

## **PRINCIPLES OF CHARGING FOR WATER SERVICES 2010-2014 – DRAFT STATEMENT**

The following charging principles are those that Scottish Ministers expect the Water Industry Commission for Scotland (“the Commission”) to apply during 2010-14. These are set under section 29D of the Water Industry (Scotland) Act 2002 and will guide the Commission when determining the charge limits that Scottish Water (“SW”) is able to set during 2010-14.

### *Stable charges*

1. Ministers recognise the importance that customers attach to stability and certainty in charging. The publication of charge limits at the conclusion of this Strategic Review of Charges will give customers certainty about the level of charges they will face over the regulatory period.
2. Ministers’ policy is for charge caps that are affordable, stable and do not rise by more than inflation across the period. Ministers require the Commission to determine charges at levels which will secure the efficient delivery of an investment programme of no more than the size set out in paragraph 12 below. In doing so, the Commission should take account of the need to achieve continuity of investment, and the level of lending that the Government is prepared to make available to Scottish Water as set out in para 14 below. Ministers invite the Commission to advise them if this requirement is inconsistent with charges that do not rise by more than inflation across the period.
3. Ministers have specified their Objectives in terms of 2 priorities. Their expectation is that the charges set will be sufficient to finance the efficient delivery, as a minimum, all of the Priority 1 Objectives. Ministers will confirm the Priority 2 Objectives that are to be delivered once the Commission publishes its draft determination of charges in June 2009. Ministers invite the Commission to advise them if it does not consider that all the Priority 1 objectives can be financed within the parameters set at paragraph 2.

### *Full cost recovery*

4. Charges should cover the full costs of providing services to customers. Public expenditure support to SW will take the form solely of lending from Ministers. In addition, customers will only be asked to meet additional costs beyond those allowed for in a charges determination, where these arise as the result of external factors beyond the influence of SW. This arrangement protects the position of customers and ensures that they do not pay twice for the same service or compensate SW for inefficiency or poor management.

### *Cost-reflective charges*

5. Charges in general should be broadly cost-reflective - i.e. charges for given services to particular customer groups should be set to recover the cost to SW nationally of providing that service to that group as a whole. The

principle of affordable charges for low income households should be an exception to this.

#### *Phasing of increases*

6. Ministers recognise that achieving stable charges in real terms could mean that some charges for individual customers will rise above inflation and others will fall. In particular this could arise in those circumstances where some tariff rebalancing is justified i.e. to correct any historic under charging where the cost to serve has been found to be greater than present charge levels.

7. Ministers wish to ensure steady progress to be maintained in removing cross subsidies from the charging framework.

8. Where charge increases are expected for individual customers as a result of any such rebalancing, Ministers' general expectation is that the Commission will do so over the review period. However, they invite the Commission where they identify disproportionate impacts on customers, in light of the wider circumstances they face, to consider whether it would be appropriate to extend any transition period to cover two full regulatory periods - i.e. to 2019.

9. While Ministers fully support the move to cost-reflective charging they recognise that the implications of the unwinding of cross subsidies may be significant for individual business customers or sectors. Ministers will study closely the evidence that emerges from the pricing review as it progresses so that if there is a disproportionate impact on the continuing competitiveness of particular sectors, they can consider what other actions outside the price review may be taken to address this.

10. Through the determination process, Ministers request that the Commission consult with SW, licensed providers and customers on the best approach to unwinding the identified cross-subsidies - recognising that the benefits to some businesses of cross-subsidies are paid for by other businesses and public sector organisations. The consultation should identify clearly the extent of the likely increase for different classes of customer.

#### *Harmonised charges*

11. A fundamental tenet of Ministers' policy regarding charges is that customers in the same group should pay at the same rate for the provision of the same service, regardless of their location, or of the actual cost of serving one such customer as against another. Section 29D (2) of the 2002 Act enshrines this principle in statute by requiring Ministers to set policy regarding charges that secures that outcome. Consequently, Ministers confirm that charges for all of SW's core services in the period must be recovered from customers on the basis of all tariffs being set at a nationally averaged rate for Scotland as a whole. This means that charges for services to particular

customer groups should be set to recover the cost to SW nationally of providing that service to that group as a whole.

#### *Financing and capital expenditure*

12. Ministers believe that it is important that the capital investment programme for the 2010-14 period is no larger than can be delivered efficiently, and following the research published by the Commission, propose that the maximum level should be £2bn over the 2010-14 period – i.e. £500m (in 07/08 prices) per year on average. Ministers request that the Commission advise them if it considers that the size of the capital programme is likely to exceed this amount.

13. The Government will not take a dividend from its ownership of SW and financial outperformance should be used to build up a financial reserve. It considers that SW's financial strength should be appropriate to the governance framework within which it operates.

14. The Government will continue to make finance available through lending to Scottish Water in the 2010-14 period in support of its investment programme. The Government wishes to ensure that this lending is at the lowest practicable level consistent with the principle of stable charges. In considering this the Commission should take into account Ministers' expectation that their lending to Scottish Water will be less than £150m per annum for the 2010-14 period.

#### *Household charges*

15. Ministers confirm that the present domestic water collection arrangements and the tariff structure should continue for the period 2010-14.

#### *Paying for public roads drainage*

16. SW household and wholesale charges should continue to include an appropriate element to recover the cost to SW of draining public roads.

#### *Paying for increased local capacity*

17. Where enhancements to the local infrastructure are required to enable new developments to be connected to the public networks, developers should meet the net cost to SW of such enhancements. Ministers also require the Commission to continue to provide for SW to levy infrastructure charges for each new property connected to the water or sewerage infrastructure.

#### *Surface drainage charging arrangements for non-household customers*

18. To minimise disruption for customers during the current difficult economic times, Ministers believe that it may be appropriate to defer the introduction of charging for surface drainage with reference to surface area,

perhaps until 2014. Ministers will consult key industry stakeholders on this proposal and finalise their position shortly.

*Small organisation exemption scheme*

19. Ministers confirm that the exemption scheme is to be extended in its present form until 2014.

*Paying for economic regulation and customer representation*

20. Ministers confirm that the cost of economic regulation and customer representation should be covered by an annual levy on SW funded out of charge income.

March 2009