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STRATEGIC REVIEW OF CHARGES 2027-33 DRAFT DETERMINATION:

CONSULTATION RESPONSE



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1 Scottish Water Draft Determination Consultation Response

1.1 Introduction

Delivering high standards of service, evidence-based decisions and sustainable investment at lowest reasonable overall cost

1.1.1 Scottish Water welcomes the opportunity to respond to WICS' Draft Determination for SR27. We recognise the significant work undertaken by the WICS team and appreciate the clear and accessible way in which its analysis and conclusions have been presented. This has enabled meaningful engagement with the evidence, assumptions and judgements that underpin the Draft Determination.

1.1.2 Scottish Water also welcomes constructive challenge. Robust, evidence-based scrutiny has played an important role in strengthening our plans and improving performance over successive strategic review periods. So far in SR27 we have rebalanced investment proposals in our Draft Business Plan following feedback from customers and stakeholders. We postponed around £400m of investment into future periods to enable a reduction in the proposed charges from CPI +4% p.a. to CPI +3.3% p.a., in order to address concerns raised regarding the affordability of bills for customers.

1.1.3 We approach this response in the spirit of Ethical Business Practice and Regulation, with a shared commitment to acting transparently, using evidence well and delivering the best outcomes at an efficient cost for customers, communities and the environment.

1.1.4 Scottish Water's purpose is to support a flourishing Scotland by being trusted to care for the water on which Scotland depends. We play a key role in delivering the Water Sector Vision for Scotland and our Long-Term Strategy, which together seek to secure sustainable water services and lasting value for customers, communities and the environment. We are also building from a successful SR21, which has seen a record level of investment and some of the strongest performance levels we have ever delivered, despite significant global challenges facing the early years of the period, which continue to have an impact on customers, the environment and our supply chain as we head into SR27.

1.1.5 WICS' Final Methodology identifies four priorities for SR27:

- maintaining high standards of service and reliability;
- improving the evidence and analysis which supports decision-making;
- investing for a sustainable industry at lowest reasonable overall cost;
- placing customers at the heart of decision-making.

1.1.6 Scottish Water supports these priorities and has considered the Draft Determination against those same tests.

1.2 Significant Areas of Agreement

1.2.1 There is significant common ground between Scottish Water and WICS. We welcome WICS' recognition that our Final Business Plan reflects wide-ranging and sector-leading engagement with customers, that the investment needs identified are broadly aligned with Ministerial Objectives, that Scottish Water is broadly efficient, and that there are opportunities to deliver improved outcomes for customers, communities and the environment.

1.2.2 We welcome WICS' challenge on some elements of capex and opex costs and can accept around £140m of this. We also acknowledge the additional £168m funding proposed to support additional improved outcomes, and have set out where we believe this should be invested for the benefit of customers and the environment.

1.2.3 We agree that customers benefit from strong challenge, stretching performance expectations and a continued focus on efficiency and value. Scottish Water's Board applies such a challenge on behalf of customers through its review and scrutiny of our Business Plan proposals and this Draft Determination response. Taking account of recent performance, we recognise that there are areas where Scottish Water can and should seek to go further, provided the overall settlement gives us a clear and evidenced route to delivery.

1.3 Significant Further Modifications are Needed to Strengthen the Final Determination

1.3.1 While there is broad agreement on the outcomes Scotland needs and the investment required to achieve them, further modifications to the Draft Determination are required before it can provide a robust, deliverable and sufficiently funded framework for SR27.

1.3.2 Our concern is not whether Scottish Water should be challenged. Robust challenge helps to ensure that investment is efficient, well-evidenced and focused on the outcomes that matter most. The issue is whether the combined effect of the Draft Determination provides a clear and evidenced route to delivering the outcomes expected of Scottish Water while enabling us to exercise our core functions effectively.

1.3.3 In reaching a Final Determination, WICS is tasked with assessing whether the revenues Scottish Water is seeking to recover through charges represent the lowest reasonable overall cost in order to effectively exercise its core functions with a view to achieving Ministerial Objectives. If the Final Determination remains substantially aligned with the Draft Determination, Scottish Water does not consider that it would have sufficient funding during SR27 to deliver the outcomes expected of us while continuing to exercise those core functions effectively.

