

Directions issued to licensed providers pursuant to Standard Licence Condition B3

The Water Services (Rateable Value Transition) Directions 2018

DIRECTIONS ISSUED TO LICENSED PROVIDERS
PURSUANT TO
STANDARD LICENCE CONDITION B3

BY

THE WATER INDUSTRY COMMISSION FOR SCOTLAND

**TRANSITION TO 'LIVE' RATEABLE VALUES
IMPLEMENTATION REQUIREMENTS
FOR
WATER AND SEWERAGE SERVICE PROVIDERS**

Directions issued to Licensed Providers pursuant to Standard Licence Condition (SLC) B3

1 Introduction

From April 2018, unmeasured water and waste water charges, and property and roads drainage charges will be calculated using the same Rateable Value (RV) used for Business Rates (Live RV), as assessed by the Local Council Regional Assessor (LCRA). The Scottish Government consulted on its policy proposals in summer 2016. Following that consultation, the Scottish Government confirmed its policy intentions, indicating that these changes will take effect from April 2018, and should be phased in through transition arrangements that deliver equal cash changes in customers' RV-based charges over a three-year transition period.

The Commission intends that the change to Live RV charging is transitioned over the period 1 April 2018 to 31 March 2021. In order to support this, the Commission has modified the Standard Conditions of Water and Sewerage Services Licences, adding a condition B3. Paragraph 1 of this condition allows the Commission to issue directions to Licensed Providers detailing the steps that any licensed provider, to whom that condition applies, must take in pursuance of the objective (at paragraph 2 of that condition) of ensuring that changes to RV-based charges at wholesale level are appropriately reflected in the charges paid by the customer at retail level.

Under Standard Condition B3, each Licensed Provider to whom that condition applies is obliged to transition the relevant Supply Point's (SPID's) RV-based charges for the services supplied between 1 April 2018 and 31 March 2021 (the Transition Period). RV-based charges are applied to:

- Relevant unmetered SPIDs which are supplied with water and sewerage services and are charged based on the RV of the premises; and
- Relevant SPIDs which are supplied with property and roads drainage services and are charged based on the RV of the premises.

This document constitutes the directions issued by the Commission under paragraph 1 of Standard Condition B3.

In these directions words and expressions shall, unless stated otherwise, have the same meaning as in the Standard Conditions of Water and Sewerage Services Licences. Licensed Providers subject to Standard Condition B3 shall apply customer charges in accordance with the methodology set out in these directions

2 Transitional Glide Path

2.1 Background

The overall approach to the transition to Live RV-based charging is designed to deliver changes to RV-based customer charges in equal cash steps in each tariff year¹ over the Transition Period for the relevant SPIDs.

Wholesale charges will also transition from Current RV-based charging to Live RV-based charging on a linear Glide Path (Wholesale Glide Path) that delivers equal cash changes after the effect of inflation in each year of the Transition Period. A market wide annual update of the Wholesale Glide Path for each SPID will be provided by the CMA's Central Systems to the Licensed Provider in advance of each financial year. Licensed Providers shall be responsible for any recalculation of the Glide Path during the financial year.

2.2 SPIDs subject to transition arrangements

Transition charging arrangements apply to all SPIDs:

- With a connection date recorded at the CMA that is earlier than 1 April 2018; and
- Where the recorded unique address reference number (UARN) associated with the premises has a RV assigned to it with an Effective Date earlier than 1 April 2017 (i.e. a RV assigned at the 2010 valuation or pre-2017 valuation); and
- Where the Live RV that was assigned by the LCRA in 2017-18 was not amended as the result of:
 - Full redevelopment of the premises, either the start or end of works undertaken;
 - Merger of multiple premises into a single rated entity;
 - Disaggregation of a single rated entity into multiple individually rated entities; or
 - Addition or removal of an Apportionment Note².

Licensed Providers are required to transition all such SPIDs on a Retail Glide Path. This includes SPIDs that are being charged based on standard contracts, default tariffs, deemed contracts or on customer-specific contracts.

Scottish Water will identify whether or not each SPID is to be subject to transition arrangements, and will flag this at the CMA systems.

Where a SPID is subject to transition arrangements, RV-based wholesale charges will follow the Wholesale Glide Path. Where a SPID is not subject to transition arrangements, RV-based wholesale charges will be calculated based solely on the Live RV.

2.3 Termination of the Glide Path

The Retail Glide Path of SPIDs that are being transitioned shall be terminated if during the Transition Period, the relevant premises are:

- Merged into a single rated entity;

¹ We refer to a tariff year as the period that runs from 1 April of the relevant year to 31 March of the following year.

