

Strategic Review of Charges 2021–27:

Methodology refinements and clarifications





Preface

In our role as the economic regulator for the water industry in Scotland, we set limits on the prices that customers pay for their water and wastewater services. This process is called a Strategic Review of Charges. In April 2017 we published 'Innovation and Collaboration'¹ which set out our methodology for the next Strategic Review of Charges which covers the six-year period 2021-27 (SRC21).

We are currently around half way through the programme of work set out in 'Innovation and Collaboration'. During 2017, we published thirteen Initial Decision Papers, and this year we have published a further eight 2018 Decision Papers. These Decision Papers update customers and stakeholders on the Commission's latest thinking on the key elements of the Strategic Review. This thinking has benefitted greatly from the input of stakeholders and good progress has been made with identifying approaches to tackling the challenges facing the industry whilst ensuring that customers continue to receive value for money.

The Commission has adopted the principles of Ethical Based Regulation for SRC21 and has committed to conducting a fully transparent and collaborative price review process. In keeping with this approach, we are publishing these refinements and clarifications to our April 2017 methodology to update customers and stakeholders on our latest thinking. At this key stage in the SRC21 process, ahead of the publication of Scottish Water's Strategic Plan, it is timely for the Commission to reflect on the feedback from stakeholders to date, and to set out our expectations and approach for the remainder of the process.

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Strategic Review of Charges
2021-27 – methodology available at
[www.watercommission.co.uk/
view_Approach_2021_27.aspx](http://www.watercommission.co.uk/view_Approach_2021_27.aspx)

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Scottish Water has made remarkable progress – but real challenges remain: both for Scottish Water and to futureproof the framework for economic regulation...

Scottish Water compares well with the companies south of the border in levels of customer service and investment; charges and balance sheet strength.

There is also a high degree of collaboration within the industry.

However, asset replacement; information security; trends in demographics; improving water quality; increasing provision to rural areas and addressing the need to remove lead from the network will require further increases in the level of investment. Any increase in the levels of investment will impact charges.

The Commission has reviewed how the economic regulatory framework will have to change if it is to be sufficiently flexible to meet these challenges and ensure that charges are as stable as possible.

The Commission has concluded that it is particularly important that Scottish Water can, and should be expected to, plan for the future. It should take ownership of its strategy.

Such a step will require the Commission to establish a regulatory framework, which limits the impact of asymmetries of information and time. The framework cannot be based on winners and losers or a parent-child relationship. It will have to be inclusive and collaborative.

Scottish Water has acknowledged the need to develop further its understanding of the condition and risks of its assets and manage repair, refurbishment and replacement in as effective a way as possible.

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Professor Chris Hodges has shown what makes regulatory frameworks effective. The Commission has adopted his principles of ethical based regulation...

Professor Hodges has demonstrated that a regulatory system will be more effective in influencing the behaviour of individuals when it supports and facilitates ethical and fair behaviour.

To avoid a reversion to more adversarial regulation, businesses should continually demonstrate evidence of their commitment to fair and ethical behaviour that will support the trust of regulators and enforcers, as well as of all levels of management and employees, customers, suppliers and stakeholders.

It would appear to be unrealistic to expect such behaviour if Scottish Water did not have full confidence that it will be appropriately funded for both the short and longer-term.

Given this regulatory commitment, Scottish Water should work collaboratively with its owner, its customers and its other stakeholders to co-create a clear Strategic Plan.

Subject to their expectations on compliance, regulators will have to reciprocate by recognising that they may not get everything else that they might want. Similarly, they and other stakeholders have to understand, and accept, that Scottish Water does have to make difficult choices in complying fully with the Ministerial Objectives and be accountable for them.

Regulators and stakeholders also need to understand that Scottish Water faces real challenges in consistently and reliably delivering the levels of service that its customers and communities rightly expect.

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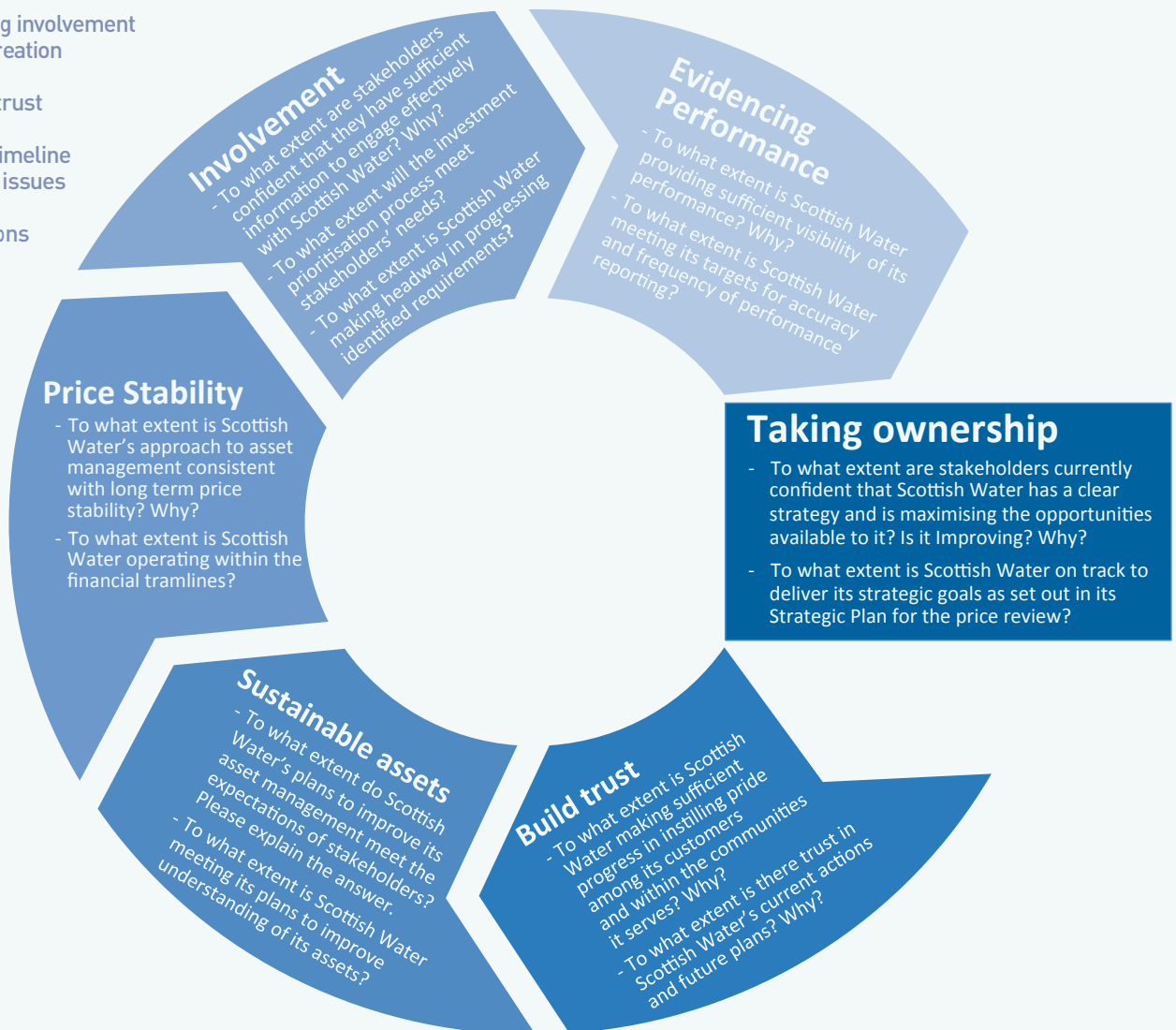
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The Commission has agreed with stakeholders the creation of an EBR review group. This group will develop initial thinking on indicators of an effective regulatory framework.



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The Commission welcomes Scottish Water's proposal to produce a Strategic Plan. It will be quite different to what Scottish Water might previously have provided...

In previous Strategic Review of Charges, the Commission adopted a more traditional approach to setting prices. It expected Scottish Water to prepare a detailed Business Plan, which gave its view of the price caps and public borrowing needed to fund a confirmed list of investment outputs.

As such, Scottish Water's Business Plan included detailed (and technical) forecasts for:

- Operating Expenditure, PFI expenditure, interest and capital maintenance expenditure;
- Growth in revenue arising from changes in the chargeable customer base; and
- The cost of delivering the outputs for the enhancement programme.

Going forward, the Commission is pleased that Scottish Water will work with its stakeholders to co-create its Strategic Plan:

- What are the expectations that customers and communities have for the water industry that will serve their children and grandchildren?
- How does Scottish Water propose to meet and exceed these expectations in doing the right thing for customers, communities, stakeholders and Scotland more generally?
- How will Scottish Water meet the compliance requirements of its quality regulators?
- How would it address the challenges identified in its Strategic Projections? Which of these challenges need urgent attention? (For example, Scottish Water may need to start soon to address longer-term issues such as rural connections, removing lead from the water supply and being appropriately funded for asset repair, refurbishment and replacement.)
- What does Scottish Water believe that it will need from its stakeholders?

Subject to the Ministers' Principles of Charging and Objectives and the Commission's decisions, the Customer Forum will seek to agree:

- whether the Strategic Plan has taken proper account of the evidence that the Customer Forum provides on the views and aspirations of current and future customers; and
- the price profile required to deliver the Strategic Plan, within the ranges set by the Commission.

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The Commission has revised the financial framework, recognising three broad categories of expenditure. Each category requires a different approach...

Category	Characteristics	Proposed approach
Operating, maintenance, financial and other expenditure.	Recurring expenditure and broadly stable from year to year.	The allowance for such expenditure would have an appropriate range to allow for year to year variation.
Capital Expenditure freely available to spend within the regulatory period.	Significant information and time asymmetries.	The allowance would be subject to the investment planning and prioritisation framework.
Additional Capital Expenditure ring-fenced and subject to progress in understanding and evidencing long-term asset replacement.	Significant time asymmetries (i.e. mismatch between capital expenditure and smooth charging profiles).	The allowance could be released subject to a review process. The conclusions of an independent reviewer are also likely to be important.

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The appropriate long-term allowance for capital expenditure is inherently uncertain. It will depend on on-going and more detailed analysis of the appropriate level of asset replacement.

