

STRATEGIC REVIEW OF CHARGES 2027-33: DRAFT METHODOLOGY OVERVIEW

14 August 2024

Overview

INTRODUCTION

Water is a precious resource, essential for both life and our economy. As a society, we rely on Scottish Water to deliver clean, high-quality drinking water at the turn of a tap, responsibly collect and treat wastewater and surface water, and return it to the environment without detriment – all while ensuring these services remain affordable.

The people of Scotland have benefitted considerably from a model where Scottish Water is publicly owned, commercially run and subject to rigorous independent economic regulation. As a result, water charges in Scotland remain among the lowest in the UK, while Scottish Water has invested the most per person since 2002.¹ This investment has enabled Scottish Water to make significant improvements in the levels of service it provides.² Scottish Water is among the top-ranking companies in Scotland on customer service, as measured by the UK Customer Satisfaction Index (UKCSI)³, and it outperforms the average UKCSI for the water sector across the UK.⁴

As economic regulator we play a key role in ensuring that Scottish Water delivers for the people of Scotland. One of the ways that we fulfil this role is by setting caps on Scottish Water's charges through a process known as the Strategic Review of Charges. Through this process, we make sure that customers pay no more than is necessary for essential water and wastewater services. We carefully monitor and report on Scottish Water's performance and investment to ensure it is efficient and effective in delivering high-quality services now and for years to come.

Looking ahead, our approach for the Strategic Review of Charges which covers the six-year period 2027-33 (SRC27) will create a framework from which Scottish Water can continue to improve and make progress delivering against key challenges. It will focus on:

- Maintaining high standards of service and reliability
- Improving the evidence and analysis which supports decision-making
- Investing for a sustainable industry at lowest reasonable overall cost
- Placing customers at the heart of decision-making

¹ This is based on comparing Scottish Water to the water and sewerage companies in England and Wales over the same timeframe.

² Over the period from 2002-03 to 2022-23, Scottish Water levels of service (as measured by the overall performance assessment metric) has trebled. See Figure 4 in section 2.5 of the methodology document.

³ Scottish Water ranked 6th out of 22 companies from Scotland on the UK Customer Satisfaction Index (UKCSI) survey score in 2024. The Institute of Customer Service publishes the UKCSI survey score as an objective, independent perspective on the state of customer satisfaction in the UK across 13 sectors.

⁴ Scottish Water scored 77.1 points out of 100 on the UKCSI compared to the average for the water sector of 70.7. See Institute of Customer Service (2024), *'UK Customer Satisfaction Index: the state of customer satisfaction in the UK'*, July 2024, p.73; and Scottish Water's annual return for 2024, which will be published on the WICS website in late 2024.

This draft methodology sets out the direction of travel for Scottish Water to make further progress on the journey towards delivering the water sector vision and ensuring the industry is sustainable for generations of customers to come.

As in 2021-27, our approach is underpinned by the principles of Ethical Business Practice and Regulation (EBP&R) which will continue to support open and frank conversations about industry challenges and the best ways to address them.

We look forward to working closely with Scottish Water, SEPA, DWQR, Consumer Scotland and other stakeholders throughout this Strategic Review of Charges.

We value input on our proposals to improve the regulatory framework for SRC27 and we are inviting responses to this consultation by 12pm on 9th October 2024.

This overview sets out the high-level principles and proposals contained within our detailed draft methodology document. The full detailed document can be accessed [here](#).

THE STRATEGIC REVIEW OF CHARGES

Every six years, we examine the resources that Scottish Water needs to provide high-quality water and sewerage services both now and into the future, ensuring that as a sector we can adapt and evolve to the challenges and uncertainty of climate change. We do this by determining the level of revenue Scottish Water must collect through charges to deliver the Objectives set for it by Scottish Ministers.

After analysing Scottish Water's costs and efficiency, we set a cap on the charges it can collect from customers over a six-year regulatory control period. This process is known as the Strategic Review of Charges. Our Strategic Review of Charges involves working closely with other organisations in the water industry to ensure that the charge caps we set allow Scottish Water to deliver the environmental, water quality and service objectives set by the Scottish Ministers.