² Apportionment Notes are flags assigned by the LCRA to indicate situations where a business premises is partly used as a residence.

- Disaggregated into multiple individually rated entities;
- Completely redeveloped or reconstructed, either the start or end of works; or
- In receipt of an addition or removal of an Apportionment Note.
- Subject to the addition or removal of a meter.
- Re-assessed resulting in unmeasured charges replaced by charges based on a pseudo meter.

Scottish Water will identify when any of these circumstances arise at a SPID, and will flag this at the CMA systems. In such cases, from the effective date flagged at the CMA, RV-based wholesale charges will no longer follow the Wholesale Glide Path and will be calculated based solely on the Live RV, and the Licensed Provider shall terminate the Retail Glide Path.

2.4 Recalculating the Glide Path

The Wholesale Glide Path and/or the Retail Glide Path will have to be recalculated to accommodate changes to the Live RV during the Transition Period. There are two types of changes that can occur.

1. Changes to the RV assessed by the LCRA, which could include but may not be limited to:
 - Changes to the RV due to premises alterations, such as partial redevelopment, extensions or reconstruction;
 - Changes to the RV following a successful appeal against the Live RV;
 - Change to the Current or Historic RV recorded at the CMA; or
 - Data corrections to the RV assessed by the LCRA or data corrections to the RV as recorded in the CMA systems.

These changes will affect the Wholesale and Retail Glide Path.

Furthermore changes to the Historic or Current RV and changes to the vacancy status at unmeasured premises will also affect the Glide Paths.

The amended RV following a successful appeal or due to premises alternations will be used for RV-based charging from the valuation notice issue date (i.e. the date the assessor notifies interested parties of the outcome of the appeal review).

2. Market or service related changes, which could occur when but may not be limited to when:
 - A contract comes to an end during the Transition Period and the customer does not agree a new contract or renew the existing one;
 - A contract comes to an end during the Transition Period and the customer positively agrees to a new contract; There are material changes to the existing contractual arrangements during the Transition Period (e.g. a customer stops paying by direct debit and as a consequence does not receive the same discount level);

- Allocation of SPID(s) to a different Licensed Provider as the result of the customer switching to a new Licensed Provider or via the Provider of Last Resort (PoLR) process.

These changes only affect the Retail Glide Path and do not have an impact on the Wholesale Glide Path.

2.5 RV-based charging scenarios

Based on these transition arrangements there are one of five different charging scenarios which could apply to any SPID subject to RV-based charging. During the Transition Period, each SPID must be charged according to one of charging scenarios set out below (which can change during Transition Period for a given SPID):

1. No Glide Path;
2. Glide Path;
3. Recalculated Wholesale Glide Path;
4. Recalculated Retail Glide Path; or
5. Terminated Glide Path.

These charging scenarios are described in further detail below.

1) No Glide Path

Charging Scenario 1	No Glide Path
Description	SPIDs are subject to Live RV-based charging.
Scenarios	<ul style="list-style-type: none"> - New SPIDs subject to RV-based charging with a connection date recorded at the CMA that is after 1 April 2018; or - Where the unique address reference number (UARN) associated with the premises has a RV assigned to it with effective date later than 1 April 2017; or - During 2017-18 the premises have been: <ul style="list-style-type: none"> - Subject to full redevelopment of the premises; - Merged into a single rates entity; - Disaggregated into multiple individually rated entities; or - Subject to, or have been removed from an Apportionment Note.
Determined by	Scottish Water
Retail approach	No additional requirements on Licensed Providers with respect to retail charges.

2) Glide Path

Charging Scenario 2	Glide Path
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Description	SPIDs are subject to transition from Current RV-based charging to Live RV-based charging over the Transition Period. The Glide Path is calculated prior to the start of the 2018-19 tariff year and delivers transition in equal annual cash steps both in terms of wholesale charges and retail charges.
Applies to	<ul style="list-style-type: none"> - SPIDs subject to RV-based charging which have a connection date recorded at the CMA that is earlier than 1 April 2018; and - The recorded unique address reference number (UARN) associated with premises has a RV assigned to it with an effective date earlier than 1 April 2017; and - SPIDs that during 2017-18 have not been: <ul style="list-style-type: none"> - Subject to full redevelopment of the premises; - Merged into a single rates entity; - Disaggregated into multiple individually rated entities; or - Subject to, or have been removed from an Apportionment Note.
Determined by	Scottish Water
Retail approach	Retail charges must be transitioned on a Retail Glide Path. See Section 3.3 for further details.

