

Methodology Information Paper 10: The new competition framework

Introduction

This information paper sets out our views on the benefits that we believe could accrue to customers from the introduction of retail competition for non-household water and sewerage customers in Scotland. It explains how we will factor the new arrangements into our charge-cap setting process and how the Strategic Review will ensure both household and non-household customers are protected as competition develops.

The new competitive framework and how it will benefit customers

For most goods and services, customers can choose between a range of different suppliers that compete for their custom. Customers generally choose the supplier that offers the best value for money. That is, a supplier that offers the lowest prices, best level of service, or some combination of the two. Suppliers competing to offer goods and services are incentivised to find service and price combinations that benefit customers.

However, if the good or service has a monopoly supplier, customers cannot exercise choice and are therefore customers of the monopoly supplier. In such circumstances, it is not clear what incentives the supplier faces to improve service or lower prices to customers.

In industries characterised by natural monopolies¹, such as the water industry, economic regulators generally try to replicate the pressures of a competitive market by providing incentives for companies to reduce costs and improve service to customers. However, regulation is likely to have only a limited impact.

Where there is a large natural monopoly element in the industry, it is not necessarily the case that all parts of the service need to be supplied by a single firm. In order to improve value for money to customers, policymakers and regulators have sought to introduce competition to industries where previously none existed

However, competition is a means to an end; it is not an end in itself. It is worth pursuing because it improves value for money to customers. We believe that the new arrangements for non-household water supply will result in relatively lower prices, better levels of service, or some combination of both.

¹ A natural monopoly is one where the most efficient market structure is a single firm. This generally involves high fixed costs of supply and low (and declining) marginal costs of supply. It is therefore technically infeasible (or prohibitively expensive) to replicate the assets required to serve customers. Utilities are generally thought of as being natural monopolies, however, there are other examples (such as mines for scarce resources).

The Water Services etc. (Scotland) Act 2005 introduced retail competition for non-household water and sewerage customers from April 2008. Figure 1 shows the value chain and responsibility for providing water services as existed prior to the Water Services etc. (Scotland) Act 2005. Figure 2 shows the same value chain, but updated to reflect the new responsibilities envisaged by the 2005 Act. Non-household retail competition for sewerage services is also being introduced and a similar value chain exists for these services.

Figure 1: The value chain for water services prior to the Water Services etc. (Scotland) Act 2005

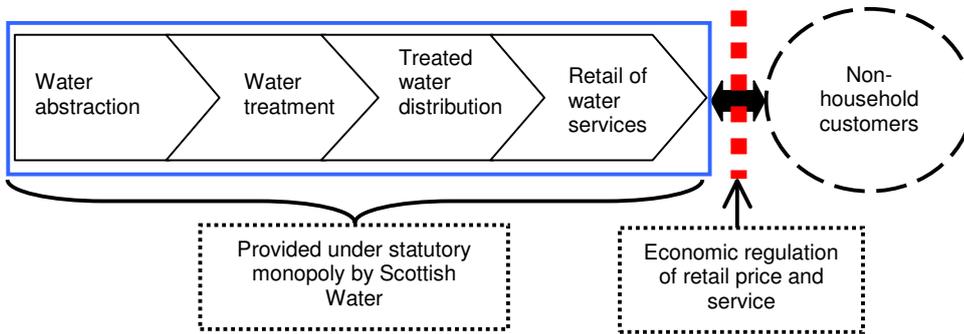
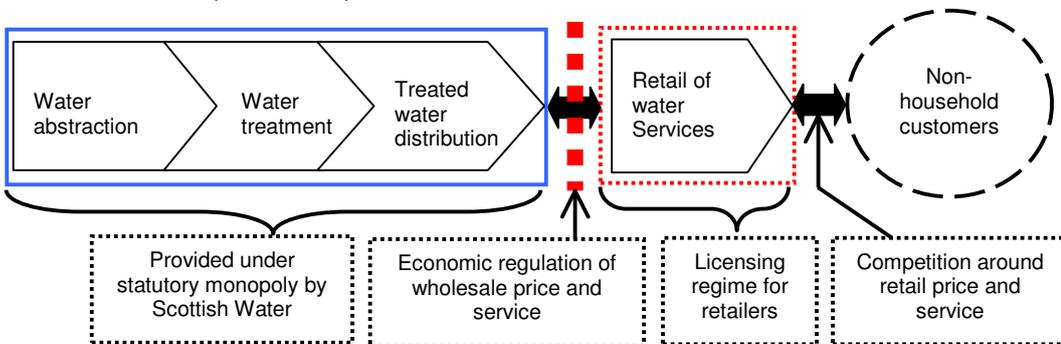