The co-creation of the Strategic Plan is an important opportunity for stakeholders to input in documenting a list of aspirations and needs.

The categorisation of the capital expenditure allowance available within the regulatory control period would include:

- Responsive repair and refurbishment investment associated with assets that have failed and require immediate restoration of service;
- enhancement investment based on recent average annual expenditure;
- non-responsive investment for maintenance, inspections, repairs and refurbishment;
- growth investment, not already funded from developer contributions; and
- an allowance for planned asset replacement (comprising the elements of capital maintenance which are associated with the end of life replacement of an existing major asset such as a pumping station, treatment works or pipe network).

There is time to transition to an appropriate annual level of expenditure on asset replacement but there must be an appropriate and agreed transition.

The absolute appropriate annual level of expenditure could also vary within quite a wide range.

Consistent with Ministers' Objectives, Scottish Water will allocate the capital expenditure allowance to projects through the investment planning and prioritisation framework. Reviewing Scottish Water's project appraisals will provide stakeholders with reassurance that the proposals are addressing priority projects in an effective and efficient way.

Scottish Water should expect to have to evidence whether, and how, potential projects are progressing through the investment planning and prioritisation framework.

There will be scope for the capital expenditure allowance to be increased during the regulatory period; for example from the proceeds of out-performance (subject to Minister's approval) or the agreed release of funds from the ring-fenced allowance.

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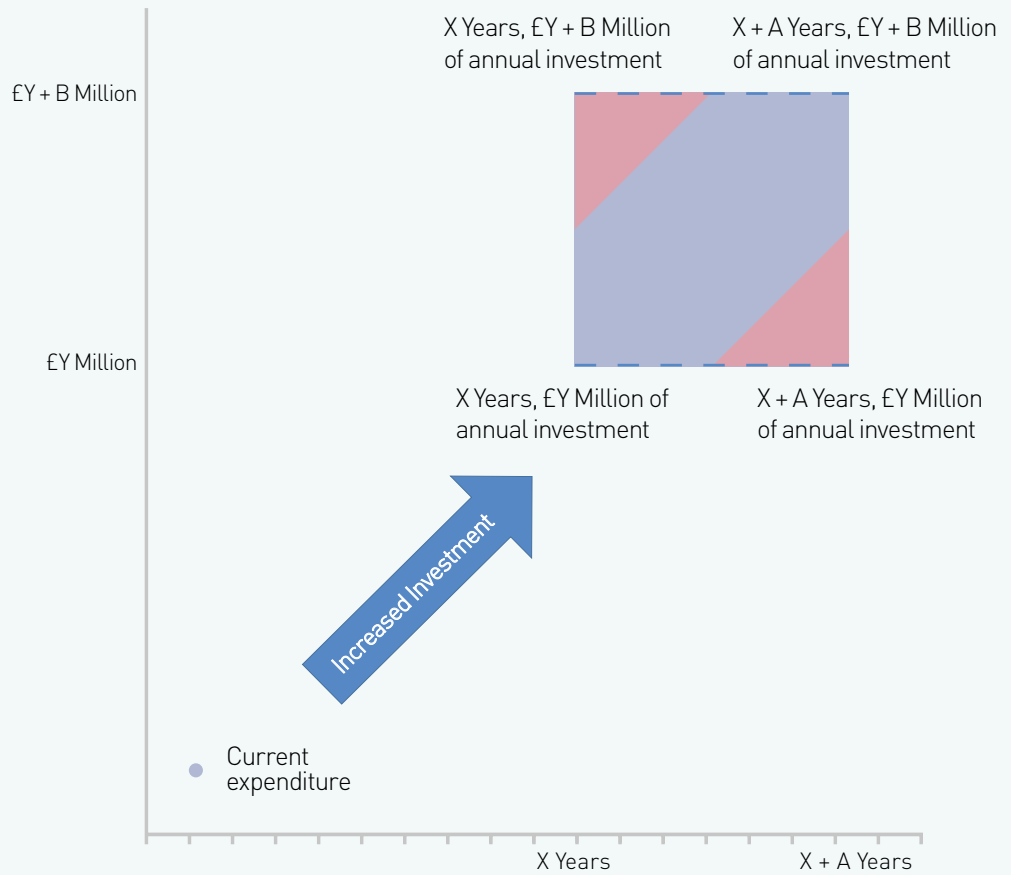
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Nonetheless, it is possible to identify, in very broad terms, an appropriate landing area for the transition in required investment expenditure...



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The Commission now proposes a modest revision to the timeline. It allows more time for Scottish Water to co-create its Strategic Plan.

Original timeline	Date	Proposed new timeline	Date
		Co-creation begins	11/18
		Outline Strategic Plan	14/12/18
		Commission publishes its draft view on long-term price profiles	Not later than 29/03/19
Draft Business Plan Published and Final Strategic Projections published	05/19	Co-created Strategic Plan and Strategic Projections finalised	Not later than 16/12/19
Final Decision Papers Published	07/19	Final Decision Paper on charge profiles published	Two months after Strategic Plan (Not later than 14/02/20)
Agreement on Business Plan	09/19	The Customer Forum seeks to agree: <ul style="list-style-type: none"> • whether the Strategic Plan has taken proper account of the evidence that the Customer Forum provides on the views and aspirations of current and future customers; and • the price profile required to deliver the Strategic Plan, within the ranges set by the Commission. 	+ Three Months (Not later than 16/03/20)
Draft Determination	11/19	Draft Determination	+ Five Months (Not later than 15/05/20)
Final Determination	03/20	Final Determination published	+ Nine Months (Not later than 21/09/20)

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The Commission clarifies and refines its methodology for the Strategic Review of Charges 2021-27...

The Scottish Government's Principles of Charging make it clear that in setting prices for the next regulatory control period, the Commission will have to provide a strong indication of the profile of charges beyond 2027.

Taking full advantage of an ethical based regulatory framework will require all stakeholders to engage actively in the co-creation of Scottish Water's Strategic Plan. This will require a move from bi-lateral to multi-lateral meetings in most circumstances.

The Customer Forum's role to act as a conduit for the views of customers and communities will be essential to the co-creation of the Strategic Plan and ultimately their view on the appropriate price profile required to allow for the effective and efficient delivery of the Strategic Plan.

The Commission has allowed for some flexibility in the timing of Scottish Water's Strategic Plan since Scottish Water has adopted a co-creation approach.

The Commission will publish its draft view on long-term price profiles by the end of March 2019.

There will likely be a transition over up to three regulatory control periods to the point where Scottish Water will have an appropriate level of annual investment funding to meet its needs for the improvement and replacement of its assets.

Going forward, a 'no blame' culture and candour will be increasingly important.



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Scottish Water has transformed itself into one of the leading water companies in the United Kingdom since its creation in 2002...

Scottish Water has delivered the second largest investment programme per connected property. Only South West Water has done more. Scottish Water's average annual investment is £262 per connected property, South West invested £288 and the England and Wales average was £207.

At the same time, average real household bills in Scotland have decreased by 5% relative to Retail Price Inflation (RPI). The smallest increase in England and Wales is 11% and the average is 19%. Scottish Water's charges are around £40 below the industry average in the UK – despite having one of the most challenging supply areas.

Scottish Water has the strongest balance sheet of any of the water companies. It has increased its debt by the second least of any of the water and sewerage companies (£51 per connected property versus an average south of the border of £131).

Scottish Water has achieved consistently high levels of service – its overall performance assessment (OPA) score was in the range of 393-406 points over the past five years (out of a maximum of 418).



Scottish Water's performance is better than anyone could have expected back at the time of the merger of the three former water authorities in 2002.

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However, there is no room for complacency. The industry has to develop further the trust and confidence of customers, communities and stakeholders, while it...

- Refines its understanding and addresses the need for asset replacement;
- Continues to meet stakeholders' expectations of investment in water quality, environmental improvements and supply security;
- Responds to changing demographic trends, which could have implications for meeting new demand from growth;
- Meets long-term challenges such as increasing rural provision and reducing the levels of lead in drinking water; and
- Consistently exceeds expectations in augmenting natural and social capital.



All of which will place a significant upward pressure on customers' charges; and

There are no longer major efficiency gains sufficient to offset increased investment expenditure.

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The Commission's methodology set out its aims for the revised regulatory framework...

Providing a stable framework that is sufficiently long-term, achieving:

- Broadly stable prices;
- Appropriate levels of funding over the long-term; and
- Appropriate levels of investment in light of the asset replacement challenge and other emerging investment requirements.

Providing flexibility to respond to changing circumstances or new information while maintaining strong levels of incentives

More accessible and regularly updated information to facilitate stakeholder engagement:

- Demonstrating appropriate levels of funding;
- Setting out the resources available for investment prioritisation; and
- Evidencing progress towards understanding and addressing the asset replacement challenge.

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The methodology explained the rationale for the approach to the Strategic Review of Charges 2021-27...

Information asymmetry – where the regulated company inevitably knows more than any of its other stakeholders – reduces the effectiveness of benchmarking. The Commission’s approach to setting prices needs to recognise this potential pitfall.

The Commission has looked carefully at the results of different approaches to benchmarking. Its methodology concluded that there are now relatively small gaps in performance between water companies. This means that traditional benchmarking techniques can play no more than a limited role in identifying the scope for further performance improvements.

Competitive markets could be an alternative approach to resolving information asymmetry. A review of markets in utility services suggests that competitive markets are inconsistent with the commitment of appropriate investment for the long-term.

This suggests that there may also be an asymmetry of time horizon to add to the asymmetry of information. The Commission considers that the focus of the water industry has to be on the long-term maintenance, replacement and improvement of its assets if service levels are to be maintained and enhanced. Consistent levels of customer service, water quality and environmental performance all require this longer-term focus.

The Commission is also concerned that a focus on defined regulatory control periods may also reduce the scope for thinking longer-term.

For example, what if operating expenditure could be used to deliver a particular improvement but it pays back only after the end of the control period?

The Scottish industry has already begun to recognise this by increasing the use of study and water modelling and by allowing for longer-term projects (such as addressing Glasgow’s drainage) but there is more that could be done.

Moving away from the defined regulatory control period in analysing costs and outputs requires the Commission to reconsider its previous approach of setting a ‘hard budget constraint’ on Scottish Water.