3) Recalculated Wholesale Glide Path

Charging Scenario 3	Recalculated Wholesale Glide Path
Description	SPID is being transitioned on a Glide Path. Due to a change in the RV the Wholesale Glide Path must be recalculated.
Applies to	<p>SPIDs being transitioned on a Glide Path where:</p> <ol style="list-style-type: none"> 1. Current RV updated by the Licensed Provider due to correction to Current RV data. 2. Live RV updated by Scottish Water due to correction to Live RV data. 3. Live RV updated by Scottish Water due to premises extensions or partial demolitions due to a change by the LCRA (not complete redevelopment or reconstruction). 4. Live RV updated by Scottish Water following successful appeals against the assigned Live RV. 5. Changes in the vacancy status at unmeasured premises.
Determined by	Scottish Water (for Live RV updates) or Licensed Provider (for Current RV updates).
Retail approach	Retail charges must be on a recalculated Retail Glide Path. See Section 3.3 for further details.

4) Recalculated Retail Glide Path

Charging Scenario 4	Recalculated Retail Glide Path
Description	SPIDs are being transitioned on a Wholesale Glide Path (or on a Recalculated Wholesale Glide Path).

	The Retail Glide Path must be recalculated because of a material change in the relationship between the Licensed Provider and the customer. This scenario group does not have an impact on wholesale charges.
Scenarios	<p>SPIDs being transitioned on a Glide Path where:</p> <ol style="list-style-type: none"> 1. A contract ends during the Transition Period and the customer does not agree a new contract. 2. A contract ends during the Transition Period and the customer positively agrees a new contract and a new price with his existing Licensed Provider. 3. Changes to contractual arrangements (e.g. a customer moves to new discount level and is charged a different price). 4. A customer switches to a new Licensed Provider and agrees to new contractual arrangements. 5. A change in the vacancy status. 6. SPID(s) allocated to a new Licensed Provider via the PoLR process.
Determined by	Licensed Provider
Retail approach	Retail charges will be based on the recalculated Retail Glide Path. See Section 3.4 for further details.

5) Terminated Glide Path

Charging Scenario 5	Terminated Glide Path
Description	<p>SPIDs are being transitioned on a Glide Path.</p> <p>Due to changes in the RV of the premises the Glide Path is terminated. This may be followed by SPID deregistration and/or new SPID registration.</p>
Applies to	<p>SPIDs being transitioned on a Glide Path where:</p> <ol style="list-style-type: none"> 1. Live RV changes due to a merger of premises (this applies only to existing SPID(s) that will remain registered). 2. Live RV changes due to a disaggregation of a single rated entity into multiple rated entities (this applies only to existing SPID(s) that will remain registered). 3. Live RV changes due to complete redevelopment or reconstruction of a premises, either the start or end of works. 4. Addition or removal of an Apportionment Note. 5. Addition or removal of a meter. 6. Re-assessed resulting in unmeasured charges replaced by charges based on a pseudo meter.
Determined by	Scottish Water
Retail approach	Retail charges no longer need to be on a Retail Glide Path. See Section 3.5 for further details.

3 Calculating the Retail Glide Path

3.1 Introduction

To transition RV-based charges in equal annual changes over the Transition Period, Licensed Providers will calculate and apply a linear Retail Glide Path for non-household charges at relevant SPIDs. In all such cases, the Retail Glide Path will be based on one of two other Glide Paths: Wholesale Glide Path or Default Retail Glide Path.

3.2 Default Retail Glide Path

All transitioning SPIDs that are being charged on default tariffs should be on a Default Retail Glide Path. The Default Retail Glide Path will be unique for each SPID and will be calculated as shown in Table 1.

Table 1 – The Default Retail Glide Path

Year	2017-18	2018-19	2019-20	2020-21
Default Retail Charge	RV-based charge calculated using 2017/18 Default Maximum Tariffs and the Current RV	2/3 of the 2017/18 Default Retail Bill + 1/3 of the 2020/21 Post-Phasing Default Retail Bill	1/3 of the 2017/18 Default Retail Bill + 2/3 of the 2020/21 Post-Phasing Default Retail Bill	RV-based charge calculated using the 2020/21 Rebased Default Maximum Tariffs and the Live RV

The 2020-21 Default Maximum Tariffs will be published in advance of the 2018-19 tariff year to enable Licensed Providers to calculate the Default Retail Glide Path for relevant SPIDs, and to ensure effective communication with customers.

3.3 Calculating the Retail Glide Path

We assume there are broadly two different approaches to price water and waste water retail services:

- Wholesale Plus – where retail prices are based on wholesale charges plus an uplift; or
- Default Minus – where retail prices are based on the default tariff less a discount.

Licensed Providers will calculate a Retail Glide Path for non-household RV-based charges of transitioning SPIDs for each service at each relevant SPID. The calculation of the Retail Glide Path depends on how the Licensed Provider calculates retail charges for the relevant SPID, as detailed in the table below.