Figure 2: The value chain for water services envisaged by the Water Services etc. (Scotland) Act 2005



As can be seen from Figure 1, prior to the Water Services etc. (Scotland) Act 2005, Scottish Water was a vertically-integrated supplier of all parts of the value chain – abstraction, treatment, distribution and retailing. The retail price that Scottish Water charged and the level of service that it provided were subject to economic regulation. However, non-household customers were not able to exercise choice over their supplier. As such, individual end customers could apply only limited pressure on Scottish Water to improve service or lower costs.

Under the Water Services etc. (Scotland) Act 2005 Scottish Water continues to be the monopoly supplier of water abstraction, treatment and

distribution of water in Scotland. The Act also required Scottish Water to separate its wholesale and retail activities.

We will continue to regulate the price and service of the monopoly wholesale operation of Scottish Water. The Strategic Review of Charges 2010-14 will set Scottish Water's wholesale charge caps.

In addition, we are responsible for setting up a licensing regime for new retail entrants and for ensuring orderly development of the market. Retailers will compete for customers by offering a range of services and prices. As with any other good or service, we would expect the ability of non-household customer to choose suppliers to lead to better value for money. We also expect dynamic efficiencies to emerge where retailers put pressure on Scottish Water to reduce costs and improve wholesale services.

Introducing retail competition

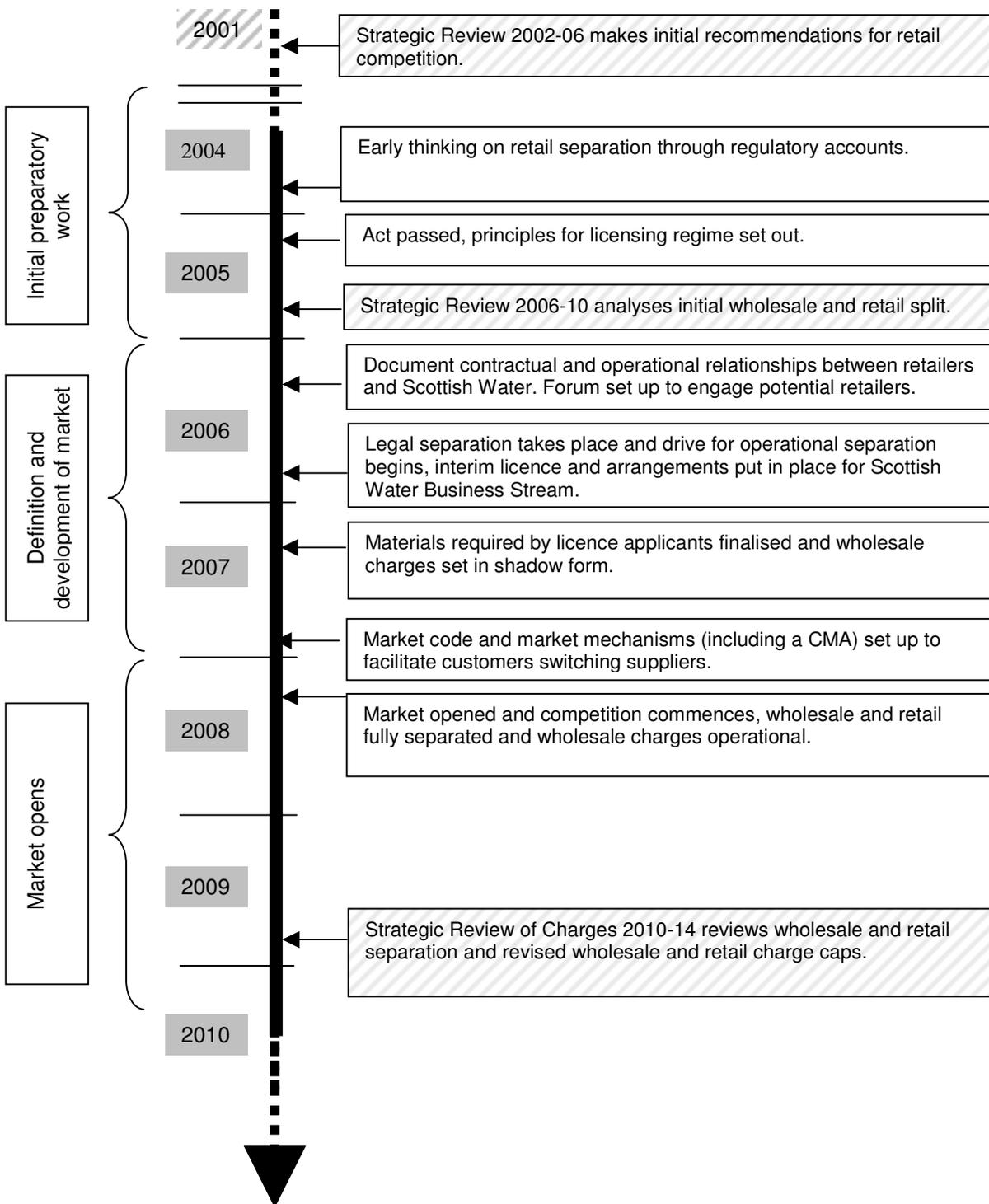
The process of introducing retail competition for non-household water and sewerage customers has a number of stages. These are set out in figure 3.