At an early stage of the Strategic Review of Charges we set out how we propose to set charge caps and a detailed timeline in line with the requirements set by Ministers in the Commissioning letter. This document, known as our methodology, sets out our proposed approach for SRC27.

In developing our methodology for SRC27, we consider our regulatory approach and where there are opportunities to strengthen the model. This involves reviewing our approach in previous Strategic Review of Charges and building on the elements that worked well, ensuring that we are looking to the future and helping to deliver maximum benefits for Scotland's water customers.

OUR REGULATORY APPROACH

Our process to determine charges for the regulatory control period covered by the Strategic Review of Charges 2021-27 (SRC21) concluded with the publication of our Final Determination in December 2020. We adopted the principles of EBP&R, which requires candour and transparency in all communications between regulator and regulated company. This approach facilitates open and honest discussions about the long-term challenges the industry faces and how to address them.

Our SRC21 regulatory approach placed more emphasis on working together to tackle industry challenges, such as delivering net zero emissions by 2040 and investing to replace Scottish Water's ageing assets. This review represented an important step in the journey to move away from the short term thinking inherent in traditional regulatory models, towards working together to deliver the best outcomes for Scotland's current and future customers. It provided Scottish Water with a high degree of flexibility in its investment planning, since it was in customers' interests to reduce the regulatory barriers to collaboration and innovation; two key elements to tackling these long-term challenges. It was one of our most collaborative Strategic Review of Charges to date and it paved the way for the first joint water sector vision.

Box 1: Sector vision

The water sector vision

- Scotland's water sector will be admired for excellence, secure a sustainable future and inspire a Hydro Nation.
- Together we will support the health and wellbeing of the nation.
- We will ensure that all of Scotland gets excellent quality drinking water that people can enjoy all of the time. Scotland's wastewater will be collected, treated and recycled in ways that generate value and protect the environment.
- We will enable the economy to prosper.
- We will transform how we work to live within the means of our planet's resources, enhance the natural environment and maximise our positive contribution to Scotland achieving net zero emissions.
- We will involve and inspire Scotland's people to love their water and only use what they need.
- We will promote access to the natural environment and encourage communities to enjoy and protect it.
- We will be agile and collaborate within the sector and with others to be resilient to the challenges which will face us.
- We will keep services affordable by innovating and delivering the greatest possible value from our resources, helping those who need it most.
- We will serve all customers and communities in a way that is fair and equitable to present and future generations.
- We are a vital part of a flourishing Scotland.

The importance of adopting a more flexible regulatory framework was highlighted during the early years of the 2021-27 regulatory control period. At this time, the UK experienced a period of high inflation and the cost of living crisis that arose from the Covid-19 pandemic and geopolitical factors. The regulatory framework enabled Scottish Water to respond by reprofiling charges and investment to ease the financial pressures on individuals and families across Scotland.

Climate change is also placing increasing pressure on our essential services, and it will be important to ensure that the water industry continues to adapt to climate change, while recognising these challenging economic times. It is essential for Scottish Water to evidence the investment it requires and play its part in improving efficiency, to reduce the impact on customer charges. We also need to ensure there is clarity over what Scottish Water will deliver, when and at what cost to ensure that customers receive the benefits they have paid for.

OUR APPROACH FOR SRC27

Recognising these key long-term challenges, the Scottish Government is currently developing policy that will determine the guiding principles for the water industry as it addresses longer-term challenges including climate change adaptation and mitigation. The policy work focuses on equipping the water industry with the necessary tools and legislation to ensure that essential water, wastewater and drainage services can continue to be provided in a changing climate.

Through this policy development work the Scottish Government has consulted on principles that will underpin the water industry's approach to providing water, wastewater and drainage services for decades to come. The Strategic Review of Charges 2027-33 will be an important step on the journey towards responding to these longer-term challenges in line with the policy principles and is reflected in our proposed approach.