Table 2 – The approach to retail charges

Basis of retail charges	How to calculate Retail Glide Path	The approach
'wholesale plus'	Calculate Retail Glide Path as the Wholesale Glide Path plus the retail percentage margin (%) as at the later of the following dates, 1 January 2018 or the date of registration or switch of the SPID.	This fixes the retail percentage margin over the Transition Period and ensures equal cash steps for changes in non-household charges. The margin is calculated on a percentage basis relative to the wholesale charges.
'default minus'	Calculate the Retail Glide Path as the Default Charges Glide Path minus the retail percentage discount (%) as at the later of the following dates, 1 January 2018 or the date of registration or switch of the SPID.	This fixes the retail discount percent over the Transition Period and ensures equal cash steps for changes in customer charges. The margin is calculated on a percentage basis relative to the default tariffs.
Neither 'wholesale plus' nor 'default minus'	Calculate the Retail Glide Path as if it were a 'wholesale plus' Glide Path or a 'default minus' Glide Path. The margin is the retail percentage margin (%) as at the later of the following dates calculated as at 1 January 2018, or the date of registration or switch of the SPID.	This fixes the retail percentage margin over the Transition Period and ensures equal cash steps for changes in customer charges. The margin is calculated on a percentage basis relative to the wholesale charge or default tariffs.

The method for calculating the Retail Glide Path is summarised in the table below.

Table 3 - Calculating the Retail Glide Path

Year	2017-18	2018-19	2019-20	2020-21
'Wholesale Plus' based Charge	(RV-based charge calculated using wholesale tariffs and the Current RV) plus the percentage margin.	N/A	N/A	(RV-based charge calculated using rebased 2020-21 wholesale tariffs and the Live RV) plus the percentage margin.
'Default Minus' based Charge	(RV-based charge calculated using default tariffs and the	N/A	N/A	(RV-based charge calculated using rebased 2020-21 default tariffs

	Current RV) minus the percentage discount.			and the Live RV) minus the percentage discount.
Customer bill	'Wholesale Plus' based charge, OR 'Default Minus' based charge = Pre-Phasing bill	2/3rd of Pre-Phasing bill + 1/3rd of Post-Phasing bill	1/3rd of Pre-Phasing bill + 2/3rd of Post-Phasing bill	'Wholesale Plus' based charge OR 'Default Minus' based charge = Post-Phasing bill

3.4 Recalculating the Retail Glide Path

Licensed Providers must recalculate and re-apply the Retail Glide Path to each relevant service at each relevant SPID when any one of the following charging scenario changes occurs:

1. Recalculated Wholesale Glide Path

Licensed Providers recalculate the Retail Glide Path to incorporate the changes to the Wholesale Glide Path. The calculations are set out in Section 3.3. The recalculated Retail Glide Path is applied to the retail non-household bill from the effective date of the change in the Wholesale Glide Path; or

2. Recalculated Retail Glide Path

Table 4 describes the required adjustment to the Retail Glide Path under each scenario. The Retail Glide Path calculations are consistent with those set out in Section 3.3.

Table 4 – Recalculating the Retail Glide Path

Scenario	The requirement on the Licensed Provider	Application date of the recalculated Retail Glide Path
Recalculated Wholesale Glide Path.	Recalculate Glide Path based on RV change.	Effective date at CMA
Contract ends and the customer does not agree a new contract	Recalculate Glide Path based on Licensed Provider's retail charges applicable under Deemed Contract (if different to current charges).	End date of the contract
Contract ends and the customer agrees a new contract with a different discount level/margin.	Recalculate Retail Glide Path consistently with the change in discount level/margin of the new contract terms.	Start date of new contract
Changes to contractual arrangements – customer	Recalculate Retail Glide Path to mirror changes in discount level/margin.	Date of change in contractual arrangements

moves to new discount level/margin.		
Customer switches to a new Licensed Provider and positively agrees to new contractual arrangements.	The incoming Licensed Provider calculates a new Retail Glide Path using the new margin or discount level agreed with the customer.	Registration Start Date
Allocation of SPID to new Licensed Provider via PoLR process.	The incoming Licensed Provider calculates the Default Glide Path applicable under Deemed Contract Regulations until the customer positively agrees to a specific contract.	Registration Start Date

3.5 Terminating the Retail Glide Path

When Scottish Water flags to the CMA systems that a SPID has terminated its Wholesale Glide Path, the Licensed Provider will terminate the Retail Glide Path for any relevant service of the SPID, and will charge the relevant customer on such basis as they agree with their customer.