Scottish Water has now separated its wholesale and retail functions. On 31 October 2006, we granted Scottish Water's retail subsidiary – Scottish Water Business Stream – a provisional licence. It will initially provide retail services to all non-household customers.

Retailers can now apply for permanent licences and once these are awarded can start to approach customers. In the period leading up to April 2008, retailers will be able to approach customers and offer deals to these customers. Once a retailer has a permanent licence, it will be able to enter into pre-agreements with customers to provide their water and sewerage services from April 2008.

The Strategic Review of Charges for 2006-10 set out the initial pricing framework. This will be further developed in the next price review.

Figure 3: Introduction of retail competition



The Strategic Review of Charges 2006-10 set:

- retail charge caps: that applied initially to the vertically-integrated Scottish Water and limit price increases to customers during the review period; and
- provisional wholesale charge caps: these limit real increases in the wholesale charges that Scottish Water could charge to licensed retailers.

In June 2007, the Commission will consider Scottish Water's proposed wholesale charges scheme for the period to April 2008.

Experience of introducing competition in other utility services suggests that we may have underestimated the cost of retail activities. Wholesale charges may therefore fall.

In the Strategic Review of Charges 2010-14, we will set wholesale charge caps that will limit prices that Scottish Water charges licensed retailers. We also propose to set further default retail charge caps. These will apply only to customers who have been unable to identify a better offer in the market.

Regulated wholesale tariffs to retailers for defined wholesale services

In the Strategic Review of Charges 2010-14, we will set charge caps that limit the increases in wholesale charges that Scottish Water levies on licensed retailers. This will require us separately to identify wholesale and retail costs and revenues. We intend to use the same method as we used in the last review to do this.

That is, we will again calculate the household and non-household revenue required by Scottish Water and its retail entity. We will then subtract an appropriate level of non-household retail costs, including the retailers' cost of capital. Again, this will be based on a full and complete accounting separation of costs.

We believe that it remains valid to analyse Scottish Water as a vertically integrated company because:

- the base year on which we make our efficiency comparisons for the review is 2007-08. This will be prior to market opening and the costs will therefore represent Scottish Water and its retailer as the sole supplier; and
- it will allow transparent comparisons of the effects of competition on customers. That is, we would expect value for money to customers to improve relative to this base position due to competition.

We acknowledged above that we might need to review the overall level of wholesale charge on the basis of market evidence. We will work with

market participants to ensure that the tariff charges are broadly reflective of the costs that are incurred. We will take full account of evidence on wholesale and retail costs that is available at the time of our review. The wholesale charge caps we set for 2010-14 will reflect a detailed assessment of the wholesale costs of supply.

We propose to express our wholesale charge caps using three tariff baskets:

- all water services;
- foul sewerage and surface water drainage; and
- trade effluent.

In setting wholesale charge caps, we take account of Ministers' principles of charging. Ministers are due to publish a consultation on these principles in November 2007 and issue decisions by September 2008. We expect these principles to cover, amongst other things, the appropriate balance of revenue from each of our tariff basket categories. We will set wholesale charge caps that are consistent with these principles.