1.3.4 SR27 will be delivered in a materially different operating environment from SR21. Heightened climate risk, natural capital depletion, greater weather volatility, energy market uncertainty, competition for resources to deliver utility

investment and increasing demands on natural and built asset resilience are changing both the risks Scottish Water must manage and the cost of maintaining reliable services. It would therefore not be appropriate to treat the charge profile agreed for SR21 as a fixed benchmark for SR27 without recognising the significantly changed context in which Scottish Water is now and will continue to operate. There are of course new opportunities too, particularly from deployment of new technology and the leverage of new operating and enterprise models. Scottish Water will pursue these with vigour. However, the scale of cost pressures created by a more challenging climate which affects every aspect of operations far outweighs the realisable benefits from technology or other innovations during the SR27 period.

1.3.5 This is not a matter of resisting challenge. It is a matter of ensuring that the final settlement provides a clear and balanced position between outcomes, investment, funding and risk that protects both current and future customers. A Final Determination that does not sufficiently align these elements would risk weakening the resilience of the essential infrastructure that supports water and wastewater services in Scotland, the standards of service customers expect to receive, and public confidence in the Scottish water sector. Recent experience in England and Wales illustrates the long-term challenges that can arise where investment, resilience and service expectations are not adequately aligned over time.

1.3.6 Across this response, our analysis identifies a consistent theme. The Draft Determination broadly accepts the need for investment and identifies areas where outcomes could be improved. However, several of the funding assumptions, efficiency challenges and uncertainty provisions create severe risks to deliverability. Considered individually, some of these issues may appear manageable. Taken together, they create an unmanageable level of risk that the outcomes expected, the funding provided and the route to delivery are not properly aligned. And, in Scottish Water's publicly funded model, it is customers who will suffer the consequences of such misalignment.

1.3.7 We believe the Final Determination should be strengthened in four important areas.

Updating the evidence base

1.3.8 Throughout SR27, both Scottish Water and WICS have worked with the best information available at the time decisions were taken. Since publication of the Draft Determination, additional information has become available in a number of important areas, including performance, household growth, cash collection and other funding assumptions. We are grateful for the engagement WICS has undertaken so far to assess this additional information.

1.3.9 Scottish Water now has access to updated forecasts and additional evidence in several areas. Where we believe adjustments are justified by the latest available information, either in the shape of changes to our Final Business Plan position or refinements to the Draft Determination, these have been included within our response.

1.3.10 We believe the Final Determination should reflect the latest available evidence wherever it materially affects the conclusions reached.

Ensuring outcomes are deliverable

1.3.11 We welcome WICS' ambition to secure improved outcomes for customers and the environment. However, customers should only be promised outcomes where there is a clear and evidenced route to their delivery.

1.3.12 Whilst WICS has broadly agreed with the level of investment required over the SR27 period, the Draft Determination introduces significant challenges to capital and operational costs, alters a number of revenue assumptions and seeks to increase levels of performance. Our analysis indicates that the combined effect of these positions creates a risk that expected outcomes, available funding and delivery obligations will be misaligned during the regulatory period.

1.3.13 Our analysis suggests that the Draft Determination removes more than £700m in funding[1] whilst seeking a further stretch in outcomes. If not managed through additional funding, this contributes towards an overall efficiency challenge of circa 2% per annum despite WICS concluding that Scottish Water is already operating efficiently. This compares with Scottish Water's Final Business Plan assumption of 0.8% per annum, which is already above the UK water sector efficiency benchmark of 0.7% recently set by the Competition and Markets Authority (CMA) as part of its rigorous and detailed PR24 redeterminations.

1.3.14 Several of WICS' proposed cost adjustments and funding assumptions require further evidence and consideration before they can be relied upon with confidence.

Protecting current and future customers from underfunding

1.3.15 Scottish Water is concerned that, if the positions set out in the Draft Determination remain substantially unchanged, there is a material risk that the funding allowed for during the SR27 period will not be sufficient to support the expenditure required for the effective exercise of those core functions. We therefore believe careful consideration should be given to whether the combined effect of the proposed efficiency assumptions, cost adjustments, revenue assumptions and performance expectations provides an appropriate basis for WICS to satisfy itself that the Final Determination is sufficient and deliverable.

1.3.16 Customer protection is about more than affordability. It is also about ensuring customers receive the services, resilience and environmental improvements they have indicated that they want and are willing to pay for and which the Final Determination will promise. The challenge is therefore not simply to minimise charges today. It is to strike the right balance over time between affordability,

[1] Split between revised funding assumptions, reduced opex allowance, and reduced capex allowance.

service quality, resilience, environmental improvement and intergenerational fairness. It is important, and more efficient, to keep necessary charge increases smooth over time. Otherwise, as has been seen in England and Wales, there is then a need to seek large catch-ups later, to recover lost ground. This is something which customers have told us they want to avoid.