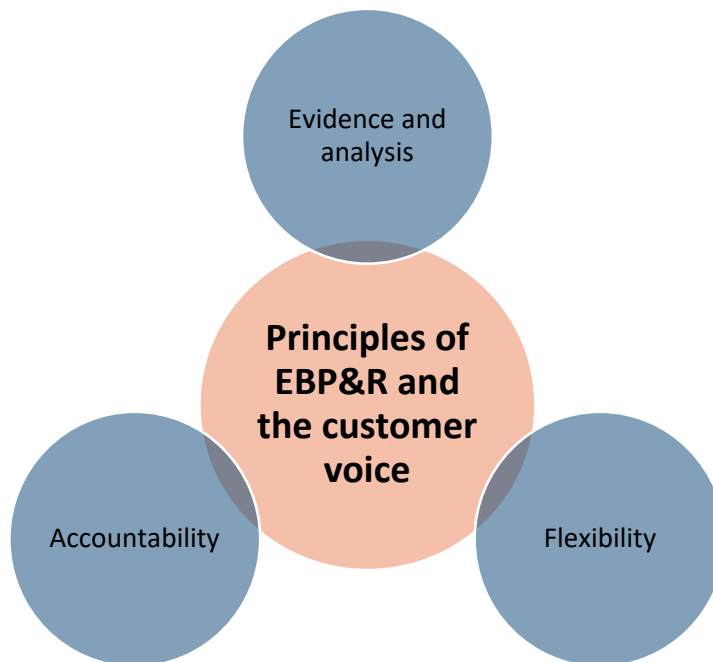
The publication of this methodology is an important first step in the Strategic Review process and represents the next phase of the journey towards ensuring the Scottish water industry is equipped to face future challenges.

Our approach will be a natural continuation of the progress towards the longer-term thinking initiated as part of SRC21 and reflect the lessons learned from that process. It will place even greater emphasis on the evidence and analysis that Scottish Water will provide. Our approach will also ensure there is appropriate flexibility and adaptability in the framework.

KEY PRINCIPLES

Taking account of the strengths of the regulatory framework to date, we propose that SRC27 will be based on the following key principles:

Figure 1: The key principles of SRC27



Embedding the principles of ethical business practice and regulation (EBP&R)

Our approach will continue to be underpinned by the principles of EBP&R. We will aim to ensure there is a high level of engagement throughout the Strategic Review of Charges process, consistent with EBP principles and consultation best practice. We will ensure the customer voice is placed at the heart of the decisions taken in SRC27.

A focus on high-quality evidence and analysis

Our proposals for SRC27 place even greater emphasis on evidence-based decision making, including demonstrating how risk is both understood and taken into account. As such, we will focus on the quality of Scottish Water’s evidence and analysis underpinning how it plans to meet Scottish Ministers’ Objectives in the context of the water sector vision.

We expect Scottish Water to provide a range of options for investment, including innovative and nature-based solutions to support a range of possible charge paths which demonstrate best value for customers.

Ensuring clear accountability

It is important that Scottish Water has full ownership and accountability for its performance during the regulatory control period. This requires defining what Scottish Water is expected to deliver during 2027-33, in the form of financial forecasts and commitments, and then monitoring Scottish Water’s progress over this period. If investment priorities change over time, then EBP&R places a

greater onus on Scottish Water to explain and document the changes it intends to make through the Scottish Government Investment Group (SGIG).⁵

Building appropriate flexibility

We recognise that Scottish Water needs sufficient flexibility to respond effectively to the challenges it faces, particularly where changes in risk or additional evidence impacts the investment priorities.

CONSULTATION QUESTIONS

- To what extent do you agree with the key principles outlined for SRC27?
- Are there other relevant principles that should be considered? Why?

OUR PROPOSALS

Our approach to SRC27 is rooted in regulatory best practice and will deliver best value for customers while helping to improve the overall sustainability of the water industry.

Our proposals are based on Scottish Ministers expectations, as set out in the Commissioning letter, and the lessons learned from SRC21 and in the first three years of the current regulatory control period.

We have summarised our proposals in this overview based on key themes and outline the benefits we expect our proposals to bring to customers and the overall regulatory framework.

A long-term approach

As set out above, SRC27 will be an important step on the journey towards responding to these longer-term challenges in line with the Scottish Government's policy development work and policy principles.