We consider that the combination of defined wholesale services and published, regulated tariffs for these services will help ensure a level playing field amongst retailers. This should assist the orderly development of competition, to the benefit of customers.

Default tariffs and service levels

We have set a requirement on all retailers to offer default tariffs and default levels of service to customers. The default tariffs will limit increases in customers' bills where customers have not identified a better price or service in the market. The regulatory contract will apply only to Scottish Water's wholesale activities.

The default tariffs play an important role in ensuring that no customer could end up without a retailer. As a further safeguard, we intend to require each licence holder to sign up to a code of practice that will apply to all customers who pay the default tariffs. As such, each retailer will have to provide a minimum basic service to any customer paying the default tariffs.

We have also put in place arrangements to ensure that, in the event that a customer does not choose a retailer, they are allocated to a retailer and the default standards and charges will apply.

For 2006-10, the default tariffs are based on the retail charge caps that we set at the last Strategic Review. In the Strategic Review of Charges 2010-14 we propose to indicate default retail tariffs for licensed retailers.

Bespoke wholesale prices and services

In most cases, non-household customers are likely to find that a standard price and level of service offering from a licensed retailer meets their needs. Licensees will be able to develop additional services to offer customers.

However, the Water Services etc. (Scotland) Act 2005 also allows for a more bespoke wholesale service to be provided from Scottish Water to the retailer where this is appropriate. It introduced a mechanism² that allows Scottish Water to apply the Commission for a departure from wholesale charges. The Commission may approve the departure where a customer has done, or has agreed to, something that reduces the costs incurred by Scottish Water in providing the services.

If a customer has taken action to reduce the cost of supplying a water or sewerage service, this should be reflected in the wholesale charge levied by Scottish Water on that customer's retailer. Any reduction or increase in costs claimed must be a net reduction or increase in the Net Present Value³ (NPV) of costs. For example, if a customer has taken action that reduces one category of its costs, but causes a greater increase in costs in other categories then the arrangements as a whole do not decrease Scottish Water's costs. In this case, there will be no grounds for a departure.

As an example, if a customer agreed to a supply of water that was not available during peak times, the customer would not be placing a peak demand on Scottish Water's network. This may be possible by, for example, the customer installing on-site water storage facilities.

For example, Scottish Water's wholesale water charge for a customer may be £500,000. Scottish Water may be able to demonstrate that it saves around 15% per year⁴ by not providing peak water supply services. This results in a benefit of £75,000.

Some of this benefit will accrue to the retailer (and we would therefore expect to the individual customer) and some of the benefit will accrue to Scottish Water.

If, in the above example, we split the benefits two-thirds to the retailer and one-third to Scottish Water, the retailer's wholesale charge would fall from £500,000 to £450,000. Scottish Water would be £25,000 per year better off as a result of the departure.

The customer could still choose to switch retail supplier, in which case their revised wholesale charge would be levied on the new retailer (provided that

² Through section 29E of the Water Services etc. (Scotland) Act 2002.

³ The Commission will publish the discount rate to be used in such calculations.

⁴ Net of any cost increase.

the reason for the original departure from the wholesale scheme of charges remained valid).

Scottish Water is not disadvantaged by these arrangements since they only apply when the actions of a retail customer have changed the level of costs it incurs.

In the Commission's view it is a good thing that Providers should seek to reduce their costs to be served. The Commission is in favour of efficiency as it is in the interest of all customers; efficiency may create capacity in the system and make it cheaper for others to connect. We have recently consulted⁵ on our application of Section 29E.

Summary

The new arrangements for retail competition introduce incentives that should result in better value for money for non-household water and sewerage customers. That is, customers should benefit from lower prices, higher levels of service or some combination of both.

In the Strategic Review of Charges 2010-14 we will set charge caps that limit increases in the wholesale charges that Scottish Water can levy on licensed retailers. Retailers will compete from this level playing field to offer services to customers.

Related Documents

'Strategic Review of Charges 2002-06', Section 3 'Competition', Water Industry Commissioner for Scotland, November 2001.

'The Strategic Review of Charges 2006-10: The draft determination', Volume 2, Water Industry Commissioner for Scotland, June 2005.

'The Strategic Review of Charges 2006-10: The final determination', Water Industry Commission for Scotland, November 2005.

⁵ Section 29E departures – The Commission's approach to making determinations', Water Industry Commission, May 2007.