1.3.17 The strong body of high-quality customer research undertaken through the Memorandum of Understanding between WICS, Consumer Scotland and Scottish Water demonstrates that customers support the outcomes and associated charges set out in Scottish Water's Final Business Plan[2]. Customers generally accepted that the plan was ambitious, but questioned whether the outcomes would remain achievable, particularly if investment was delayed or reduced.

1.3.18 Some customers also raised concerns that delaying investment could affect outcomes and increase costs in future periods. Having considered the Draft Determination, we do not believe these concerns have been fully addressed, as it moves Scottish Water further away from the long-term investment projections set out in our Long-Term Strategy and from the support for the Final Business Plan that customers have indicated.

1.3.19 Scottish Water's public ownership model is also important in this context. Under that model, surplus funding can be reinvested for customers or reflected in lower future charges, while the consequences of underfunding are borne by current and future customers in the shape of reduced outcomes and potential large bill increases in future.

1.3.20 This distinction matters when considering comparisons with water companies in England and Wales. Scottish Water does not operate with international infrastructure funds or private shareholders. There is no opportunity to seek additional funding, nor any incentive to generate distributable profits. The Scottish Water Board's aim is to deliver the best outcomes at the lowest affordable cost and it has assessed this position in reaching its conclusions as set out in this response. In the absence of shareholders, the consequences of any underfunding are borne by current and future customers through reduced resilience, delayed investment or lower service and environmental outcomes and potential cost shocks in later periods. WICS should therefore take full account of Scotland's public ownership model, and the statutory and legal framework in which Scottish Water operates, when drawing conclusions from comparator evidence.

1.3.21 The risks associated with underfunding and overfunding are fundamentally asymmetric and should be considered accordingly. We must also not lose sight of the increasingly challenging impacts of climate change[3] on our assets, our operations and on the services received by customers. Recent years have seen

[2] "The research found support for, and acceptance of, Scottish Water's Final Business Plan, which was broadly considered to be balanced and sensible by the participant household and non-household consumers." Consumer Scotland's Letter to WICS – Final phase 3 outcomes for SRC27 – findings – 20/4/26

[3] Since publishing our Final Business Plan we note there is growing concern that the pace and impact of climate change is under-represented in national climate projections, as referenced in 'A Well-Adapted UK, The Fourth Independent Assessment of UK Climate Risk' from the Climate Change Committee and the National Emergency Briefing

significant shifts in our climate and the associated weather extremes, with more frequent instances of water scarcity, higher summer temperatures and increased intensity and frequency of rainfall. Decisions taken in SR27 will have implications not only for current customers, but also for the resilience of Scotland's water infrastructure over the longer term.

Managing material uncertainties

1.3.22 Scottish Water supports the principle of uncertainty mechanisms where costs arise from factors outside management control. However, we believe WICS' current proposals require further development to provide balanced protection for customers and ensure we can meet the needs of stakeholders.

1.3.23 A strengthened approach which balances customer charges and outcomes would help ensure that customers do not pay for costs that do not arise, while also reducing the risk that agreed outcomes become undeliverable when unavoidable cost pressures do materialise. We believe this is particularly important in relation to real price effects, household growth assumptions and cash collection risk.

1.3.24 We have concerns about the use of the proposed conditional charge cap for West Central Bioresources, as it would create a significant degree of funding uncertainty that could delay and/or increase the costs of the delivery of this project. It is also contrary to the appropriate use of the Investment Planning and Prioritisation Framework process.

1.4 A Final Determination Informed by Consultation

1.4.1 The purpose of consultation is to improve decisions. As additional evidence has emerged since publication of the Draft Determination, Scottish Water's assessment has also evolved in some areas. Equally, WICS will receive further evidence and perspectives from a wide range of stakeholders through this consultation process.

1.4.2 We believe it would be reasonable for the Final Determination, informed by consultation responses, updated evidence and further engagement, to differ materially from the Draft Determination where the evidence supports that change. This should be viewed as a strength of the process. It reflects the purpose of the Strategic Review of Charges and its various stages: testing assumptions, improving evidence, refining proposals and strengthening decisions in the interests of customers now and in the future.