We aim to ensure that Scotland's water industry is sustainable for the long term, so that future generations can rely on the same services we enjoy today. This means that Scottish Water needs to invest in addressing long-term challenges, such as maintaining and replacing assets, adapting to and mitigating the impacts of climate change, and transitioning to net zero. Considering these broader industry challenges, we will continue to adopt a long-term approach to determining charges for 2027-33.

⁵ The Scottish Government Investment Group (SGIG) is the group that ensures that the water industry is developing a sufficient programme of investment to meet the Objectives that Ministers set and that the industry is delivering on these objectives. The Scottish Government chairs the SGIG. The governance process relates to how Scottish Water develops the investment programme through the IG. Scottish Government (2024), 'Water Industry: Scottish Government Investment Group'.

In light of these challenges and difficult economic circumstances, it is even more critical for Scottish Water to communicate clearly the progress it is making towards achieving its contribution to the water sector vision outcomes and Ministerial Objectives, including the overall benefits that will be delivered to customers.

To support this, we will ask Scottish Water to prepare a business plan in the context of the water sector vision outcomes and that sets out clearly the progress it will make towards delivering these outcomes during 2027-33.

The business plan will be evidence-based and set out:

- price profiles and assumed levels of borrowing;
- the allowed for level of investment;
- a forward-looking plan for investment projects and nature-based solutions;
- the outputs necessary to deliver or contribute to the outcomes in the water sector vision in the near term; and
- levels of service measures and annual commitments for those measures.

Through this business plan, we will hold Scottish Water accountable for its performance throughout regulatory control period ensuring that benefits to customers are delivered in the most efficient way.

As part of its forward-looking plan for investment, we will require Scottish Water to set out its approach to maintaining the vast network of pipes and treatment works used to provide the water, wastewater and drainage services that we all rely upon in our daily lives. These assets have finite lives and will require replacement as well as ongoing servicing, repair and refurbishment. Given that many of these assets last several decades, we need to consider how the costs of maintaining these assets are shared between current and future customers. SRC21 started a journey towards gaining a better understanding of the future maintenance requirements and transitioning towards a level of charges that reflect the full cost of replacing assets over time.

Our approach in SRC27 will require Scottish Water to continue improving its understanding of long-term asset replacement costs. As part of improving this understanding, we will require an investment baseline which includes clear descriptions of expected measurable outcomes across different asset categories and how these investments will impact the condition and performance of the asset base. We will also require that Scottish Water sets out the medium and long term consequences of not making these investments, recognising that this will impact on levels of service, risk and the costs borne by future customers.

This approach will enable Scottish Water to deliver a sustainable industry where current and future generations of customers continue to receive high-quality services.

CONSULTATION QUESTION

- What further information could Scottish Water provide in its business plan?

Clear ownership

In line with the principles of EBR&P, it is important that Scottish Water has full ownership and accountability for its performance during the regulatory control period – this means it must have full ownership of its business plan and overall delivery of its investment programme.

In line with good regulatory practice, we will require Scottish Water’s Board to provide an assurance statement on each of the key areas that will significantly impact the outcome of the Strategic Review of Charges. These areas will include that the business plan:

- commands customers’ support;
- is consistent with the long-term sector vision (see Box 1);
- is efficient and contains challenging proposals for efficiency and levels of service performance;
- is deliverable, considering factors such as the capacity of the supply chain in Scotland to deliver the proposed investment programme; and
- maintains an appropriate level of financial strength over the 2027-33 regulatory control period, to ensure that proposals for 2027-33 are not storing up problems for the future.

Additionally, we will work with Scottish Water to create an external assurance framework that will offer additional verification of the data and explanations included in the business plan.

This approach will enable Scottish Water to demonstrate to customers and industry stakeholders how it has ensured the robustness of its information and establish a high degree of confidence in its business plan.

CONSULTATION QUESTION

- Which key elements of Scottish Water’s business plan would benefit most from assurance? Why?

Ensuring efficiency

Scottish Water must demonstrate that its proposals for expenditure are efficient and deliver the best possible value for customers’ money.