Methodology Information Paper 11: Establishing a revenue baseline

Introduction

This information paper explains how we, the Water Industry Commission, propose to establish Scottish Water's revenue base in the Strategic Review of Charges 2010-14. The Review will set charge caps that limit the average increase in customers' bills during the regulatory control period.

The overall approach

There are two main steps for establishing a revenue base for each year of the review. These are:

- establish an initial customer base: this should be the customer base where use of Scottish Water services at the applied tariffs would equal the revenue of Scottish Water; and
- forecast changes to this customer base and assess the impact of these changes on current revenue at current tariff levels.

We now discuss these in turn.

Initial customer base

In order to establish a revenue baseline, we:

- ask Scottish Water to submit detailed information about its customer base; and we
- review Scottish Water's information and seek to verify this against external information sources.

There are different charging arrangements for household and non-household customers. We therefore make different assessments for these customer groups.

Initial customer base: household customers

Household customers can be billed for their water and sewerage services in two ways. These are:

- measured basis (where a customer has a meter installed); or
- unmeasured basis (where a customer does not have a meter).

Only around 400 of the 2.2 million household customers in Scotland have a meter installed.

Customers with a meter pay their bills directly to Scottish Water. These customers pay a fixed charge based on the size of their meter connection and a volumetric rate based on how much water they consume. In its Strategic Business Plan, we will ask Scottish Water to provide information on these customers' meter size and consumption.

The overwhelming majority of household customers in Scotland pay for water and sewerage services on an unmeasured basis. Unmeasured household customers bills are based on the Council Tax band of the property.

For Council Tax purposes, properties are banded from A to H. In setting water charges, we consider the number of Band D equivalent properties. The 'Band D equivalent' is calculated by multiplying the number of customers in each category by the relevant number of ninths of a Band D bill and dividing by 9.

A number of discounts apply to unmeasured household customers. For example:

- bills for customers in receipt of disability benefits are discounted by one band from the banding of the property in which they live;
- properties with single adult occupancy receive a 25% discount;
- properties that are subject to Council Tax relief receive up to a 25% discount; and
- in limited circumstances, properties that are in effect unoccupied may receive a 50% discount.

Table 1 shows the percentage of a Band D bill paid by each band.

Table 1: Proportion of Band D bill for each customer

	Full charge	25% discount	50% discount
Band A (disabled relief)	5/9	3.75/9	2.5/9
Band A	6/9	4.5/9	3/9
Band B	7/9	5.25/9	3.5/9
Band C	8/9	6/9	4/9
Band D	9/9	6.75/9	4.5/9
Band E	11/9	8.25/9	5.5/9
Band F	13/9	9.75/9	6.5/9
Band G	15/9	11.25/9	7.5/9
Band H	18/9	13.5/9	9/9

We propose to ask Scottish Water to provide customer information at an individual band level in its Strategic Business Plan for 2007-08. We would review this information to ensure that Scottish Water's reported household

revenue is consistent with the reported numbers of customers by band and discount rate. We also propose to cross-check the household revenue information with financial information in the annual report and accounts prepared by each local authority.

If we consider that Scottish Water's information about its initial household customer base is inaccurate, we may make adjustments to set charge caps.

Initial customer base: non-household customers

Non-household customers in Scotland benefit from a competitive market for the retail element of water and sewerage services.

All non-household water and sewerage customers are billed by a retailer (and not Scottish Water) for services. Retailers may offer a range of billing arrangements to customers. These may include both fixed and volumetric tariffs. Retail competition is discussed further in Information Paper 10.

Scottish Water (the wholesaler) charges retailers on the basis of the volume of water consumed (or sewage discharged) by their customers¹. All wholesale charges that Scottish Water levies in respect of non-household customers are therefore measured.

Measured wholesale charges in respect of non-household customers currently comprise three main elements:

- an annual fixed charge for connection based on the size of their meter;
- a volumetric charge based on the volume of water customers consume and sewage they discharge; and
- a charge for surface water (and highway) drainage based on the rateable value of the property.

In the Strategic Review of Charges 2006-10, we raised concerns that the non-household customer base that Scottish Water reported may have been smaller than the actual non-household customer base. We were concerned that a 'data cleansing' exercise by Scottish Water had reduced the reported number of non-household customers from around 140,000 to 120,000. We noted that Scottish Water's information appeared inconsistent with reported non-household customer numbers from England and Wales. If Scottish Water does not bill part of its non-household revenue base, this would increase its wholesale charges in respect of the non-household customers that are billed.

