N Tables Transfer Pricing

General Comments

The N tables for 2024/25 have been prepared in accordance with Regulatory Accounting Rule 4 and related definitions.

The N tables detail the financial and contractual transactions which have taken place between Scottish Water (Regulated) and the following associates:

1. Scottish Water Business Stream Ltd (SWBS): the subsidiary responsible for retail – non household activities.
2. Scottish Water Business Stream Holdings Ltd (SWBSH): the holding company for SWBS.
3. Scottish Water Horizons Ltd (SWH): the subsidiary responsible for the majority of Scottish Water's non-regulated activities.
4. Scottish Water Services (Grampian) Ltd (SWSG): which was the operating company of the 4 wastewater treatment works in North-East Scotland to 30 September 2022 but since 1 October 2022, its primary role is the servicing and accounting for the former employees of both the Grampian PFI and the Highland PFI sites. The main driver being to allow these employees to continue to be part of the defined contribution pension scheme for SWSG and Highland PFI employees. Employment costs are recharged to Scottish Water at cost.
5. Scottish Water Horizons Holdings Ltd (SWHH): the holding company for SWH, SWBSH, AES and SWSG.
6. Scottish Water (Non-Regulated): following the issuance of revised Regulatory Accounting Rules 3 and 4 in January 2025, activities undertaken by Scottish Water are classified as non-regulated if they are not related to one or more of the following:
   A. The provision of water and sewerage services to premises in Scotland, as defined in relevant legislation (requirement 1);
   B. The output of the Activity is used in the provision of water and sewerage services in Scotland as defined in relevant legislation; and
   C. The Activity involves extracting commercial value from Assets required for the provision of a core Activity meeting requirement 1.

   Consequently, activities previously regarded as non-regulated in the prior year have been reassessed and reported under regulated activities in our M table submission. New activities will continue to be assessed as they arise.

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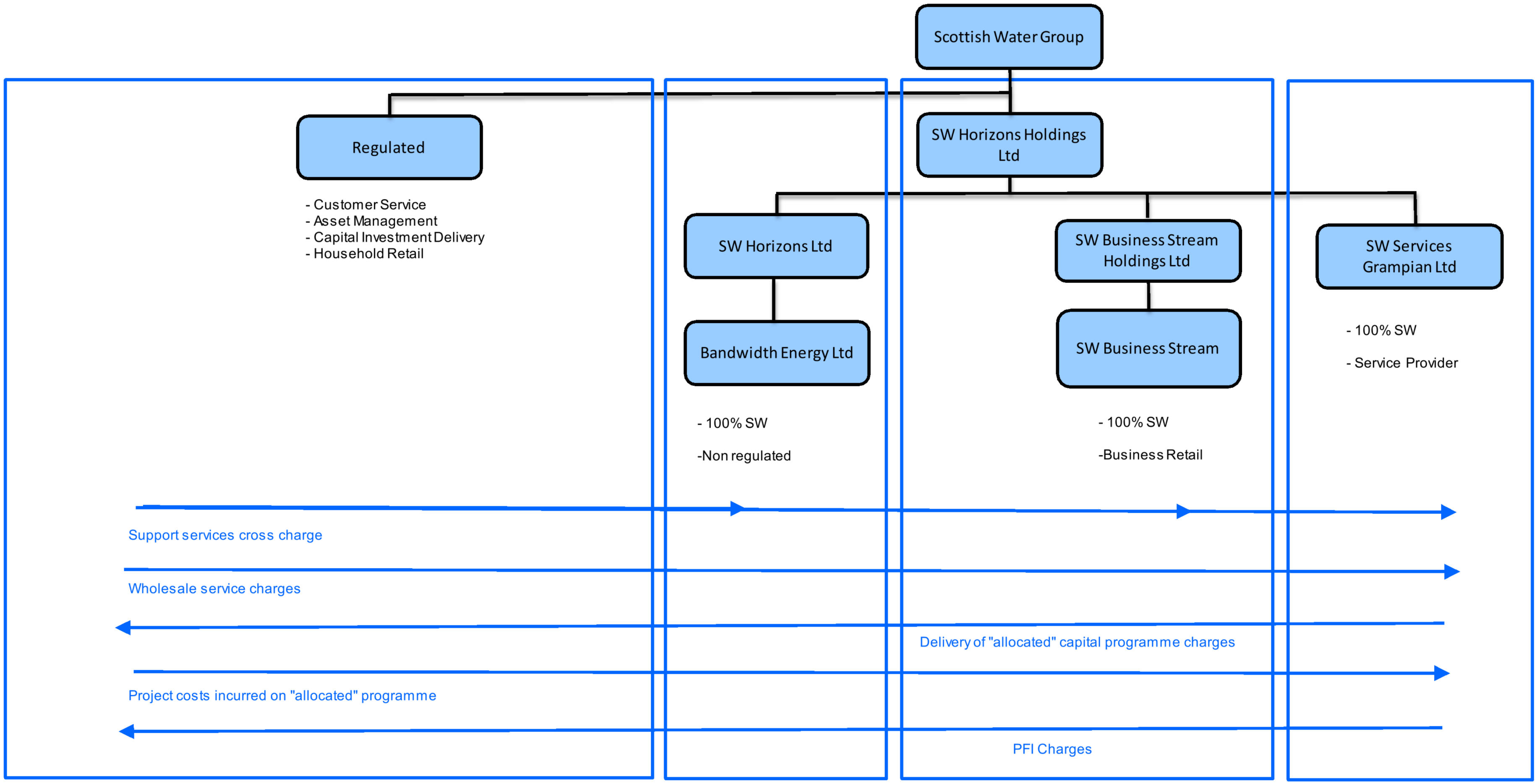
The main transfers between associates are illustrated below.