1.4.3 Scottish Water has worked with key stakeholders and taken account of their views in developing this response to the Draft Determination. This has included engagement with our quality regulators, SEPA and DWQR, on specific areas of our investment programme. We have made pragmatic choices that balance stretching but achievable outcomes against cost. We have also considered the overall balance of the plan with Consumer Scotland and the Independent Customer Group, providing early sight of areas of challenge and overall messaging so they can respond independently to the Draft Determination.

1.5 Our Central Proposition

1.5.1 Scottish Water believes the Final Determination must balance:

- the outcomes expected;
- the investment required to deliver them;
- the funding available to support delivery; and
- the risks and uncertainties that may arise during the period.

1.5.2 Customers should be able to understand not only what outcomes are being promised, but also how those outcomes will be delivered, how risks and uncertainties will be managed and what trade-offs may be required if circumstances change. In our view, this transparency sits at the heart of Ethical Business Practice and Regulation.

1.5.3 The modifications proposed throughout this response are intended to strengthen that connection and support a robust Final Determination. The changes proposed are based on the best available and most up-to-date evidence and we are confident that WICS, as an evidence-based regulator, will take these into account in reaching a Final Determination that creates the conditions for successful, efficient delivery of desired outcomes over the regulatory period, and enable Scottish Water to maintain and improve high standards of service and reliability, protecting the interests of current and future customers.

1.5.4 We look forward to continuing to engage constructively with WICS and other stakeholders as the Final Determination is developed.

2 Question One – To What Extent Do You Agree That the Draft Determination Strikes the Right Balance Between Outcomes, Investment and Charges?

2.1 How We Have Reviewed the Proposal

2.1.1 The Draft Determination sets out WICS' initial view on whether Scottish Water's proposals for investment, charges and outcomes in the Final Business Plan are justified, efficient, and provide value for money. WICS is tasked with assessing whether the revenues we are seeking to recover through charges represent the lowest reasonable overall cost for us to exercise our core function, achieve Ministerial Objectives, and protect the interests of current and future customers. As such it is essential that the right balance is struck between outcomes, investment and charges.

2.1.2 To respond to this question, we have reviewed each individual proposal on its own merits, with additional detail being contained throughout this response. We have then considered the impact of each proposal "in the round" to assess the overall balance of the Draft Determination. This has involved detailed analysis conducted by subject matter experts, a full review of the assumptions and positions contained within the Draft Determination and taking independent advice from acknowledged regulatory economics experts.

2.1.3 We have also obtained specific external economic advice to help us assess matters such as Real Price Effects and efficiency considerations. We have taken legal advice on the relevant legal framework, specifically WICS' statutory duties and functions when setting price controls and how this applies to SR27.

2.1.4 In considering the balance between outcomes, investment and charges, we find that, in the round, the proposals in the Draft Determination create a package that does not provide a sufficient level of funding to deliver the outcomes expected. This therefore hampers Scottish Water's ability to meet the Ministerial Objectives. It means that the expectations of our customers and stakeholders are also likely not to be met. And it means that Scottish Water's Board cannot be confident that Scottish Water can exercise its core functions.

2.1.5 We have heard from customers about the importance that they place on Scottish Water delivering outcomes in return for a level of charging which represents value for money. This has come through strongly as part of the research programme under a Memorandum of Understanding between WICS, Consumer Scotland and Scottish Water.

2.1.6 In Consumer Scotland's phase 2 research participants noted that, "Scottish Water should generally be braver about investing more money into the system sooner, and a further assertion made by some participants that this would be likely to save customers money in the long-term. This was thought to

be particularly relevant when discussing investment in infrastructure, including maintenance of infrastructure."[4]

2.1.7 We have also given close consideration to WICS' functions in relation to the setting of charge caps. In doing so, we have considered the reasonableness of regulatory challenges to what Scottish Water regards as the necessary funding levels for the effective exercise of its core functions to achieve the objectives set by Scottish Ministers at the lowest reasonable overall cost, both to customers during the SR27 period and over the longer-term.

2.2 Our Conclusions

2.2.1 In the round, while there are some areas where we agree with challenges WICS has made, our analysis demonstrates that the Draft Determination does not strike the right balance between outcomes, investments and charges.

2.2.2 Our primary concern is that the proposals in the Draft Determination create an overall package that does not provide a sufficient level of funding to enable the delivery of our Final Business Plan for the SR27 period. A Final Determination on the basis proposed by WICS in its Draft Determination would not allow Scottish Water to meet the Ministerial Objectives and the expectations of our customers and key stakeholders.