In 2006, we commissioned Oxera to provide an independent estimate of the numbers of non-household water customers in Scotland. Their report (which

¹ During 2008-11 a phasing programme will operate for customers that are compulsorily metered by Scottish Water during 2006-08 where part of their consumption will be assessed from their rateable value.

is available on our website) estimated Scottish Water should have between 135,000 and 150,000 non-household customers. We therefore remain concerned that Scottish Water is not billing all of its non-household customer base.

We propose to scrutinise Scottish Water's reported non-household information carefully. We will ask Scottish Water for detailed information for 2006-07 and 2007-08, which should reconcile to Scottish Water's reported revenue. We will also compare this information to other regulatory information on the customer base, including the Annual Return.

If we consider that Scottish Water's information about its initial non-household customer base is inaccurate, we may make adjustments to set charge caps.

Under the competition framework, the CMA will be responsible for maintaining an accurate record of non-household customers. Retailers will have an incentive to identify customers not presently being billed, as they will be able to offer services to these customers and earn a return.

We propose to use information supplied by the CMA in reaching our conclusions about the baseline for non-household customers.

Forecasting changes to the initial customer base

Once we have established an initial customer baseline, we need to forecast this for each year of the review.

In the Strategic Review of Charges 2006-10, we distinguished between the underlying growth in the customer base and growth that would come about as a result of investment to alleviate development constraints. We propose to use the same method at the Strategic Review of Charges 2010-14.

Background changes

The customer base is slowly increasing. For example, housing in Scotland tends to grow at a relatively constant and predictable rate that is a function of changes in population and demographics. We will analyse underlying trends in the customer base and propose to use this information to inform our judgements about the future customer base.

We will ask Scottish Water to set out its view on changes to the customer base in its business plan.

At the last review, Scottish Water claimed that there would be a large decline in the volumes consumed by larger customers. We allowed for a smaller decline in volumes consumed by larger customers in the charge caps. We will only allow for such a change if it can be justified through analysis of historical trends.

We recognise that alleviating development constraints in some areas may reduce growth in other areas where network capacity has not been an issue. This is because developers may be able to exercise greater choice about the location of a development. We therefore propose to reduce by half the underlying growth rate in those years where development constraints are being released.

Releasing development constraints

We propose to reflect the required outcome of investment to relieve development constraints in our forecast of Scottish Water's future customer base.

In the Strategic Review of Charges 2006-10, we assumed that there would be a two-year time lag between the investment in alleviating development constraints and the premises becoming a billable customer. We propose to take a similar approach at the 2010-14 Review.

Summary

At the next review, we will place considerable emphasis on defining an accurate initial customer base. We propose to forecast future customer numbers, which take into account both underlying growth and the Ministerial objectives.

Related Documents

'The Strategic Review of Charges 2006-10: The draft determination', Volume 7, Section 4 'Charges and their impact on customers', Water Industry Commissioner for Scotland, June 2005.

'The Strategic Review of Charges 2006-10: The final determination', Water Industry Commission for Scotland, November 2005.

Methodology Information Paper 12: Levels of service

Introduction

This information paper reviews the appropriateness of OPA targets and discusses the reasons why the Commission proposes to focus on setting only prices, not service levels, for the regulatory period 2010-2014.

It begins by discussing the issues for a regulator with setting both maximum charge caps and service levels. It goes on to discuss the emerging retail market and the adjustments required to the OPA once the retail market has developed. The paper continues with the changes we plan to make to update the OPA to improve consistency with Ofwat for the next price review. It concludes by outlining the proposed approach for setting prices only, not service levels.

Levels of service

It is a guiding principle that Scottish Water should not seek to live within its charge caps by reducing the level of service it provides to customers. We therefore set clear milestones for improvements in customer service during the 2006-10 regulatory control period. This section explains the approach we took, and the progress Scottish Water has made since then.

How levels of service are measured

The Water Industry Commissioner agreed the introduction of Guaranteed Minimum Standards (GMS) for the Scottish water industry in 2000. These are the minimum standards of service that Scottish Water must meet, and which customers have a right to expect. Failure to comply with the standards entitles customers to financial compensation. The GMS cover Scottish Water's performance in relation to:

- planned and unplanned interruptions;
- internal sewer flooding incidents;
- payment enquiries; and
- complaints.