An alternative approach is to consider the level of appropriate funding for the long-term.

The ‘hard budget constraint’ previously created the conditions necessary for the regulated company to identify and implement more efficient and innovative approaches.

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The methodology identified that the ‘hard budget constraint’ is not immediately consistent with transitioning customers’ charges to a level consistent with timely repair, refurbishment and replacement of assets.

Regulators set a ‘hard budget constraint’ – access to cash should be just sufficient to meet the efficient expenditure required to deliver the desired levels of service.

For many, if not most, assets a ‘portfolio’ effect will apply. Actual replacement can be scheduled given that Scottish Water will be funded appropriately.

However, as we start to plan for the long-term replacement (rather than just the repair and refurbishment) of assets, Scottish Water may have to set aside cash or seek to advance its borrowing from the Scottish Government.

It will likely take more than two regulatory control periods to transition charges to a level consistent with Scottish Water being funded appropriately for the long-term. Such a transition will futureproof levels of service to customers, communities and other stakeholders.

Moving away from the short/ medium term focus of the next regulatory control period will require Scottish Water to build further the confidence of the Scottish Government, its regulators and its customers. This will require Scottish Water to co-develop its approach and pro-actively to explain how it currently sets its priorities and takes decisions.

The investment planning and prioritisation framework, the revised financial framework and reassurance processes (set out in the 2018 Decision Papers) should ensure that outcomes are at least as good as those achieved under the current ‘hard budget constraint’.

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The Commission refines and clarifies its methodology for the Strategic Review of Charges 2021-27...

The Scottish Government's Principles of Charging make it clear that the Commission should provide a strong indication of the profile of charges beyond 2027 when setting prices for the next regulatory control period.

Taking full advantage of an ethical based regulatory framework would require Scottish Water to co-create its Strategic Plan. Building trust and confidence means that there should be a move from bi-lateral to multi-lateral meetings in most circumstances.

The Customer Forum's role to act as a conduit for the views of customers and communities will be essential to the co-creation of the Strategic Plan and ultimately their view on the appropriate price profile required to allow for the effective and efficient delivery of the Strategic Plan.

The Commission has allowed for some flexibility in the timing of Scottish Water's Strategic Plan since Scottish Water has adopted a co-creation approach.

The Commission will publish its draft view on long-term price profiles by the end of March 2019.

There will likely be a transition over up to three regulatory control periods to the point where Scottish Water will have an appropriate level of annual investment funding to meet its needs for the improvement and replacement of its assets.

Going forward, a 'no blame' culture and candour will be increasingly important.

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Long-term demands on the investment programme appear to be growing.

The Commission noted several pressures including:

- Water quality and environmental investment seems likely to continue at current levels for the foreseeable future;
- Customers have higher expectations than previously;
- The Commission expects further growth in the number of properties that Scottish Water serves;
- There is evidence of increasing ambition on the part of Scottish Government and other stakeholders to address the risk of flooding, tackle lead and improve rural provision; and
- Asset replacement is not being adequately addressed.

Scottish Water will also have to manage the ending of the PFI contracts. It should reap a long-term benefit from income growth and a reduction in costs when the PFI contracts end – but there may be one-off costs at the end of the contracts. The Commission notes that even if the significant benefits expected are realised, these will not fully offset the impact on prices of higher investment levels.

Managing a likely increase in investment creates challenges...

To reach a satisfactory outcome and ensure that price increases can be kept to a minimum, Scottish Water will have to think and act more strategically and innovatively.

In particular, Scottish Water will have to improve the capacity, capability and effectiveness of its asset management. There will likely be both a significant increase in total capital expenditure and a decrease in the average project size.

Improving the effectiveness of asset management will require, amongst other things, a comprehensive understanding of asset condition.

If Scottish Water is to develop further and maintain the confidence of its customers, it needs to show that it is spending customers' money prudently. To achieve this, Scottish Water will have to evidence why it should have access to more capital expenditure in the next regulatory control period.

Customer, community and stakeholder input to the planning and prioritisation of investment will therefore be essential if Scottish Water is to build further trust.



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Professor Chris Hodges has shown what makes regulatory frameworks effective. The Commission has adopted his principles of ethical based regulation.

- A regulatory system will be more effective in influencing the behaviour of individuals when it supports and facilitates ethical and fair behaviour;
- A blame culture will inhibit learning and an ethical culture, so businesses and regulators should support an open collaborative culture;
- Regulatory systems need to be based on collaboration if they are to support an ethical regime, as well as maximising performance, compliance and innovation;
- To avoid a reversion to more adversarial regulation, businesses should continually demonstrate evidence of their commitment to fair and ethical behaviour that will support the trust of regulators and 'enforcers', as well as of all levels of management and employees, customers, suppliers, investors and stakeholders; and
- Where there is unethical behaviour, people expect a proportionate response. This is consistent with strong sanctions for intentional wrongdoing.

So it follows that Scottish Water should:

- Develop further a culture of openness at all levels of its organisation;
- Evidence that it is acting efficiently and effectively;
- Evidence awareness and the support of its customers and communities and involve them in its decision making;
- Be open to suggestions and different ways of thinking about an issue; and
- Maintain and make available to its stakeholders high quality information on asset performance, condition and risk at a disaggregated level – and demonstrate that it has a comprehensive understanding of that information.



But it would be unrealistic to expect such behaviour if Scottish Water did not have full confidence that it will be appropriately funded for both the short and the long-term.

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Working with stakeholders, the Commission set out the factors that would allow for effective economic regulation operating under the principles of ethical based regulation...

Scottish Water should work collaboratively with its owner, its customers, and its other stakeholders to co-create a clear strategy. Such a strategy should maximise the opportunities available and provide clear evidence for the approaches that it plans to adopt.

Scottish Water should adopt behaviours that build trust and make progress in instilling pride among its customers and within the communities that it serves. It should expect its regulators and customer representatives to behave similarly.

This will involve developing its approach to asset management through providing evidence of the resources needed to improve performance and improving its asset knowledge; both of which will underpin effective, efficient and timely replacement of assets.

In return, it should expect its owner and regulators to ensure that it is appropriately funded and to recognise that even the best made and intentioned plans are not always realised exactly as initially intended or desired.

Scottish Water should continually seek to improve its efficiency and, where appropriate, take advantage of innovation to ensure that prices are kept as low as is consistent with an industry appropriately funded for the long-term.

Scottish Water should improve the transparency and frequency of its reporting on performance. It should evidence its performance and improvements and admit any shortfall to its owner, regulators and customer groups. They, in turn, should recognise good performance when it occurs.

Scottish Water should seek, on an on-going basis, to work collaboratively and constructively with regulators and other stakeholders to identify and implement the most effective and efficient solutions.

Subject to their expectations on compliance, regulators will have to reciprocate by recognising that they may not get everything else that they might want. Similarly, they and other stakeholders have to understand, and accept, that Scottish Water does have to make difficult choices in complying fully with the Ministerial Objectives and be accountable for them.

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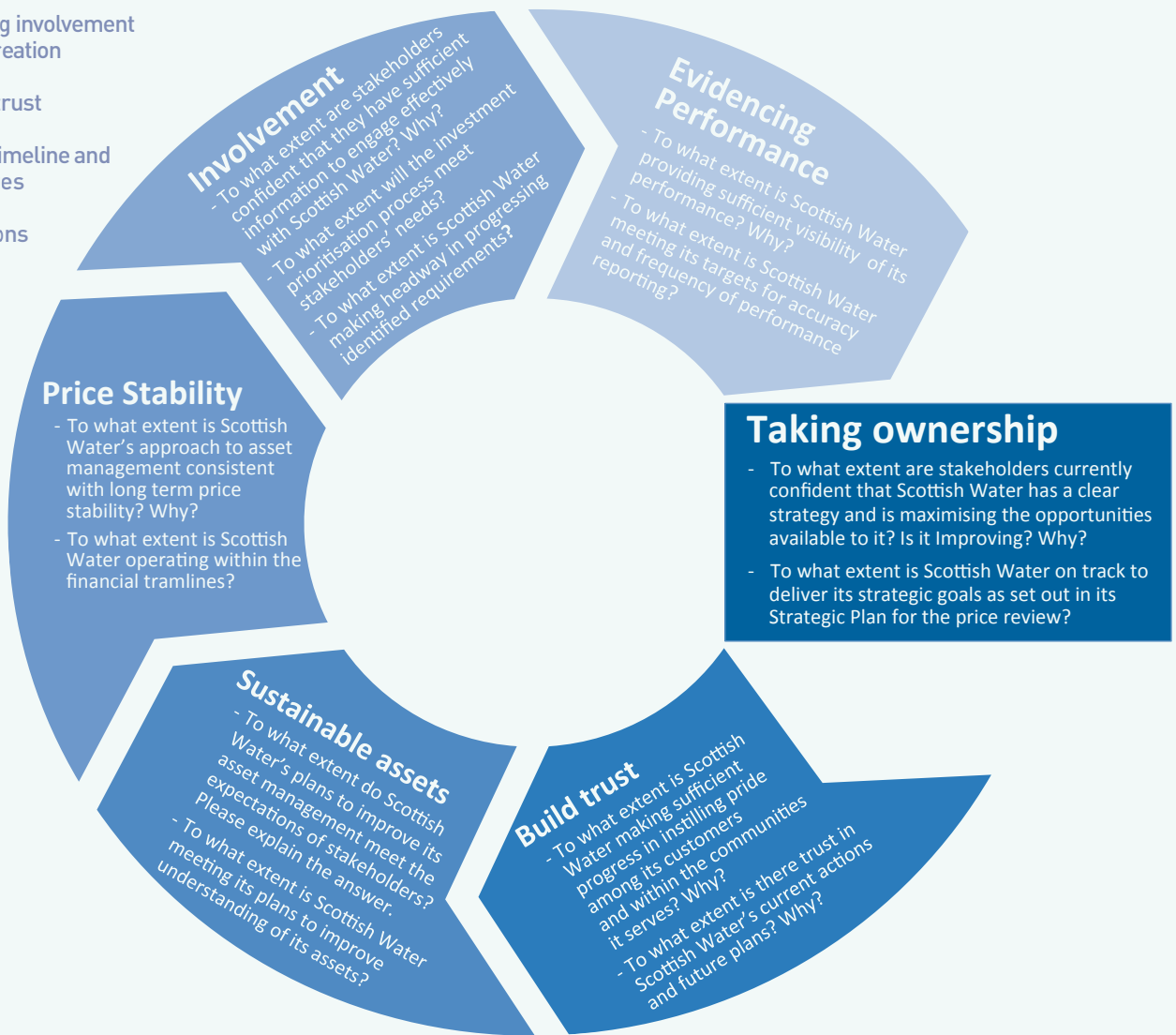
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The Commission has agreed with stakeholders the creation of an EBR review group. This group will develop initial thinking on indicators of an effective regulatory framework.



