31 March 2025. In doing so, Scottish Water shall take account of extant development plans and their associated action programmes, the General Register Office for Scotland’s population projections\(^3\) and the SEPA/Scottish Water Memorandum of Understanding on the Impact of Proposed Development on the Public System.\(^4\)

(b) Prioritise the delivery of that part of the investment specified under 1.3(a) in accordance with:

- the spatial priorities identified in the National Planning Framework,
- development priorities identified by local authorities in their Structure Plans/Strategic Development Plans; and
- associated action programmes and Local Plans/ Local Development Plans and Local Housing Strategies.

In addition, so as to minimise the likelihood of redundant assets, Scottish Water shall act in a manner so as to ensure that such ‘strategic assets’ are delivered in support of committed development. This shall be ascertained in accordance with the developer confirming, as a minimum, the following:

(i) Land ownership or control;
(ii) The development is supported by the local plan and/or has full planning permission;
(iii) The time remaining on the current planning permission;
(iv) That plans are in place to mitigate any network constraints that will be created by the development through a minute of agreement with Scottish Water; and
(v) Reasonable proposals in terms of annual build rate within the approved development.

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3 Projected Population of Scotland (2008-based), published by GROS 21\(^{st}\) October 2009
1.4 EFFICIENT PUBLIC SERVICES

To support a Wealthier and Fairer Scotland, Scottish Water is required to identify and deliver longer term investments which will reduce the future costs of service delivery. In particular, Scottish Water shall work with other stakeholders to identify and pursue opportunities available to achieve more innovative and sustainable means of delivering services.
2. **A Healthier Scotland**

To support the delivery of the Scottish Government’s Healthier strategic objective, Scottish Water shall contribute to improvements that help people to sustain and improve their health. In particular, it shall in respect of:

2.1 **DRINKING WATER QUALITY**

Reduce the risk of non compliance with the Drinking Water Directive 98/83/EC, the Water Supply (Water Quality)(Scotland) Regulations 2001 and the Cryptosporidium (Scottish Water) Directions 2003\(^5\), by improving the resilience to risks as identified in its Drinking Water Safety Plans;

2.2 **SECURITY OF SUPPLY**

(a) Provide an appropriate level of physical security to Security Service standards agreed with the Scottish Government and the Drinking Water Quality Regulator;

(b) Provide the necessary improvements to provide a level of service in water supply zones, to be agreed with the Drinking Water Quality Regulator, such that these zones are adequately protected against the risk of water shortages; and

(c) Maintain a sufficient supply of water in all water supply zones that reflects the most cost effective operating regime, and takes account of the opportunities for demand management including leakage control and water efficiency measures.

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\(^5\) These Directions are currently under review.
3. **A Greener Scotland**

To support the delivery of the Scottish Government’s Greener strategic objective, Scottish Water shall contribute to improvements to Scotland’s natural and built environment and the sustainable use and enjoyment of it. In particular it shall as regards:

3.1 **ENVIRONMENTAL WATER QUALITY**

(a) Support compliance with the Water Framework, Marine Strategy Framework and Urban Wastewater Treatment Directives:

(i) reduce the impact of its discharges, abstractions and impoundments so as to contribute to the achievement of the environmental objectives for water bodies and protected areas in line with the measures identified in the River Basin Management Plans.

(ii) undertake strategic studies to understand future investment requirements for discharges and abstractions identified as potentially contributing to the failure of environmental water quality objectives in line with the requirements of the River Basin Management Plans.

(iii) work with SEPA and licensed providers to undertake catchment management and customer education to reduce the impact of Priority Substances being disposed of via the sewer and drainage system. In addition it shall undertake research which may assist in identifying the effective treatment of substances that catchment management may not be successful in reducing to acceptable levels.

(iv) improve intermittent discharges identified through modelling and agreed with SEPA as downgrading the aesthetic or environmental condition of water bodies to support compliance with the Urban Wastewater Treatment Directive.

(v) in partnership with other stakeholders, SW shall take steps to reduce the impact of its discharges on sewage-related litter in the marine environment.

(b) Support the improvement of the water environment by providing first time provision of sewerage where there is a net environmental or public health benefit, and there is community willingness to connect and the scheme is cost effective, as agreed with SEPA.

3.2 **NATURE**

Support the achievement of the Scottish Government targets for the proportion of natural features in favourable condition, work with Scottish Natural Heritage to identify and undertake management activities at identified sites that will contribute to achievement of the National Indicator ‘Increase to 95% the proportion of protected nature sites in favourable condition’.

3.3 **WASTE**

Manage the environmental risk associated with sludge historically stored at wastewater and water treatment sites as agreed with SEPA.
3.4 CLIMATE CHANGE ADAPTATION

Improve Scotland’s resilience to climate change by continuing to invest in modelling the likely impact of climate change on its assets, and where appropriate, investing to manage risks arising from climate change impacts.

3.5 CLIMATE CHANGE MITIGATION

Contribute towards Scotland meeting its climate change obligations of achieving greenhouse gas emissions reductions in Scotland of 42 per cent by 2020 and by 80 per cent by 2050, by taking all necessary steps to fulfil its duties and obligations required of it as set out in the Climate Change (Scotland) Act 2009. In particular Scottish Water shall:

(a) work with relevant stakeholders to assess, pilot, and where appropriate, implement measures needed over the 2015-2025 period to reduce its direct greenhouse gas emissions and energy usage;

(b) ensure that all investments made as a consequence of these Directions take into account the associated carbon impact; and

(c) invest to reduce its demand for Scotland’s resources (water and electricity from the national grid) where it is cost effective to do so.
4. **A Safer and Stronger Scotland**

To support the Scottish Government’s Safer and Stronger strategic objective, Scottish Water will assist local communities to flourish, becoming stronger, safer places to live, offering improved opportunities and a better quality of life. In particular it shall as regards:

4.1 **FLOOD MANAGEMENT**

Take all necessary steps to fulfil its duties and obligations required for the period 2015-2025 as set out in the Flood Risk Management Act. In particular, Scottish Water shall:

(a) Assess flood risk from sewerage systems and update the latest assessment as required.

(b) Through its participation in the Metropolitan Glasgow Strategic Drainage Partnership and working collaboratively with their partners continue to deliver its agreed share of the improvements that will reduce the risk of flooding in Greater Glasgow;

(c) In partnership with responsible authorities, undertake studies to inform investment requirements in future regulatory periods as agreed with the Scottish Advisory and Implementation Forum for Flooding (SAIFF); and

(d) In partnership with responsible Authorities, commence its agreed share of the investment requirements arising from the flood studies as agreed with the Scottish Advisory and Implementation Forum for Flooding (SAIFF);

(e) Take action to protect its own assets where they lie within an area vulnerable to flooding.