The GMS do not cover every situation in which poor levels of service arise. So while we regard Scottish Water's performance in meeting the GMS as important, we believe that the overall performance assessment (OPA) provides a more comprehensive picture of the level of service. For this reason we measure the level of service that Scottish Water provides to its customers using a version of the OPA.

The OPA framework was developed by Ofwat to assess the performance of the water and sewerage companies in England and Wales. It takes account

of the factors that customers consider to be most important, and combines individual service measures such as how quickly supply is restored after an interruption, how quickly Scottish Water handles complaints and its performance in improving drinking water quality and environmental compliance.

The OPA depends on performance in each of 15 individual performance measures. We can also compare performance for each individual measure. We included as many of the measures that are used by Ofwat as possible in our assessment of the OPA score for Scottish Water.

To calculate the OPA score, we converted Scottish Water's performance in each service area to a score out of 50 points. Once all of the individual service measures had been converted to scores out of 50, they were weighted according to the importance of each measure to customers. Further details about the OPA are available on our website¹.

Scottish Water's performance over 2003-2006

We published information about Scottish Water's levels of service performance in our 'Customer service report 2003-06' (September 2006). This showed that Scottish Water's OPA score improved during the period 2002-03 to 2004-05, from 133 to 177. However, it fell back in 2005-06 to 165. This resulted in an overall improvement of 24% during the period to 2005-06.

We welcomed this improvement and expect to see Scottish Water building on this foundation in the 2006-10 regulatory control period.

Our approach to levels of service at the 2006-10 review

At the 2006-10 price review, we had originally intended to adjust our benchmarking of Scottish Water's efficiency relative to that of the companies in England and Wales to take account of the poorer level of service provided to customers in Scotland. However, Scottish Water did not provide the information we needed to do this, so it was not possible to assess the full scope for efficiency (including both reductions in costs and improvements in the levels of service).

We therefore decided to take another approach, which was to set separate targets for Scottish Water to reduce costs and to improve customer service. We set price limits in the final determination on this basis.

We required Scottish Water to improve its level of service – as measured by the OPA – by some 40% by the end of the 2006-10 regulatory control period, as Table 3.1 shows. We set annual milestones for improvement in the OPA.

¹ Information note 07 'Customer Service: Overall Performance Assessment (OPA)'.

Table 1: OPA milestones set at the 2006-10 review

	2004-05 actual	2005-06	2006-07 milestone	2007-08 milestone	2008-09 milestone	2009-10 target
OPA	177	-	195	213	232	250

In setting targets for improvements in levels of service, the Commission took the view that it was in the best interests of customers for them to benefit from the levels of service enjoyed by customers in England and Wales. Scottish Water is making welcome progress against these targets, and we expect the gap in performance with England and Wales to reduce significantly by 2010.

Appropriateness of OPA targets: regulatory incentives and process

Issues for 2010-14

As Scottish Water improves its levels of service performance, further target setting for the period beyond 2010 may well require the Commission to determine the relative merit of a unit of service improvement and a unit of additional cost to achieve that improvement. For example, what is the relative merit – ie benefit to customers - of setting targets for levels of service higher (or lower) than those achieved in England and Wales, but requiring higher (or lower) costs than those incurred in England and Wales?

In monitoring progress against targets that cover both levels of service and costs, it is likely to be difficult to measure the marginal impact of either missing or exceeding the regulatory targets. For example, how would the Commission assess overall performance and value for money to customers if Scottish Water were to deliver better levels of service than required by targets, but at higher costs than were allowed for in prices?

Our proposals

For the period 2010-14, we would expect Scottish Water to ensure that its performance as measured by OPA is comparable with companies in England and Wales, without the Commission setting specific targets. Ofwat has not in the past set levels of service targets for companies. Instead, it publishes annual performance tables that act as an incentive for companies to deliver improving levels of service. It may prove difficult for us to predict the strategies that companies will adopt in response to this incentive over the period to 2014. In view of this, we propose to concentrate on setting the maximum charge cap for Scottish Water to deliver a level of service comparable to the level of service delivered by the leading companies in England and Wales in 2007-08. This level of performance will be known before we set prices for 2010-14.

We expect that OPA will remain a very important element in assessing Scottish Water's overall performance. In its representations on the draft determination 2006-2010, the Scottish Executive indicated that it would wish to use performance against the targets set out in the regulatory contract in assessing the performance of directors. Directors' bonuses are now linked to these OPA measures.