The Group will monitor progress and challenge robustly wherever it may be appropriate...

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One of the benefits of an economic regulatory framework founded on the principles of ethical based regulation should be to allow the space for greater innovation...

At the previous Strategic Review of Charges, the Commission did take steps that were designed to encourage innovation. The Commission set out a willingness:


- To consider risk adjusted costs (Scottish Water could agree a ring-fenced sum to cover the risk that, across a portfolio of innovative projects, some may not work);
- To allow for long-term pay back initiatives.

Guided by the principles of ethical based regulation, it is now for Scottish Water to work collaboratively with its stakeholders on how it should resolve the challenges that it faces.

Scottish Water will have to improve further how it explains its potential, planned or on-going activities to its customers, communities and other stakeholders and, in particular, how it will try to do things better and more innovatively and outline the risks and potential benefits.

Customers, communities and other stakeholders expect Scottish Water fully to embed innovative thinking and approaches into its activities.

Responding effectively may require Scottish Water to set out a clear timeline for the steps that it is taking to embed innovation and report regularly and publicly on the results of its efforts.



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What the Commission said in its methodology...

The Commission asked Scottish Water to publish long-term (25 year) Strategic Projections and a 6 year Business Plan, which should be fully consistent with its longer-term Strategic Projections.

In its Business Plan, the Commission expected Scottish Water to set out a proposed level of capital expenditure and its approach to:

- Asset maintenance;
- Growth;
- The future operation of the wastewater and sludge PFI contracts;
- Innovation;
- Defining Projects; and
- Evidencing efficiency.

The Commission confirmed its intention that Scottish Water and the Customer Forum should seek to agree a Business Plan that will meet the needs of the full range of Scottish Water's customers. Again, the Customer Forum should act as a conduit for the views of customers and communities.

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The Commission expects Scottish Water's proposed Strategic Plan to be quite different to what it might previously have provided...

In previous Strategic Review of Charges, the Commission adopted a more traditional approach to setting prices. It expected Scottish Water to prepare a detailed Business Plan, which gave its view of the price caps and public borrowing needed to fund a confirmed list of investment outputs.

Through discussions with stakeholders, the Commission understands that continuing to refer to a 'Business Plan' is potentially unhelpful. The Commission welcomes Scottish Water's proposal to provide a 'Strategic Plan' and to involve stakeholders closely and proactively in its development.

Going forward, the Commission expects Scottish Water to work with its stakeholders to co-create its Strategic Plan for the future:

- What are the expectations that customers and communities have for the water industry that will serve their children and grandchildren?
- How does Scottish Water propose to meet and exceed these expectations in doing the right thing for customers, communities, stakeholders and Scotland more generally?
- How would it address the challenges identified in Ministerial Objectives and its Strategic Projections? Which of these challenges need urgent attention? (For example, Scottish Water may need to start soon to address longer-term issues such as rural connections, removing lead from the water supply and being appropriately funded for asset repair, refurbishment and replacement.)
- What does Scottish Water believe that it will need from its stakeholders?

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The Strategic Plan is an opportunity for Scottish Water to build the trust and confidence of Scottish Government, customers, communities and other stakeholders. The Commission expects Scottish Water would want to address...

Profile of customers' charges: What level of charges does Scottish Water consider is necessary? When should the transition to a long-term profile take place? To what extent could these proposals be amended?

Management of cash: Our analysis suggests that Scottish Water is likely to exit the current regulatory control period with a very significant cash balance. Subject to the view of Ministers, how does it propose to manage this cash balance? To what extent does it expect to add to this cash balance during the forthcoming regulatory control period? When, and how, would it plan to access the cash reserve?

Building and maintaining trust: What steps will Scottish Water take to build the trust and confidence of all of its stakeholders in how it is operating as a business? What steps will it take to involve customers and communities in how it provides its services and its approach to the wider public good? How will Scottish Water evidence that it is operating efficiently and effectively? What reassurance processes could be useful?

Improving the scope, detail and use of its asset information: What is its asset improvement plan? How will it implement its asset improvement plan and over what time frame? How will it establish the confidence of all of its stakeholders in the asset improvement plan and its implementation? How will it improve its understanding of the relative efficiency of repair, refurbishment and replacement approaches to the management of its assets?

Investment needs: What levels of investment will Scottish Water have to provide for? When does it expect to have to commit this investment? How long could Scottish Water take over its transition to an appropriate level of average annual expenditure on asset replacement without impacting levels of service and materially increasing risk or costs? What risk profile across its different activities is Scottish Water assuming? How will it evidence the efficiency and effectiveness of its investment? How will it evidence that innovation, carbon reduction and natural and social capital are fully embedded in its approach?

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Turning the strategic projections into an executable plan: How urgent and important does Scottish Water believe the challenges outlined in its strategic projections to be? How long does it believe that its ambitions will take to deliver? How can customers and communities be sure that their expectations will be met or exceeded?

How Scottish Water will operate within the revised regulatory framework: How will Scottish Water develop as an organisation in the light of the revised approach to economic regulation? How will the investment planning and prioritisation framework work? What sort of appraisals will Scottish Water make available? How and when might Scottish Water update its strategy?

How it should be judged: What performance measures does Scottish Water propose? How will these work? How will stakeholders have confidence that performance is improving and that Scottish Water will deliver on its strategy? How will customers have confidence that Scottish Water operates more efficiently each year?

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The move to the Strategic Plan should clarify the role of the Delivery Plan...

Area	Traditional Business Plan	Strategic Plan	Delivery Plan
Price profiles and assumed borrowing	✓	✓	✓ Confirms the price cap and tariffs.
Allowed for level of investment	✓	✓	
Detail of the investment outputs	✓	The Strategic Plan should underpin continuity in the ongoing investment programme and include the framework for investment prioritisation. It should also include an asset improvement plan.	✓ Lists of identified needs and aspirations and those advanced to revised 'Technical Expression'. Current and expected progress.
Outline of the performance measures		✓	
Performance targets	✓ Against regulatory targets		✓ Could confirm the minimum expected (not potential) level of performance.

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Review of Charges](#)**► Vision and Strategy**[Long-term and
appropriate funding](#)[Increasing involvement
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open issues](#)[Conclusions](#)**In line with the Tri-Partite Co-operation Agreement, the Customer Forum will act as a conduit for the views of customers and communities in inputting to Scottish Water's Strategic Plan, and will ultimately, agree the price profile...**

Scottish Water will now produce a Strategic Plan. It will seek to co-create its Strategic Plan together with its stakeholders. It will be important that this process is fully multi-lateral.

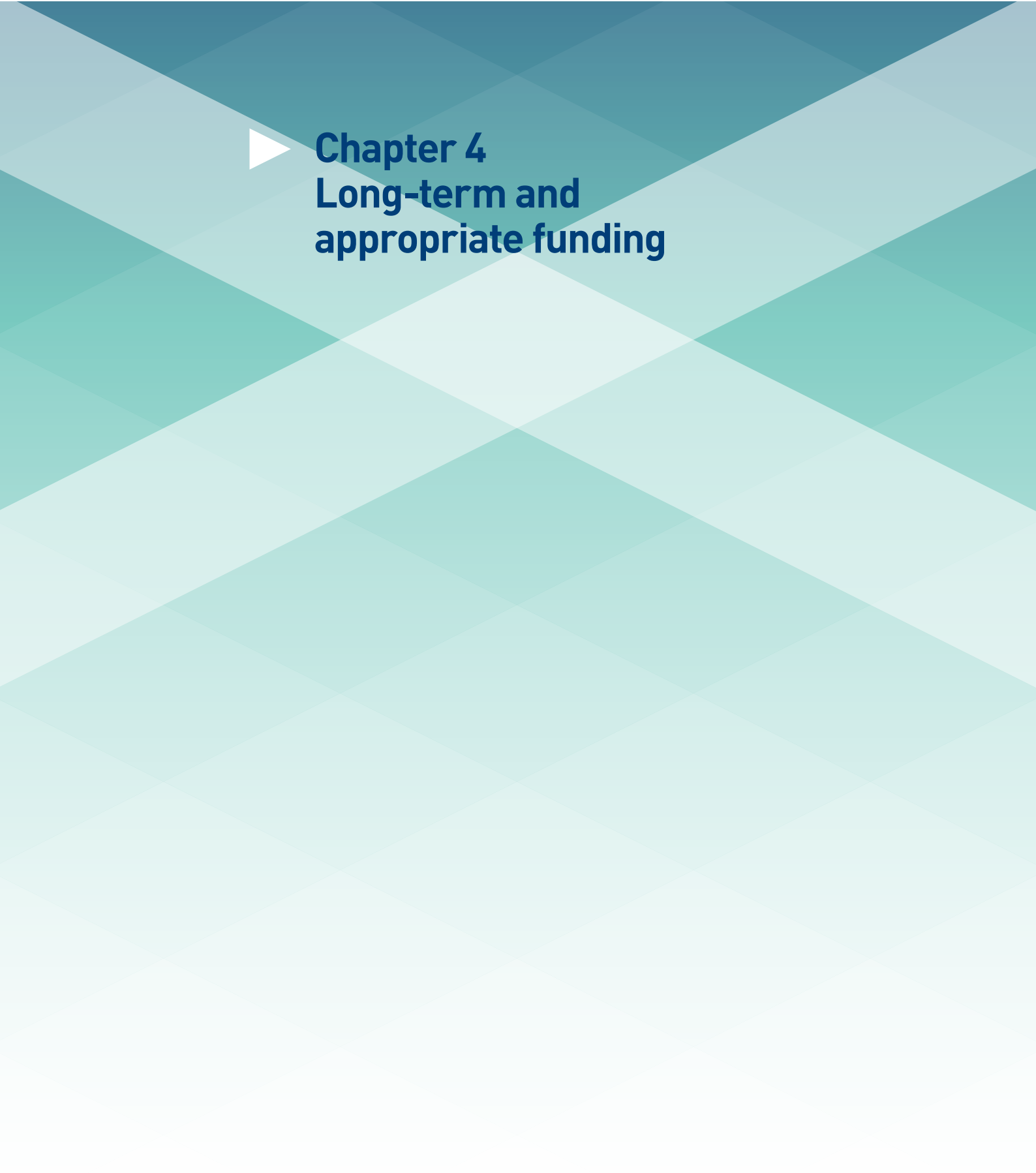
Scottish Water should own and facilitate the co-creation process. The co-created Strategic Plan should set out:

- The available evidence relating to the likely ongoing, long-run level of average annual expenditure on asset replacement and its implications;
- How quickly a transition to this annual level of expenditure can reasonably be made;
- How, when and how often Scottish Water will refine this evidence and its implications;
- The efficiency challenge on the other (non-capital) expenditure that Scottish Water plans;
- How Scottish Water's Strategic Plan will safeguard the interests of customers and communities?