Compliance with Regulatory Accounting Rule 4 – Transfer Pricing

Contracts and transactions between Scottish Water and its associates are governed by Transfer Pricing Rules which comply with WICS' Regulatory Accounting Rule 4 (Transfer Pricing). Transfer prices for transactions reflect either the actual cost of the service where individual costs are directly attributable (e.g. actual fuel charge, actual mobile phone call charges) or reflect cost of the service as calculated via our Activity Based Management System (ABM). ABM calculates the actual cost of the support activity and allocates the cost of that support activity across internal customers based on the share of activity cost drivers.

The policies and methods adopted for cost allocation, transfer pricing and reporting are consistent with previous years. There has been no market testing of transactions between Scottish Water and its associates in 2024/25.

Statement of Compliance

Alan Dingwall, Chief Financial Officer, has signed the N Table return and accompanying commentary, and in so doing has confirmed Scottish Water's compliance with Regulatory Accounting Rule 4 – Transfer Pricing.

Declaration of Interest

SWHH, SWH, and SWSG are fully owned subsidiary companies of Scottish Water with their own board of directors. The actions of the directors are governed by the Companies Act 2006.

SWBSH is a fully owned subsidiary of Scottish Water, via SWHH, with its own board of directors. The actions of SWBSH's Directors are governed by the Companies Act 2006 and the Governance Code agreed between the Water Industry Commission for Scotland, Scottish Water and Business Stream. Business Stream has its own separate board of directors.

Scottish Water (Regulated) and Scottish Water (Non-Regulated) previously formed part of the same legal entity and in most cases utilised common, shared resources. For 2024/25, as referenced above, under new Regulatory Accounting Rule guidance, no activities carried out by the Scottish Water legal entity were considered non-regulated.

Table N1 Transfer Pricing Summary (Capex)

No capital expenditure was recharged between core and associates / non-core during the year.

Table N2 Transfer Pricing Summary (P&L)

The approach taken involves analysing and providing detailed explanations for any year-on-year variances that exceed the threshold of £25,000.

A. Market Testing

There has been no additional market testing of Table N2 services in 2024-25.