Appropriateness of OPA targets: the impact of competition

The Commission is introducing a licensing framework that will allow licensees to supply retail services to non-household customers. Accordingly, non-household customers will be able to choose a new retail supplier of water and sewerage services from April 2008.

This new framework will require us to adjust our use of the OPA to reflect the split between retail and wholesale activities. We will require an OPA that covers wholesale and household retail activities, consistent with the final determination, in order to monitor Scottish Water's performance after the separation of retail non-household activities in 2008.

We do not believe that this will prove to be difficult; we would continue to exclude from our OPA the percentage of bills to metered customers that are based on a meter reading (as opposed to an estimated reading, as there are very few metered household properties in Scotland). The elements of our current OPA that will be affected are:

- Percentage of billing contacts dealt with within 5 days;
- Percentage of written complaints dealt with within 10 days; and
- Percentage of telephone calls answered within 30 seconds.

The billing contacts measure would need to be removed from the OPA from 2008 (Scottish Water bills only very few households directly). This removal would reduce the targets for 2008-09 and 2009-10 in the final determination by around 7 and 9 points respectively.

Scottish Water will continue to be responsible for dealing promptly with household written complaints after separation in 2008. It will continue to handle calls from household customers. There will need to be minor changes in how these measures are defined but this would have no significant impact on the OPA score.

Non-household customers will continue to be protected by requirements placed on new licensed retailers to deliver a defined level of service when they charge the default tariff² (see information paper 10).

² In order to safeguard customers, it is our intention that all licensed providers will be obliged to offer the same default tariffs.

Updating the OPA and improving consistency with Ofwat

Bringing our version of the OPA into line with Ofwat's would strengthen our benchmarking comparisons. There are three areas where we are working to improve consistency with the OPA, as it is currently used by Ofwat.

These are:

- Pollution incidents;
- Assessed customer service; and
- Leakage targets.

Pollution incidents are not included as there is a difference in the definition of an incident between Scotland and England and Wales. We have worked with the Scottish Environment Protection Agency (SEPA) to resolve these differences by ensuring that the way in which Category 1, 2 and 3 pollution incidents are measured and reported in Scotland is brought into line with those used by the Environment Agency south of the border.

The measure 'assessed customer service' concerns the quality of customer service that is delivered in England and Wales. Ofwat does not publish information for the companies in England and Wales on 'assessed customer service'. Therefore performance in this measure cannot be assessed on a consistent basis. The measure is based on assessments of seven aspects of customer service, including complaint handling and services for disabled and elderly customers. The customer representative organisation in England and Wales, the Consumer Council for Water (formerly Water Voice), contributes to these assessments. To improve consistency with Ofwat we have asked Waterwatch to explore ways of incorporating an assessment of customer service similar to that provided by the Customer Council for Water in England and Wales. In view of the new licensing framework, this assessment would have to distinguish between household and non-household customers.

We have worked with our engineering advisors and the Reporter to ensure that leakage in Scotland is estimated on a basis that is consistent with England and Wales. We have agreed annual targets for leakage reduction with Scottish Water. From 2006-07, the OPA will take into account Scottish Water's performance against leakage targets.

In addition to the improvements above, there is a possibility that Ofwat may seek to revise the OPA to differentiate the level of service provided by the best companies. We will want to track Ofwat's plans for the OPA but we understand from Ofwat that any further development of the OPA will be made only after its 2009 price review. Since the base year for the draft determination will be 2007-08 any revisions by Ofwat would not affect our proposed approach.

Summary

We do not propose to continue to set both prices and targets for the level of service to be delivered. We believe that the assessment of performance could become much more complicated if we continued with this approach. At the 2010-14 Review, we propose to ask Scottish Water to indicate the costs incurred in improving levels of service to customers. We propose to use this information to assess the scope for efficiency, consistent with Scottish Water matching, by 2014, the performance of leading companies south of the border in 2007-08. This approach also ensures that we would not be immediately impacted by any changes that Ofwat decides to make to the OPA.

Related Documents

'The Strategic Review of Charges 2006-10: The draft determination', Volume 6, Water Industry Commissioner for Scotland, June 2005.

'The Strategic Review of Charges 2006-10: The final determination', Water Industry Commission for Scotland, November 2005.

Information note 07 'Customer Service: Overall Performance Assessment (OPA)', Water Industry Commission, 2006.