Stakeholders could seek a consensus on how charge caps could reflect appropriate progress by Scottish Water in delivering its Strategic Plan and understanding and evidencing its requirement to increase expenditure on replacing assets. This might reasonably cover the next regulatory control period and the subsequent two regulatory periods.

The Commission will provide its views on the range of price profiles that it considers to be consistent with an industry that is appropriately funded for the long-term, once Scottish Water has made significant progress in the co-creation of its Strategic Plan.

The Customer Forum will then engage with Scottish Water and seek to agree the exact price profile and, subject to Ministers' lending decisions, the level of contribution to any ring-fenced allowance for asset replacement.



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What the Commission set out in its methodology...

In its methodology, the Commission identified three options for addressing asset replacement needs:

- Scottish Water could build up balance sheet reserves for future expenditures (keeping prices more stable);
- It could operate a 'pay as you go' approach that is designed to meet the likely requirements identified at the start of each regulatory control period; or
- It could continue to operate the 'pay the minimum that is demonstrably required' approach.

The Commission explained that the first option was likely to be most consistent with inter-generational equity and a long-term approach. However, it was also likely to require a level of understanding of asset performance, condition and risk that goes beyond where Scottish Water currently is.

The Commission also explained that there are other key considerations with this option. These included:

- establishing appropriate governance arrangements around the reserve; and
- establishing effective asset management processes which ensure that maintenance activity is properly targeted and carried out efficiently.

In relation to Scottish Water's overall financial performance, the Commission also noted that more could be done to improve the transparency of Scottish Water's performance through improving the 'tramlines' mechanism, including;

- how frequently Scottish Water reports its performance;
- the parameters used to measure performance on the tramlines; and
- improving the benefit sharing mechanism.

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There is good progress in developing an approach to managing the likely annual asset replacement liability...

Stakeholders will understandably expect Scottish Water to evidence the extent of its asset replacement challenge and how it plans to transition to a sustainable approach, for example in terms of the cash required, management capability and the capacity of the supply chain.

The Commission sees similarities between a defined benefit pension scheme and the asset replacement challenge. In both cases, there is a liability which will only fully crystallise over time. Likewise, it is essential that resources will be available when required in both cases if trust and confidence are to be maintained.

- Scottish Water has promised, as a minimum, to maintain service levels. The approach to funding a defined benefit pension scheme should allow this to be delivered if it commits available resources effectively and efficiently.
- Alternative approaches would be more similar to defined contribution pension schemes. Future customers would have to accept reduced (even if still compliant) service levels or higher charges.

There is a clear intergenerational trade-off between charges, reliability of services and environmental and water quality resilience.

Scottish Water has begun to analyse and quantify the likely total extent of its asset replacement challenge. Further work is likely to be required, beyond the Strategic Plan, to understand the timeframe and appropriate approach to effective and efficient asset replacement.

Increased funding for asset replacement could be released from the ring fence when stakeholders are comfortable that Scottish Water has addressed key issues such as:

- **How much?** Scottish water should seek to define more clearly the amount that it will need to spend;
- **How?** Scottish Water should be able to demonstrate how it is making progress in line with the advice of the independent expert on asset information and asset management; and
- **Why?** Scottish Water should evidence how it proposes to spend the resources available effectively and efficiently.

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There has been useful discussion with stakeholders...

There appears to be a broad consensus that charges should transition to a level where Scottish Water can replace its assets as and when it is efficient to do so. There is currently less consensus over the time frame of such a transition and over how much an efficient replacement allowance should be.

Currently, there needs to be more definitive evidence that a significant increase in the rate of asset replacement will be required during the next regulatory control period.

In 2018 Decision Paper 5, the Commission noted:

- Scottish Water should consider offering to 'ring-fence' some proportion of its allowed for revenue and propose external verification of its approach to understanding and evidencing its need for asset replacement;
- This allowance would be released when Scottish Water can evidence the requirements, in line with the advice of the independent expert on asset information and asset management, and establish a consensus on the amount that will need to be spent; and
- The investment planning and prioritisation framework will play an essential role in building confidence in this evidence.

The Commission has also developed its thinking on how the revised 'tramlines' could work in practice, including the interactions with other elements of the regulatory framework such as the investment planning and prioritisation framework.

The rest of this chapter sets out more detail on the financial framework:

- It provides clarity on the treatment of the different elements of expenditure, including separation of the elements monitored through the financial tramlines and those subject to the investment planning and prioritisation framework; and
- Thoughts on the ring-fencing (and eventual release) of a proportion of Scottish Water's allowed for revenue to fund an increase in the levels of investment in the future.

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The revised financial framework will recognise three broad categories of expenditure. Each category requires a different approach...

Category	Characteristics	Proposed approach
Operating, maintenance, financial and other expenditure	Recurring expenditure and broadly stable from year to year	The allowance for such expenditure would have an appropriate range to allow for year to year variation
Capital Expenditure freely available to spend within the regulatory period	Significant information and time asymmetries	The allowance would be subject to the investment planning and prioritisation framework.
Additional Capital Expenditure ring-fenced and subject to progress in understanding and evidencing long-term asset replacement	Significant time asymmetries (i.e. mismatch between capital expenditure and smooth charging profiles)	The allowance could be released subject to a review process. The conclusions of an independent reviewer are also likely to be important.

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This approach will improve transparency on performance, provide flexibility in delivering solutions and build trust in the overall regulatory process...

As part of its Strategic Plan, Scottish Water should seek to agree an allowance for all operational and financial expenditure, along with an acceptable range around this allowance.

- if Scottish Water is outperforming or underperforming on this range, stakeholders can observe such variation in its reported expenditure.
- outperformance on costs or revenue will be visible and could increase the investment available for investment planning and prioritisation (subject to the agreement of Scottish Ministers) and bring positive reputational benefits (reflected in the regulator's performance report).

Scottish Water should also seek to agree an allowance for the investment to be subject to the investment planning and prioritisation framework.

- the process will be supported by accessible appraisals which will give stakeholders confidence that the allowed for investment is being spent appropriately; and
- ongoing monitoring will inform stakeholders whether projects are progressing appropriately through the process.

Scottish Water should also seek to agree a price profile consistent with the delivery of its Strategic Plan (taking account of any ring-fenced allowance for long-term asset replacement).

- this will allow the industry to be appropriately funded over the long-term by ensuring adequate provision for asset replacement, once there is evidence to support the need.
- The ring fence ensures a hard budget constraint and protects the allowance in the event that Scottish Water does not make sufficient progress in understanding, and evidencing, the nature and extent of its asset replacement challenge.

The financial framework will allow stakeholders to respond proactively and flexibly if there is a change in circumstances, whilst maintaining the discipline of a hard budget constraint.

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The operating, maintenance, financial and other expenditure would be set within an allowed for range...

This allowance would include all:

- operating costs;
- PFI expenditure;
- developer contributions;
- interest and taxation; and
- the costs of responsive repair and refurbishment or replacement of existing assets.

This allowance would include an efficiency challenge to reflect the scope for productivity improvements. The efficiency challenge should apply to the whole allowance. Scottish Water would have the freedom to decide how it achieves the efficiency challenge.

Scottish Water would have flexibility to operate within this range. Scottish Water would have to evidence the reasons for any variation beyond the tramlines and engage with its owner and stakeholders on subsequent actions.

The range between the bottom and the top of the 'tramlines' could reasonably be reduced as the monitored expenditure is less volatile. The Commission suggests that about £20 million (c 2.5%) a year, above and below the allowed for expenditure, could be reasonable.

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The capital expenditure allowance would be subject to the investment planning and prioritisation framework.

The capital expenditure allowance available within the regulatory control period would include:

- Sufficient investment to deliver Ministerial Objectives in full;
- enhancement investment based on recent average annual expenditure;
- non-responsive investment for maintenance, inspections, repairs and refurbishment;
- growth investment, not already funded from developer contributions; and
- an allowance for planned asset replacement (comprising the elements of capital maintenance which are associated with the end of life replacement of an existing major asset such as a pumping station, treatment works or pipe network).

Scottish Water will allocate the capital expenditure allowance to projects through the investment planning and prioritisation framework.

This process is an important opportunity for stakeholders to input both in terms of co-creating a list of aspirations and needs and through reviewing Scottish Water's project appraisals. This will provide stakeholders with reassurance that the proposals are addressing priority projects in an effective and efficient way.

Scottish Water should expect to have to evidence whether, and how, potential projects are progressing through the investment planning and prioritisation framework.

There will be scope for the capital expenditure allowance to be increased during the regulatory period (subject to Ministers' approval); for example from the proceeds of out-performance or the agreed release of funds from the ring-fenced allowance.