B. Cost Allocation. Recharges to Associate / Non-Core from Core

1. Scottish Water charges to SWBS

(i) Service & Support Charges

Service agreements are in place between Scottish Water and SWBS for the few services provided by SW.

Charges increased 15% to £68k for the year (lines 2.1.1 and 2.1.2). The services charged under service agreements were mainly in respect of Internal Audit services which are charged on a daily rate basis for the agreed audit plan.

(ii) Wholesale Charges.

Scottish Water is required to charge business retailers for Primary and Non-Primary Water and Wastewater services based on the Wholesale Scheme of Charges. Average price increases of 8.8% were applied on 1 April 2024 and wholesale charges increased by £4.7m (2.3%) £215.3m (line 2.2.1). This reflects the price increase partially offset by reduced volumes and a reduction in drainage charges following rateable value appeals.

Non-Primary Connections reduced by £74k to £341k this year due to a lower number of connections.

2. Recharges from Scottish Water to SWH

Table N2 reports the value of cross-charges between Scottish Water and SWH, which includes the following transaction types:

- Labour, material and service costs transferred from Scottish Water as actually incurred on SWH activities (projects); and
- Recharges from Scottish Water for support activities undertaken for SWH. This includes the cost of functions such as IT, Fleet, Property, Finance, HR and Customer Services. Cross charges either reflect the actual cost of the service, e.g. actual fuel charge, actual mobile phone call charges; or the cost of the service as calculated via our ABM system. ABM calculates the actual cost of the support activity and allocates the cost of that support activity across internal customers based on the share of activity cost drivers. This is in accordance with RAR 4 requirements.

During the year Scottish Water charges to SWH were £3.3m, an increase of £0.6m compared to prior year. This was mainly due to an increase in services asset management (Line 2.3.5) and reconciliation costs relating to the power purchase reconciliation charge (Line 2.3.8) as explained below.

- Line 2.3.1 - Management and support costs increased by £40k in 2024-25. These costs are captured within the regulated ledger and a recharge is made to SWH for an element of these costs that relate to Non-Regulated work, based on work throughput. Management and support costs consist of Corporate Affairs, Contact Centre, Finance, Internal Audit, Legal, Payroll and Property recharges.

- Line 2.3.2 - Waste & Sludge Processing Charge for Waste Services is for waste being treated and disposed of using SW site assets and associated transport and labour costs. The value of this is based on the Mogden formula for 3rd party waste (liquids) treatment and sludge model costs for 3rd party waste (sludge) treatment. Waste services costs decreased in 2024-25 by £129k reflecting lower volumes of waste from Nigg STC, Perth City and Shieldhall WWTW partially offset by an increase in cost in trade effluent.

- Line 2.3.3 -The cross-charge for Aquatrine work was for the SW call centre taking calls from Aquatrine clients and sampling services from SW Scientific.

- Line 2.3.4 - The cross-charge for Support Shipping Water Services relates to costs recharged from the core business in relation to the provision of shipping water.

- Line 2.3.5 - The cross-charge for Asset Management costs are charged for SW staff working on Horizons capital projects, calculated using time sheets and hourly rates which include overhead recovery. The value in 2024-25 increased by £262k due to an increase in costs relating to the sale of Deerdykes WWTW, an increase in renewables maintenance costs (in line with the growing solar portfolio) and a one-off charge for roof combustibility checks for insurance purposes.

- Line 2.3.6 - The cross-charge for ABM Support costs represents corporate overhead recovery. This year costs have increased by £32k mainly due to a mix of inflation and increase in SWH FTE driving overhead allocation.

- Line 2.3.7 - The cross-charge for IT Service costs was in respect of providing service desk support, mobile devices, provision of desktop support, security and systems management, applications management/support and IT communications. The IT Service Charge to Horizons is calculated based on the usage of Digital Applications. There are 3 different methods used to calculate the recharge of the contract costs:

- Based on the number of SWH employees as a percentage of the total number of employees across the Scottish Water group of companies, excluding SWBS;
- Based on the number of users for a specified IT applications multiplied by the user license cost; and
- Where Horizons have procured IT services separately from Scottish Water.