There is broad alignment on investment needs

2.2.3 WICS has largely agreed with Scottish Water about the investment needs identified in its Final Business Plan. It is welcome that WICS views the overall needs case for investment as generally robust and aligned with Ministerial Objectives[5].

We broadly agree we can and should go further in our performance commitments

2.2.4 Having carefully considered WICS' challenge to us on the outcomes that we should deliver over the SR27 period – and taking into account recent strong performance – we also agree there are areas in which Scottish Water could go further in its performance commitments for the benefit of customers, communities and the environment.

2.2.5 In brief we conclude that – of the 18 outcomes where the Draft Determination has proposed a more stretching target or questioned the outcome – we have sufficient evidence to enable us to accept nine of these in full and seven in part, dependent on additional funding being allowed for in WICS' Final Determination. However, for two outcomes we do not believe we can improve performance beyond the Final Business Plan level, and therefore we are proposing a revised set of targets. More information can be found in our response to Question Three and Annex 3.

[4] Consumer Scotland phase 2 report, page 24
[5] WICS, Strategic Review of Charges 2027-33: Draft Determination, Section 5.1.3, p.199

Dynamic investment planning offers the opportunity to rebalance

2.2.6 WICS and other key stakeholders will legitimately wish to ensure that customers do not "overpay". Scottish Water shares this wish. However, in the context of the Scottish model where no dividends are paid to shareholders, and any surpluses made are reinvested for the benefit of customers or returned in lower bills in future years, the risks to customers of lower than sufficient funding versus higher than sufficient funding are asymmetric.

2.2.7 Moreover, in a system where Scottish Water's Board's duties are to ensure services are provided to customers efficiently, aiming for value for money and customer satisfaction, and where WICS and other stakeholders have a very high degree of transparency over how Scottish Water spends its funds, and an on-going influence through the Investment Planning and Prioritisation Framework (IPPF), other safeguards are in place. This system means the decisions on how any surplus funds are spent (including whether they should be returned to customers) can be discussed openly with WICS and other stakeholders.

2.2.8 In considering this point we have taken into account the fact that WICS has recognised Scottish Water as a broadly efficient company and that benchmarking has demonstrated Scottish Water to be an upper quartile efficient company compared to other UK water companies. Therefore, the risk is restricted to the potential of surplus funds being available to reinvest or return to customers as opposed to surplus funds being used to cover inefficiency.

We have significant concerns about the balance of proposals regarding costs and funding

2.2.9 To support the reduction of the proposed customer charge, the Draft Determination makes a number of funding assumptions, as well as imposing various costing and efficiency challenges. We consider that a number of these assumptions and challenges require further evidence or adjustment (for example, we note that a further year of actual growth data is now available that was not available to WICS as it completed the Draft Determination). Without this, the achievement of investment and outcomes for customers would be affected. The impact of this would be felt by current customers through potential service quality implications, and by future customers through higher charges or reduced service quality in future regulatory periods.

2.2.10 In particular, we highlight the following concerns with the Draft Determination:

- **Equivalent customer charge:** The Draft Determination sets a customer charge cap of CPI+1.6% p.a. on a like-for-like basis with our Final Business Plan (which proposed CPI 3.3% p.a.), not including the proposed additional funding of £168m.
- **Efficiency challenge:** Our analysis shows that the Draft Determination effectively includes a c.2% per year on-going efficiency challenge for Scottish Water despite WICS finding the plan to be broadly efficient

overall and against recent CMA decisions that establish 0.7% as an appropriate level of frontier efficiency challenge within the UK water sector.

- **Cost Adjustments:** The Draft Determination makes what Scottish Water regards as a number of other unevidenced cost adjustments, which increase the overall efficiency challenge further. These are detailed in Annexes 4 and 5, and include a £100 million downward adjustment to the costs of operating the PFI assets which are returning to Scottish Water control.
- **Growth Assumptions:** The Draft Determination assumes household growth rates that are not in line with actual household growth in 2025/26 or up-to-date forecasts for 2026/27, thereby affecting the actual level of funding that Scottish Water will have available to invest.