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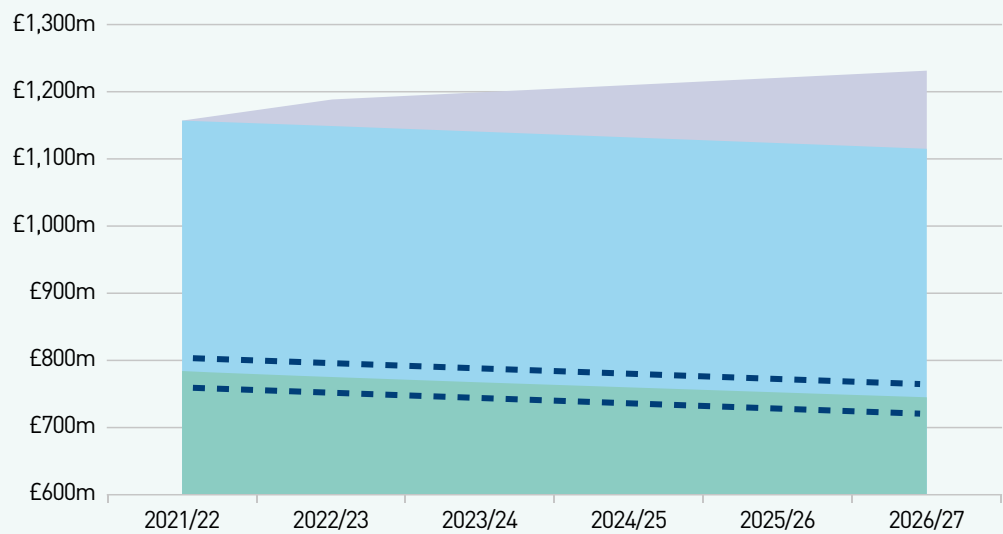
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The cash allowance would reflect these three simple revised 'building blocks.'

Application of cash (indicative, annual)



- Allocation of cash to the ring-fenced allowance
- Capital expenditure allowance which covers enhancement; growth investment; and non-responsive maintenance, inspections, repair, refurbishment and asset replacement
- Operating, responsive maintenance, financial and other expenditure
- Range for operating, responsive maintenance, financial and other expenditure

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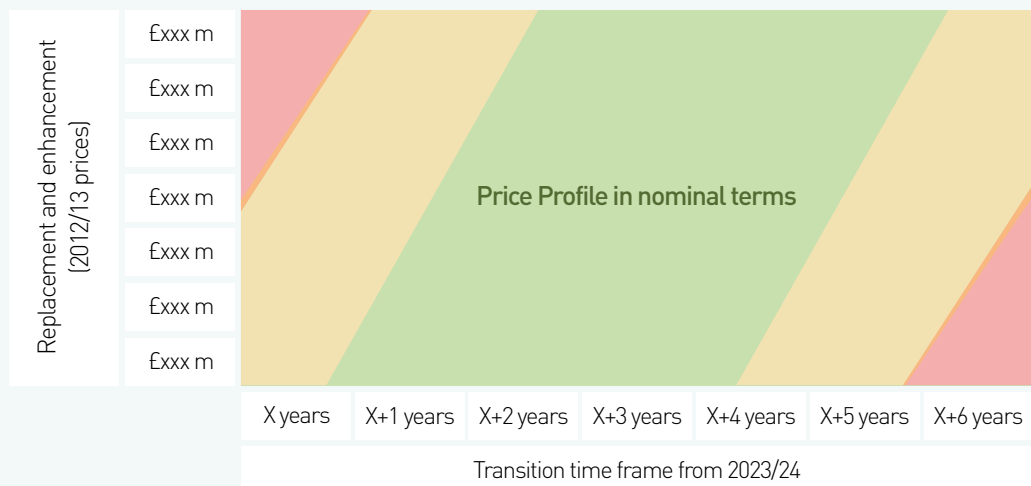
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The Commission will develop initial heat maps of combinations of potential price ranges, target ranges of funding and transition times to the target...

The heat maps will show different combinations of:

- the target annual investment on asset replacement and enhancement;
- the transition time frame from (for example) 2023/24; and
- price profiles in nominal terms.

Responsive repair and refurbishment investment will not be included in the allowed for investment choices in the heat maps or diagrams.



The upper left quadrant will be red if the transition to target is not possible without too large an increase in bills.

The Commission will have a view on a prudent transition to an appropriate level of long-term funding. A prudent level of long-term funding should make it significantly more likely that expected price increases can be reduced than that the Commission finds itself in the position where it would have to allow for higher increases. The lower left quadrant would be red if the Commission's initial view is that the target level is not sufficiently prudent.

The upper right quadrant would be red if the Commission considers that the transition is taking too long.

The lower right quadrant would be red if the Commission considers both the target to be insufficiently prudent and that it may be taking too long to complete even this transition.

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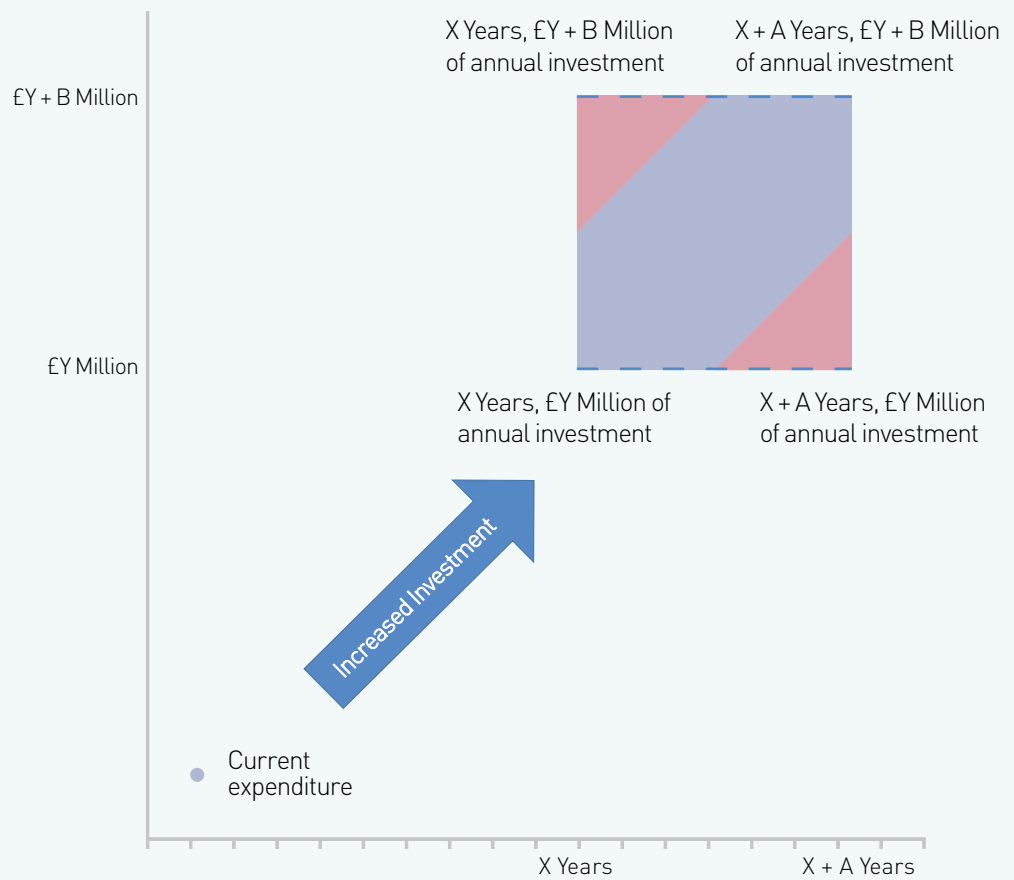
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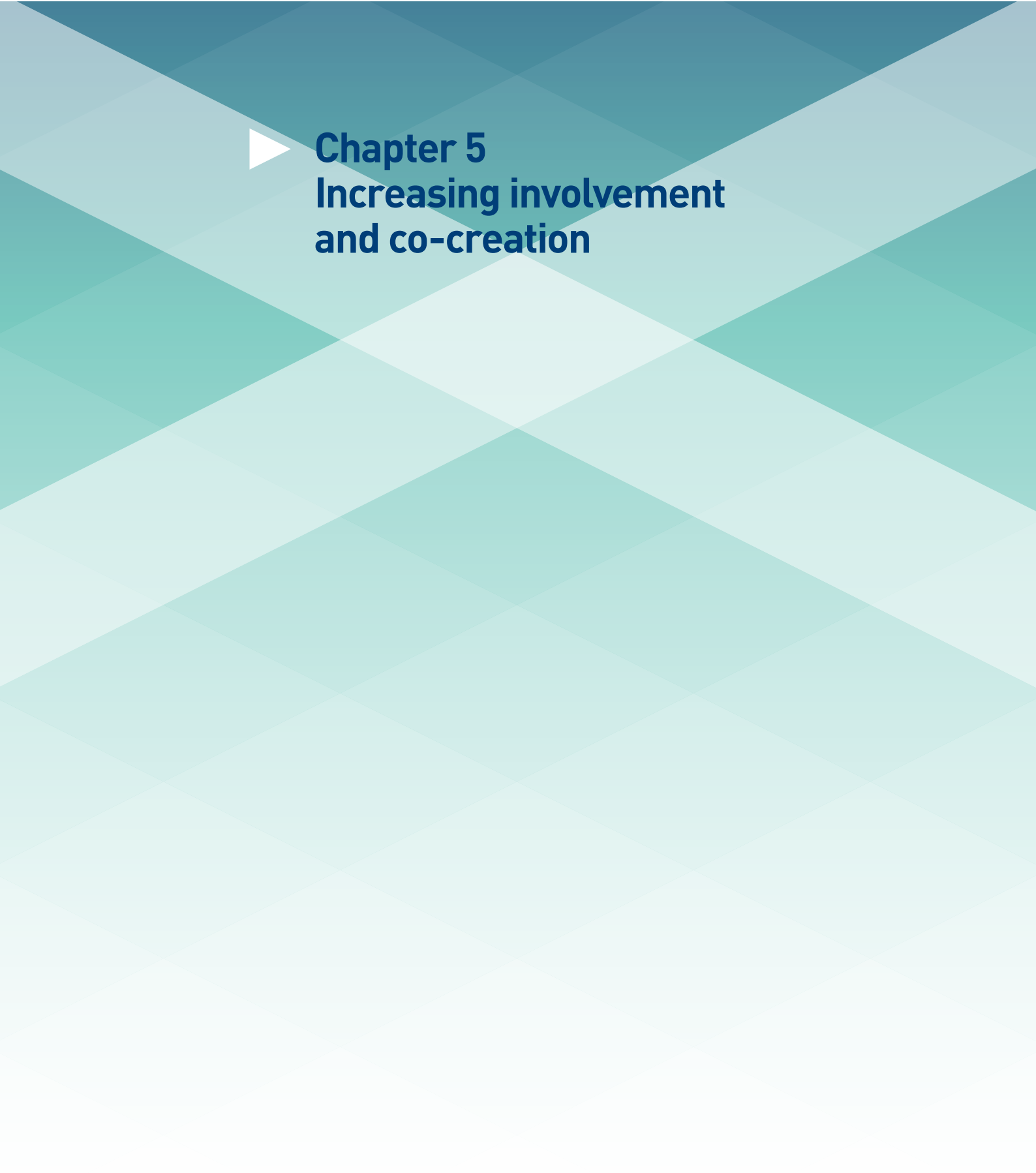
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It is possible to identify, in very broad terms, an appropriate landing area for the transition in required investment expenditure...