We will require Scottish Water to provide evidence of efficiency in both its operating and capital expenditure. As part of this, we expect Scottish Water adopt different techniques and comparators including making greater use of benchmarking against the performance of the companies in England

and Wales. Specifically, we will ask that Scottish Water uses the statistical models developed by Ofwat (the economic regulator of the England and Wales water industry) and tested by the Competition and Markets Authority in Ofwat's price review in 2019 (PR19) and those that Ofwat has developed for its price review in 2024 (PR24). We consider that this approach places greater ownership on Scottish Water; however, we will also test proposals thoroughly to ensure that Scottish Water continues to challenge itself to improve its efficiency.

In line with the Scottish Government's policy development work, we expect Scottish Water to adopt different ways of working to address the challenges posed by a changing climate. We will encourage Scottish Water to work in partnership with others to find better solutions for customers and the environment. These include nature-based solutions such as catchment management and adopting blue-green infrastructure to deal with excess surface water. Such solutions can deliver broader benefits such as reduced greenhouse gas emissions and enhancing Scotland's natural and social capital.

This approach will ensure that customer charges are no higher than necessary and that customers receive wider benefits from investment.

CONSULTATION QUESTION

- To what extent do you agree with the proposed approach to assessing Scottish Water's efficiency?

Evidence based investment

We expect Scottish Water to translate the Scottish Ministers' Objectives and its contribution to the outcomes of the water sector vision into specific service measures and annual commitments. SRC27 will require Scottish Water to develop an investment programme designed to meet these commitments.

In the Commissioning letter, Scottish Ministers have set out that they expect a suitable governance structure to be developed which identifies, on a rolling basis, the outputs necessary to deliver their Objectives. Consequently, by the time Scottish Water submits its business plan, its investment proposals will be at different stages of development, from pre-optioneering to projects that are underway. Our approach in SRC27 recognises that Scottish Water's investment will be at different stages of maturity and tailors our approach for reviewing the investment accordingly.

For investment at an early stage of development (pre-development stage in the investment planning process), we will test the reasonableness of Scottish Water's assumptions for indicative costings and outputs and conduct high-level benchmarking. For investment that is more developed or underway,

we will request standard information for projects in excess of £3m and programmes of work.⁶ This information will include forecast costs, outputs, interim milestones and milestones for projects post commitment. We also require Scottish Water to clearly set out the completion investment and the source of funding for this investment, to ensure that customers receive the benefits they have paid for.

We will use this information to evaluate the efficiency of Scottish Water's proposals and set an investment baseline in the Final Determination. We recognise that the scope and cost of some investment projects may change as they progress through the investment planning process. We will use the Final Determination investment baseline as a reference point for reviewing the investment progressing through the revised governance process on a rolling basis.

The flexibility of the investment planning process places the onus on Scottish Water to explain and document any changes to the investment baseline over the regulatory period, in order to allow stakeholders to hold Scottish Water to account for delivery on behalf of customers.

We are proposing two key changes to the investment planning process to meet our regulatory requirements:

- To support our monitoring of Scottish Water's performance, we will ask Scottish Water to produce a delivery plan showing how it proposes to meet the requirements of the Final Determination and an annual delivery plan refresh before each financial year which captures the changes to the investment baseline.
- An additional step in the investment planning process when a project is in development, which would involve us reviewing the efficiency of Scottish Water's proposed investment. We would not propose reviewing all projects; however, we propose to review a sample of projects or specific projects that stakeholders consider merit a review. We consider that such a review is consistent with our duties to set charge caps consistent with the lowest reasonable overall cost of Scottish Water meeting the Objectives of Scottish Ministers.

We will collaborate with the Scottish Government's Investment Group to revise the change process for adjusting Scottish Water's investment programme.

CONSULTATION QUESTION

- To what extent do you agree that our proposals provide the required level of flexibility for Scottish Water's investment programme, while ensuring that Scottish Water remains accountable for delivery?

⁶ We define a programme as comprising investment that share the same characteristics, involves the delivery of the same group of investment outputs, involves repeatable work of similar construction requirements and risk profiles and the location of the investment is not known.