A challenging efficiency assumption of effectively c.2%

2.2.11 Scottish Water is not seeking to avoid a stretching but achievable efficiency challenge. We recognise that customers and stakeholders rightly expect us to continue improving productivity and value for money. Our Final Business Plan therefore included a demanding ongoing efficiency assumption of 0.8% per annum, which remains above the CMA's recent 0.7% frontier shift assumption for the water industry.

2.2.12 Delivering this level of frontier efficiency will require a sustained programme of innovation and improvement across the SR27 period even as the background challenges from climate change in particular continue to increase. This includes better use of data and digital tools to support asset management and operational decision-making; targeted use of new technologies, automation and artificial intelligence where these can improve productivity or service outcomes; improved planning and prioritisation of investment through the IPPF; and continued collaboration with our supply chain including our new Enterprise Model to improve delivery efficiency, standardisation and whole-life value.

2.2.13 The scope for efficiency through innovation is real, and Scottish Water is committed to pursuing it. However, the efficiency challenge must be calibrated in a way that recognises our already efficient starting point, the current productivity environment, and the real input cost pressures faced by both Scottish Water and its supply chain. Scottish Water will be operating in a materially changed environment, shaped by climate change, natural capital pressures, energy uncertainty and increasing demands on asset resilience. A stretching but achievable challenge will best support innovation-led improvement while protecting delivery of the outcomes that customers, communities and regulators expect. The Final Determination should therefore assess the funding, efficiency and RPE assumptions required for 2027-33 on their own merits, rather than treating SR21 as a stable benchmark.

2.2.14 The Draft Determination has shifted our ongoing frontier efficiency challenge from 0.8% to 1%, has removed our allowance for labour Real Price Effects[6] (RPEs) (of 0.2%), and has made limited allowance for other above-inflation cost increases Scottish Water is likely to face in the period, providing 0.3% for the final three years in relation to potential energy and pension costs. This compares with our estimate of expected total RPEs of around 0.5% per year on opex and 0.7% per year on capex. Moreover, these decisions are made in the context of Consumer Price Index (CPI), rather than Consumer Price Index with Housing Costs (CPIH), (the commonly-used indexation indicator used by other regulators, including Ofwat and Ofgem) within the charge control.[7] Taken in the round, this provides an effective ongoing efficiency challenge of c.2% each year, should other mechanisms not be available to manage these.

2.2.15 This high level of challenge on efficiency is despite WICS finding the Final Business Plan to be broadly efficient, and before any specific opex/capex cost challenges are taken into account (such as the adjustments on returning Private Finance Initiative (PFI) sites, energy cost catch-up, unit cost challenges on the capex programme etc). We consider this level of efficiency challenge to be insufficiently evidenced, not supported by relevant comparisons with efficiency achievable in the sector or the wider economy, and unlikely to be deliverable in the context of setting charge caps for the SR27 period.

2.2.16 WICS' proposed frontier efficiency challenge appears to rely on a productivity benchmark that we do not consider appropriate for this purpose. It also conflicts with the most recent and most relevant precedent, which comes from the CMA's PR24 redeterminations, where it decided that the economic evidence supports a frontier shift challenge of 0.7% for the water industry. This is an important reference point from the Scottish water industry's appeal body, to which we believe WICS should give due weight.

2.2.17 Our proposed ongoing efficiency assumption remains at 0.8% per annum, in line with our Final Business Plan. In saying this, we acknowledge that there are reasons why it might now be appropriate to select a lower allowance (e.g. the CMA's preferred figure of 0.7%). In particular, we note that there has been a downgrading of productivity forecasts by both the Office of Budget Responsibility (OBR) and Bank of England since we worked up our SR27 costings in spring 2025. However, we believe that it is right that we stick to our previous target provided that WICS is able, when it makes its Final Determination, to incorporate the full set of cost allowances that we have explained that we require in this response.

[6] Real price effects are price/cost movements that exceed the general rate of inflation. These can arise because regulated firms' inputs (labour, energy, materials etc) differ from the basket of goods that are used to make up broader inflation indices, such as CPI. It is standard regulatory practice for a regulator to allow for changes in input prices and can be measured using agreed cost indices.

[7] The Office for Budget Responsibility (OBR) estimates a long-term positive structural "wedge" of 0.4% between CPI and CPIH. Indexation of the charge control to CPI inflation therefore provides lesser protection against inflation than the use of CPIH. Which is the ONS' preferred measure of general inflation and the basis of indexation by most other UK regulators.