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The Tri-Partite Co-Operation Agreement broadened the Customer Forum’s remit to include communities. The methodology set expectations that Scottish Water should ‘seek trust, but expect verification’.

The Commission noted that the most successful companies in competitive markets over the long-run are those that are most focused on the customer and those that treat their staff and supply chain fairly. They depend on their reputation and act as good corporate citizens.

Traditional economic regulation is quite different. It establishes a parent/ child relationship and reduces the accountability of the service provider to the customers and communities it serves.

The Commission’s approach at the last Strategic Review of Charges was to empower Scottish Water to reach an agreement with its customers that was consistent with the Commission’s analysis of lowest overall cost.

The aim was that Scottish Water focus on improving further its reputation and being more directly accountable to the customers and communities that it serves.

The Commission identified five areas where progress potentially could be made:

- Engagement
- Avoiding the consequences of loss aversion
- Managing risk
- Monitoring and reporting
- Governance

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The methodology set out areas where progress towards a framework founded on ethical based regulation could be made...

Engagement and avoiding loss aversion

Greater trust and openness between regulators and the regulated would act as a catalyst for a more productive relationship and the ability to take forward joint solutions to address the challenges ahead.

A process led by Scottish Water to co-create its Strategic Plan with its customers and other stakeholders.

Managing risk

An opportunity to agree how uncertainty and risk should be handled: helping drive improved performance and greater innovation.

An opportunity to provide revenue certainty beyond a particular regulatory control period if this could reduce costs or improve levels of service.

Monitoring and reporting

Fully transparent reporting of performance – with appropriate evidence – and progress towards meeting agreed service levels and other targets by the company – with further detail being available to those who wish it.

A mechanism to monitor financial performance and ensure that returns are fair and not excessive but also that the company is insulated from unexpected costs outside of management control.

Governance

An expectation that a regulated company will identify the extent of out-performance and discuss how to share the benefits with its owner and other stakeholders (including the scope for immediate improvements or by putting money away for the proverbial rainy day).

Scottish Water to take full responsibility for its capital expenditure and be directly accountable to its customers and to the quality regulators. It should be able to evidence why it has taken the steps that it has.

Strong regulatory bodies comment authoritatively on performance. Regulators must produce high quality and accessible monitoring reports - with further detail being available to those who wish it. This should include an expectation that negative comments from regulators have a material impact on the management of the regulated company and its reputation.

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Stakeholders have made progress in considering how best to make progress in further developing an inclusive governance framework...

Most importantly, Scottish Water is taking ownership of a co-creation process to develop its Strategic Plan. The Customer Forum will seek to agree:

- whether the Strategic Plan has taken proper account of the evidence that the Customer Forum provides on the views and aspirations of current and future customers; and
- the price profile required to deliver the Strategic Plan, within the ranges set by the Commission.

Scottish Water is now leading the development of a rigorous investment planning and prioritisation framework (2018 Decision Paper 3). Key steps are likely to include:

- Developing informative appraisals that brief stakeholders appropriately;
- A mechanism for prioritising the urgency and importance of needs and aspirations identified in Scottish Water's strategic projections and subsequently;
- A process for monitoring what progress is being made with these needs and aspirations; and
- A process for revisiting the assessment of needs and aspirations.

Scottish Water should understand, and evidence, its need for asset replacement and develop an appropriate response (2018 Decision Paper 5). Scottish Water is progressing its work on understanding its overall asset replacement liability over the long-term. The aim is to understand the potential range and establish an appropriate annual allowance and a time required to transition to such a level of expenditure. The next stage will likely be to develop a robust plan for asset information improvement (and a mechanism for evidencing progress).

Scottish Water has begun work with stakeholders on its proposals to evidence financial, service level and water and environmental performance in the coming regulatory period and beyond (2018 Decision Paper 6).



Chapter 6 Building trust

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The benefits of an EBR approach are likely to be substantial in moving towards an industry appropriately funded for the long-term. This will require new behaviours...

- Moving away from adversarial approaches to regulation and instead adopting the long-term approach requested by Ministers;
- Ensuring a supportive environment while continuing to have high expectations of each other;
- Creating a culture of openness and transparency among Scottish Water, its regulators and stakeholders;
- Avoiding the risk of loss aversion (*perhaps inevitable in a traditional regulatory process or in a negotiated settlement!*): it is important that all stakeholders feel that they have co-created the Strategic Plan and had a full opportunity to input to the choices that are being made - Scottish Water should be ready to explain why it has proposed what it has. Scottish Water also needs to be maximally candid as to what it can achieve and clear about how any outperformance will be handled; and
- Calling out behaviours that are not consistent with EBR – **before** they risk damaging trust among stakeholders.

The joint stakeholder meetings introduced for this Strategic Review of Charges have been invaluable – both in starting the journey to an EBR approach and building consensus on several areas...

- Progress on, and understanding of, the process and content of the Strategic Review of Charges 2021-27.
- Strategic issues such as the opportunities and challenges facing the Scottish water sector in the short, medium and long-term
 - including, for example, the asset replacement challenge.
- Scottish Water's initial response to these opportunities and challenges
 - for example, developing an asset information improvement plan to better understand asset condition, performance and risk.
- Development of the regulatory framework, including the creation of an investment planning and prioritisation framework (IPPF) and the overall financial framework.

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The Commission wants to build on the progress to date and embed the principles of EBR into the regulatory framework...

We need to take maximum advantage of the OECD Peer Review of this Strategic Review of Charges. The EBR Review should also allow stakeholders to move towards sustained behaviours consistent with EBR. Scottish Water and other stakeholders should agree any other steps that they consider could help.

Under EBR, there can be only a limited place for purely bi-lateral meetings and these would typically involve the role of the owner/sponsor and the technical/policing/enforcement role of a quality regulator. The Customer Forum will seek to agree:

- whether the Strategic Plan has taken proper account of the evidence that the Customer Forum provides on the views and aspirations of current and future customers; and
- the price profile required to deliver the Strategic Plan, within the ranges set by the Commission.

Scottish Water could agree confidence building points, which would allow customers, communities and other stakeholders to provide their views on progress to that point and confirm that agreed expectations have been delivered. There may well be several issues that remain unresolved at the time of the Final Determination, including the scale and timing of the asset replacement liability in the long-term.

We have worked with stakeholders to set up an EBR Review Group.

Reassuring stakeholders will be key to building and maintaining trust. Stakeholders have so far discussed...

The OECD Peer Review (already underway): The OECD is observing the entire process for the Strategic Review of Charges 2021-27 – including through interviews with stakeholders at key stages in the process – and will provide its conclusions after the Final Determination of Charges is published.

An EBR Review Group: This group will seek to understand stakeholder perceptions of the regulatory governance framework and confidence in the development and delivery of Scottish Water's Strategic Plan. These reviews will involve interviews with stakeholders at regular intervals and are currently planned to continue throughout the 2021-27 regulatory period. The EBR Review Group will debrief stakeholders after each round of interviews, to allow for any issues to be identified, discussed and addressed at an early stage.

An asset advisor: The asset advisor will provide an independent view of Scottish Water's programme for improving its underlying information on asset performance, condition and risk.

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As explained in our methodology, the OECD Peer Review will examine the regulatory process for the Strategic Review of Charges 2021...

As explained in our methodology, stakeholders asked the OECD to observe the process of setting prices for the next regulatory control period.

This involves an independent and international peer review from a group of experts in regulation and asset management.

The group will interview stakeholders at key stages of the process and publish lessons learned after the Strategic Review of Charges has been completed.

The OECD also provides support with developing stakeholders' understanding of:

- the benefits that Behavioural Insights can bring to the regulatory process and our understanding of customer preferences; and
- international best practice in long-term asset management.

The OECD has now completed their first and second peer review session. The second review point was in mid-October 2018.

The purpose of the EBR review is to provide a regular temperature check of the full implementation of an EBR framework...

The EBR Review Group will work with stakeholders to refine the six key performance indicators on page 26 and will interview stakeholders on a regular basis (perhaps every two or three months).

These interviews will continue throughout the regulatory period 2021–27. After each round of interviews, the EBR Review Group will debrief stakeholders, identifying any issues arising – acting as a regular temperature check. Or to take the pulse of the process and framework.

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The EBR Review Group would include independent and international experts who have senior level experience in other sectors or countries. This would include:

- **Carlos de Regules:** Carlos set up and led the National Agency for Safety, Energy and Environment for Mexico (ASEA). He was previously a Director at the Mexican Petroleum Company (Pemex).
- **Steve Johnson:** Steve was previously Chief Executive Officer at Electricity North West (ENW) and has held several executive roles within the water sector.
- **Jean-Yves Ollier:** Jean-Yves is a member of the French Council of State. He was previously Chief Executive of the French Regulatory Commission of Energy (CRE).

This process started during the second OECD Peer Review in October 2018.

The asset advisor will review progress against the asset information improvement plan...

Scottish Water intends to produce an asset information improvement plan – a roadmap for how it will improve its asset knowledge over the next ten years.


The stakeholders have invited Professor Dr Bryan Adey to monitor and comment on progress against this plan.