Together with Scottish Water and Consumer Scotland, we are evolving the approach to involving customers in the Strategic Review of Charges. Our approach will build on our experience in previous SRC periods ensuring that customers are placed at the heart of the decisions we and Scottish Water make.

We will place full ownership on Scottish Water to develop its business plan and demonstrate that customers' priorities are appropriately reflected. By extension, this will ensure that our Final Determination of charges commands the support of customers and communities.

Our approach will involve establishing a multi-stakeholder research coordination group to design and implement a comprehensive customer research programme. This programme will focus on understanding strategic prioritisation and customers' acceptance of Scottish Water's business plan.

We will also require Scottish Water to ensure a Customer Challenge Group provides additional assurance on the quality of Scottish Water's engagement and research, and the extent to which customer priorities and research is reflected in the business plan.

A tripartite agreement between WICS, Scottish Water and Consumer Scotland will set out key principles underpinning the approach to customer involvement in SRC27:

- **Legitimacy:** Customer research is well designed, comprehensive, robust, unbiased, independent and follows best practice. Scottish Water's business plan reflects visibly and credibly customer views including explaining how those views have been incorporated in the business plan.
- **Empowerment:** Customers and communities will be empowered by setting a clear expectation on Scottish Water to take ownership of its business plan and charges and demonstrate that both command customer support.
- **Challenge:** Scottish Water will be challenged robustly to demonstrate that plans are reflective of customer expectations through an independent group.
- **Collaboration:** Effective coordination and co-design of customer research building on the principles of Evidence Based Research.

CONSULTATION QUESTION

- Do you support our proposed approach on customer engagement? Why?

YOUR VIEWS

We value your input on our proposals to improve the regulatory framework for SRC27. We are inviting responses to this consultation by 12pm on 9th October 2024.

Your feedback is crucial in shaping our overall regulatory approach and the future of the water industry in Scotland. This consultation is an opportunity for you to share your views and help us

ensure that the regulatory framework enables Scottish Water to meet the needs of customers, communities, the environment and all other stakeholders.

WHY YOUR FEEDBACK MATTERS

Influence decision-making

Your views will help us finalise our approach to determining charges for the regulatory control period 2027-33. This will ultimately impact Scottish Water's future strategy and decisions and the future of the water industry in Scotland.

Improve the water industry

You can help us identify areas where improvements can be made to the regulatory framework that better serve current and future generations of customers.

Enhance accountability

Your feedback will help us hold Scottish Water accountable for delivering efficient and effective services in the years to come.

HOW TO PARTICIPATE

Your feedback is vital to ensuring our regulatory framework enables Scottish Water to provide high-quality services at a reasonable price. We encourage you to take a few moments to share your thoughts and contribute to the future of Scotland's water industry.

Please respond by completing our online [consultation form](#).

If you are unable to respond using our online form, please complete the respondent form and send via email to (enquiries@wics.scot) or by post to:

Water Industry Commission for Scotland (WICS)
First Floor
Moray House
Forthside Way
Stirling
FK8 1QZ

You may wish to learn more about how we will handle personal data you share with us as part of this consultation. You can find out more from our consultation [transparency statement](#) which is available on our website.

Thank you for your participation and support.

CONTINUED ENGAGEMENT THROUGHOUT SRC27

You will have additional opportunities to engage with us and other stakeholders. We will continue to ask your views and incorporate your feedback as we progress through the SRC27 process.

Table 1: Timeline for SRC27

Milestones	Dates
Close of draft methodology consultation	9 October 2024
Final methodology published	12 December 2024
Draft Ministerial Objectives and Principles of Charging	January to October 2025
Scottish Water's business plan	26 February 2026
Draft Determination of charges consultation	30 June 2026
Draft Determination of charges consultation closes	1 September 2026
Final Principles of Charging	September 2026
Final Ministerial Objectives	October 2026
Final Determination published	29 October 2026



WICS
Moray House
Forthside Way
Stirling
FK8 1QZ

T: 01786 430 200
E: enquiries@wics.scot

WICS Economic
regulation for
Scotland's water