2.2.18 Similarly, the Draft Determination's treatment of RPEs is materially out of line with the approach adopted by other UK regulators (see Table 1, below), particularly taking into account that other regulators also index to CPIH, which is expected to exceed CPI by around 0.4% on average during SR27, before then adding a further RPE allowance. This creates an efficiency stretch that we do not consider deliverable without reducing the level of investment available and therefore compromising achievement of customer outcomes and the delivery of Ministerial Objectives. We will always strive to deliver stretching efficiency targets on behalf of our customers, but these targets must be deliverable.

Table 1: UK Regulator labour RPEs[8]

Regulator, review	Year	RPE
WICS, SR27	2026	CPI + 0% [provisional]
NI UR, RP7	2024	CPIH + 1.0%
Ofwat, PR24	2024	CPIH + 0.7%
Ofgem, RIIO-GD&T3	2025	CPIH + 0.1% to 1.5%
CMA, PR24	2026	CPIH + 0.7%

2.2.19 In response to a clarification question, WICS indicated that any RPE challenges that manifest during the SR27 period would be addressed via the IPPF process. We do not consider this proposed treatment to be in the best interests of customers, nor to accord with the outcomes of the extensive customer engagement that has been undertaken.

2.2.20 RPEs are essentially costs outwith management control that are highly likely to occur. Recognising them within a price control is something that has been acknowledged in all recent regulatory decisions. If they were treated in the way that WICS proposes in its Draft Determination, it would mean that the impact of these costs would have to be absorbed entirely through reduction in investment and outcomes.

2.2.21 We do recognise that the IPPF mechanism could be used to manage some level of uncertainty about the precise quantum of RPEs.

2.2.22 However, as set out below, we believe a methodology for calculating RPEs (and other uncertain cost factors) needs to be set out in the Final Determination to ensure clarity for all stakeholders and avoid in-period disagreements.

Cost adjustments requiring further evidence or refinement

2.2.23 The Draft Determination is based on a number of cost adjustments, in relation to both operating costs and capital expenditure, which Scottish Water considers require further evidence or refinement. These adjustments also increase the risks associated with the proposed efficiency challenge.

[8] This table sets out the allowance that other regulators have made for labour RPEs. These regulators have also made separate allowances / indexation for energy and materials cost increases in their reviews.

2.2.24 With respect to operating costs, the Draft Determination's £100 million reduction in operating cost allowance for returning PFI assets assumes that Scottish Water is able to change the capital/operating models that have been selected by its PFI partners, immediately on the transfer of these assets to us to achieve greater efficiency. This is not realistic. We therefore invite WICS to recognise the need for a transition period to allow for the investment needed to reconfigure these assets that can then unlock future efficiencies.

2.2.25 While we broadly agree with the overall findings of WICS econometric benchmarking of the efficiency of forecast opex on the returning PFI sites in terms of the long-term efficient level of costs, we propose an approach which recognises the need for a transition period during which allowance is made for our actual costs of operating these sites, with efficiencies reducing the allowance in the latter part of the regulatory period. This gives an overall reduction in returning PFI operating costs of £27.1 million over the SR27 period. We have covered further reasoning on our challenge to this position, and other operating cost adjustments in the response to Question Five and Annexes 5c and 5d.

2.2.26 With respect to capital investment costs, the Draft Determination has also made some interventions where WICS believes that the investment Scottish Water has proposed is not well evidenced or where it believes there is scope for further efficiency, equating to a total of £185m difference between the Final Business Plan and the Draft Determination (excluding the frontier efficiency and RPE challenge mentioned above). Here we have accepted a proportion of this challenge, including proactively reviewing returning PFI maintenance capex and identifying material savings. In other areas we have provided further evidence and explanation to support the cost estimates included in our Final Business Plan. Further detail on the Draft Determination's adjustments on capital costs is provided in our response to Question Four and Annex 4a.

Reliance on growth assumptions

2.2.27 Due to the timing of publication, the Draft Determination included forecast household growth rates that are not in line with actual household growth in 2025/26 or up-to-date forecasts for 2026/27 which are now available. Scottish Water estimates that this risks creating a funding gap of £46m over the SR27 period compared to the forecast growth rates set out in the Final Business Plan. We propose reverting to the household growth assumptions set out in the Final Business Plan within the Final Determination.