- Dr Adey is Professor of infrastructure management at the Institute of Construction and Infrastructure Management (IBI) at the Swiss Federal Institute of Technology in Zurich, Switzerland (ETHZ).

The role of Professor Adey will involve two phases:

- Phase 1 – engaging with the development of Scottish Water’s roadmap for how it will improve its asset knowledge over the next 10 years; and
- Phase 2 – periodically assessing Scottish Water’s progress against its roadmap and debriefing stakeholders.

The monitoring and reporting of phase 1 will conclude alongside the finalisation of Scottish Water’s co-created Strategic Plan. Phase 2 will then commence and likely continue annually thereafter.



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The Commission set out a timeline that drew on its experience from previous price reviews...

The timeline (published in the Appendix 4 of our methodology 'Innovation and Collaboration') reflected Scottish Water's much improved performance.

The timeline allowed for many more opportunities for multi-lateral discussions between stakeholders. These meetings sought to ensure that all stakeholders are fully informed on the development of the Strategic Review of Charges.

The timeline proposed an earlier delivery of the Final Determination (31 March 2020). Under a traditional regulatory timetable, the Commission would have published its Final Determination on 30 November 2020.

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The collaborative approach has worked well and stakeholders have consistently engaged with the issues raised in a Strategic Review of Charges...

The joint stakeholder discussions have been successful in building a common understanding of the key issues facing the water industry in Scotland and the need to ensure the long-term sustainability for the industry, consistent with Minister's ambitions.

They have also highlighted the opportunity to improve the regulatory framework further to ensure it has the flexibility to address future challenges while strengthening the incentives on Scottish Water to deliver improvements for customers.

Working closely with stakeholders, the Commission has identified several issues, set out in these refinements and clarifications to its methodology, which, if successfully implemented, would help deliver the desired 'paradigm shift'.

However, the 'Innovation and Collaboration' timeline did not envision that Scottish Water would seek to co-create its Strategic Plan.

Scottish Water may want to include its plan to improve its asset knowledge and the detailed operation of the investment planning and prioritisation framework.

Scottish Water plans to co-create its Strategic Plan. Such an approach, if effective, should develop further the confidence of stakeholders and improve Scottish Water's understanding and responsiveness to their priorities.

A 'no blame' culture and candour will be increasingly important.

In this regard, Scottish Water has suggested providing a draft outline of its Strategic Plan for discussion by December 2018.

To give Scottish Water the flexibility to work with stakeholders to co-create its Strategic Plan, the Commission suggests that rather than set a precise date for the finalisation of the Strategic Plan, it may be better to set a 'not later than' date.

Subsequent steps in the process would date from the point at which Scottish Water finalises its Strategic Plan. There may be other dates, agreed by stakeholders, as 'reassurance points'.

The Commission would confirm the publication dates of subsequent steps in the price setting process once Scottish Water has finalised its Strategic Plan.

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The Commission now proposes a modest revision to the timeline. It allows more time for Scottish Water to co-create its Strategic Plan.

Original timeline	Date	Proposed new timeline	Date
		Co-creation begins	11/18
		Outline Strategic Plan	14/12/18
		Commission publishes its draft view on long-term price profiles	Not later than 29/03/19
Draft Business Plan Published and Final Strategic Projections published	05/19	Co-created Strategic Plan and Strategic Projections finalised	Not later than 16/12/19
Final Decision Papers Published	07/19	Final Decision Paper on charge profiles published	Two months after Strategic Plan (Not later than 14/02/20)
Agreement on Business Plan	09/19	The Customer Forum seeks to agree: <ul style="list-style-type: none"> • whether the Strategic Plan has taken proper account of the evidence that the Customer Forum provides on the views and aspirations of current and future customers; and • the price profile required to deliver the Strategic Plan, within the ranges set by the Commission. 	+ Three Months (Not later than 16/03/20)
Draft Determination	11/19	Draft Determination	+ Five Months (Not later than 15/05/20)
Final Determination	03/20	Final Determination published	+ Nine Months (Not later than 21/09/20)

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There are still open issues...

Strategic Plan

- The process of co-development of the Strategic Plan
- The finalisation of the investment planning and prioritisation framework
- Proposed measures of progress and performance
- Further steps to reinforce the ethical based regulation approach

Longer-term Issues

- Progressing work on improving asset information
- Managing the transition to an appropriate level of investment expenditure whilst maintaining the trust and confidence of all stakeholders



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The Commission has clarified and refined its methodology for the Strategic Review of Charges 2021-27...

It is now clear that in setting prices for the next regulatory control period, there will have to be a strong indication of the profile of charges beyond 2027.

Taking full advantage of an ethical based regulatory framework requires Scottish Water to co-create its Strategic Plan. This will require a move from bi-lateral meetings to multi-lateral meetings in most circumstances.

The Customer Forum's role to act as a conduit for the views of customers and communities will be essential to the co-creation of the Strategic Plan and ultimately their view on the appropriate price profile required to allow for the effective and efficient delivery of the Strategic Plan.

The Commission has allowed for some flexibility in the timing of Scottish Water's Strategic Plan since Scottish Water has adopted a co-creation approach. The following dates will be fixed from the point at which Scottish Water finalises its co-created Strategic Plan.

The Commission will publish its draft view on long-term price profiles by the end of March 2019.

There will likely be a transition over up to three regulatory control periods to the point where Scottish Water will have an appropriate level of annual investment funding to meet its needs for the improvement and replacement of its assets.

Going forward, a 'no blame' culture and candour will be increasingly important.



Appendix

Updated timeline for the Strategic Review of Charges 2021-27

Key**Complete**

Not later than Ongoing/planned

Completed Key Activities

Date	Event	Description
February 2017	Co-operation Agreement	The Commission, CAS and Scottish Water discussed and agreed the Co-operation Agreement establishing the Customer Forum.
February 2017	Commissioning letter	The Scottish Government published the Commissioning letter for the Strategic Review of Charges 2021-27 (SRC21) and provided associated guidance to the Commission.
April 2017	Methodology	The Commission published its methodology document – “Innovation and Collaboration: future proofing the water industry for customers”
May 2017	Customer Forum	The Customer Forum for SRC21 was established.
May 2017	OECD Review	The OECD Peer Review team met with the Commission, the Scottish Government, SEPA, DWQR, CAS, Scottish Water and the Customer Forum.
June – October 2017	Initial Decision Papers	The Commission published 13 Initial Decision Papers throughout 2017. These papers provided the Commission’s initial views on the key elements of SRC21.
October 2017	Joint stakeholder meetings begin	The Commission began a series of regular stakeholder meetings with Scottish Water, SEPA, DWQR, CAS, the Scottish Government and the Customer Forum to discuss SRC21 key issues.
December 2017	Joint Board Meeting	Scottish Water Board met with the Commission to discuss SRC21 in the light of the Initial Decision Papers.
February 2018	Scottish Water’s Strategic Projections	Scottish Water published its draft Strategic Projections for consultation.
July 2018	Draft Principles of Charging and Investment Objectives	The Scottish Government issued its draft Principles of Charging and Investment Objectives.
July - November 2018	2018 Decision Papers	The Commission published 8 Decision Papers throughout 2018.
21 November	Methodology refinements and clarifications	The Commission publishes its refinements and clarifications to the methodology and updated timeline for SRC21. These papers update customers and stakeholders on the Commission’s latest views and decisions for SRC21.

Future Key Activities

Date	Event	Description
14 December 2018	Scottish Water's outline Strategic Plan	Scottish Water shares its outline Strategic Plan with the Commission, the Scottish Government, SEPA, DWQR, CAS, Scottish Water and the Customer Forum.
March 2019	Joint Board Meeting	Scottish Water Board meet with the Commission to discuss SRC21 in the light of 2018 Decision Papers.
29 March 2019	Commission publication	The Commission publishes its draft views on the regulatory parameters for SRC21 and the long-term price profile.
December 2019	Joint Board Meeting	Scottish Water Board meet with the Commission to discuss SRC21 in the light of Scottish Water's Strategic Plan.
16 December 2019	Scottish Water's co-created Strategic Plan and Strategic Projections finalised	Latest date for Scottish Water to finalise its co-created Strategic Plan and Strategic Projections.
14 February 2020	Commission publication	Latest date for the Commission to publish its final views on the regulatory parameters for SRC21 and the long-term price profile.
Early March 2020	Progress on Minute of Agreement	The Commission discusses with Customer Forum and Scottish Water their progress towards agreement.
16 March 2020	Customer Forum seeks to agree the price profile required to deliver the Strategic Plan.	<p>Latest date for Scottish Water and the Customer Forum to agree:</p> <ul style="list-style-type: none"> • whether the Strategic Plan has taken proper account of the evidence that the Customer Forum provides on the views and aspirations of current and future customers; and • the price profile required to deliver the Strategic Plan, within the ranges set by the Commission. <p>If they reach an agreement, Scottish Water and the Customer Forum will notify the terms of the agreement to the Commission, if they do not reach an agreement, Scottish Water and the Customer Forum set out their reasons for not reaching agreement.</p>
15 May 2020	Draft Determination published	Latest date for the Commission to publish the Draft Determination for consultation.
June 2020	Final Principles of Charging and Investment Objectives	The Scottish Government publishes its final Principles of Charging and Investment Objectives.

Future Key Activities

Date	Event	Description
June 2020	Joint Board Meeting	Scottish Water Board meet with the Commission to discuss the Draft Determination.
August 2020	Draft Determination consultation responses	The Commission reviews responses to draft determination consultation.
21 September 2020	Final Determination published	The Commission publishes the Final Determination.
November 2020	CMA referral deadline	Scottish Water decides whether or not to accept the Final Determination.
December 2020	Joint Board Meeting	Scottish Water Board meets with the Commission to discuss the Final Determination and the Delivery Plan.
March 2021	Scottish Water's Delivery Plan	Scottish Water submits its Delivery Plan for the 2021-27 period to the Scottish Ministers for approval.

Joint stakeholder meetings

2018 – 2020	Joint stakeholder meetings	There will be a programme of regular joint stakeholder meetings throughout 2018-2020. These meetings will cover key topics relating to SRC21 including the co-creation of Scottish Water's Strategic Plan.
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