The increase between 2023-24 and 2024-25 can be broken down into the following key areas:

2023-24 IT Service Recharge	**£ 348,167**
Reduced FTE Impact	(£12,016)
Inflation Impact	£ 8,462

Additional scope/costs	£ 21,533
2024-25 IT Service Recharge	**£ 366,146**

- Line 2.3.8 – This line captures the payment from Horizons to SW to ensure that SW costs for electricity purchased from heat from sewage assets that Horizons disposed of to a third party during the year reflect market prices. The payment this year was £371k.

C. Cost Allocation. Recharges to Core from Associate / Non-Core

1. Cross-charges from Scottish Water Business Stream (Regulated) to Scottish Water (Regulated)

Interest paid to SWBS (line 2.8.1)
As per the wholesale agreement, SWBS pre-pays Scottish Water for wholesale charges. Interest was charged on this advance payment at an average interest rate of 4.92% across the year representing the quarterly average of 25 year National Loans Fund rates over the year plus a margin of 25 basis points as specified by Water Industry Commission for Scotland. There are also a series of subsequent reconciliations, as estimated charges are replaced with actuals, with interest paid on the resulting reconciliation payments between the parties. In 2024-25 interest payments to SWBS increased by £0.3m to £2.8m reflecting the increase in interest rate and the price increase of the underlying charges.

Guaranteed Service Standard Payments (line 2.8.2)
During the year Scottish Water made Guaranteed Service Standard Payments to SWBS in line with the Wholesale Scheme of Charges of £12k. The Schedule 4 of the Wholesale Services Agreement sets out a number of Service Standards with which Scottish Water must comply. Where failures occur, payments must be made from Scottish Water to the Licensed Provider in accordance with section 14 of the Wholesale Scheme of Charges. These amounts relate to such Service Standard payments.

Gap incentives (line 2.8.3)
During the year Scottish Water received a net refund from SWBS of £6k for Gap Incentives payments in line with the Wholesale Scheme of Charges. This was due to recovery of prior year overpayments.

2. Cross-charges from Scottish Water Horizons (Non-Regulated) to Scottish Water (Regulated)

During the year SWH charged Scottish Water £3.9m, an increase of £0.3m compared to prior year. This was mainly due to an increase in impact assessments of £0.4m relating to one-off support from Horizons on Scottish Water's Cumnock Academy project; an increase in Test Centre recharges of £0.2m due to a change in the mix of trials carried out for SW. These increases were partly offset by a reduction relating to renewable energy charges which decreased £0.3m reflecting the sale of Stirling and Dalmarnock heat from sewage assets which were sold halfway through 24/25.

The full list of services provided by SWH to Scottish Water is provided below:

- Impact assessments relating to the effects of new developments on the existing infrastructure;
- The provision of plan and property searches;
- The services of Horizons staff working mainly on SW projects; and
- Renewable energy supplied to SW from the renewable energy assets delivered and operated by SWH;
- Trials and training carried out by SW at Test Centres operated by Horizons;
- Supporting the delivery of SW's vesting project, bringing existing assets up to an adoptable standard to be vested by SW;
- Property recharge with regards to the IT room in Deerdykes that it is being used by SW; and
- Developer Services Charges are for work undertaken by Horizons at the request of Scottish Water to support developer connections.
- Provision of waste services at Cowdenbeath WWTW.

3. Recharges from SWSG to Scottish Water (Regulated)

Lines 3.1.1 to 3.1.3 represent the recharge of costs incurred by SWSG for the operation and maintenance of the North-East PFI assets following the absorption of these activities into the regulated activities of Scottish Water on 1 October 2022. The majority of the charges (line 3.1.2) relate to the payroll costs of SWSG employees who are now working on SW assets (£1.3m) which is a reduction of £248k (16%) from 2023/24. This is due to a reduction in the number of employees within SWSG which experienced a reduction from 25 employees to 20 employees during the year.