2.2.28 Growth has dropped markedly in the latter half of 2025/26 and fell further at the start of 2026/27. While we do not propose altering the forward-looking growth assumption included in our Final Business Plan and in the Draft Determination of 1.0% per year, we note that there are risks around this estimate. Were household growth rates to turn out higher or lower over the SR27 period, this will have a material impact on the amount that Scottish Water has available to invest. For example, if household growth averaged 0.8% over the SR27 period,

this would create a funding gap of around £90 million. Given the importance of this assumption, the uncertainty over actual growth rates and the fact that these are outwith Scottish Water's control, we propose this element of risk to revenue be dealt with through an uncertainty mechanism

2.2.29 More detailed analysis and additional evidence on growth forecasts and other material financial model assumptions which impact on available funding can be found in Annex 2.

2.3 Our Recommendation

2.3.1 As noted, we are concerned that investment will need to be reduced from the level set out in the Draft Determination due to incorrect assumptions related to costs and funding, with negative implications for outcomes for customers over the SR27 period and for costs then needing to be borne by future customers over following regulatory periods.

2.3.2 To address these concerns, we propose a series of adjustments to the proposals in the Draft Determination:

- While we accept the additional stretch in many of the outcomes proposed in the Draft Determination, we do not believe the level of stretch in leakage, per capita consumption, repeat interruptions to supply, discolouration contacts, drinking water compliance, and WWTW permit compliance are deliverable. However, we have rebased our starting position using our latest performance data and identified how the additional £168m of funding proposed in the Draft Determination could be allocated to support improvements to a number of metrics beyond those contained in our Final Business Plan.
- Reinstatement of £71.7 million of operating costs relating to returning PFI sites, of £21 million of increased energy costs and £5 million of other operating costs.
- Restoration of £131 million of capital cost allowances relating to specific cost challenges.
- Removal of a further £32 million of capital cost allowances in relation to PFI capital maintenance costs and investment at the Persley and Nigg sites. Prompted by concerns raised by WICS in the Draft Determination, Scottish Water has reviewed our investment needs in these areas and identified investment needs/scopes that are not required in the SR27 period.
- Adjustment of the frontier efficiency challenge to 0.8%, recognising that this remains a stretching and credible efficiency commitment for an already efficient water company and will be delivered through continued innovation, better use of data and digital capability, improved asset management and operational decision-making, and close collaboration with delivery partners. The efficiency challenge should be assessed on a "totex" basis rather than separately against opex and capex, in line with regulatory best practice.
- Expansion of the proposed uncertainty mechanism to ensure a balanced approach to managing the risks of in-period cost changes that are

outside Scottish Water's control, including labour, energy and materials real price effects on opex and capex, actual household growth rates, and movements in cash collection rates. We propose a mechanism that objectively and transparently quantifies the impact of these effects throughout the SR27 period and provides for an adjustment of up to +/- 0.5% on prices from year 3 of the period (i.e. 2029/30 onwards). We propose remaining cost pressures are addressed via changes in the scope of the capital programme and associated outcomes, which should be considered through the IPPF, with any surplus being utilised to deliver more outcomes or returned to customers. This should replace the Draft Determination's specific limited allowance for energy and pension costs.

2.3.3 This is what Scottish Water believes would represent the right balance between outcomes, investment and charges, consistent with delivering the outcomes that our customers have told us that they value.

2.3.4 We have provided a more detailed summary of our position of the overall impact of the Draft Determination and our response in Annexes 9a and 9b.

2.3.5 We believe that on a like for like basis, based on the challenge WICS has provided in its Draft Determination, Scottish Water can deliver the Final Business Plan, with a level of enhanced outcomes based on updated performance levels, for a customer charge of CPI+2.8% p.a.

2.3.6 We acknowledge WICS' proposal of a further £168m of funding to support further progress on the outcomes that matter to customers and regulators. If included in the Final Determination, this would increase the required unconditional charge cap to CPI+3.2% per year.

2.3.7 We propose a reformed uncertainty mechanism that provides for an adjustment of up to +/-0.5% on prices for the last 4 years of the SR27 period, with remaining cost pressures addressed via changes in the scope of the capital programme and associated outcomes, which should be considered through the IPPF.

3 Question Two - To What Extent Do You Agree That Our Proposals Provide Sufficient Customer Protection in SR27?

3.1 How We Have Reviewed the Proposal

3.1.1 In response to this question, we have reviewed the strong body of customer research gathered by Scottish Water and Consumer Scotland, this research is now complete and can be analysed in depth as a collective body of evidence, rather than as individual elements. Throughout the research we have clearly seen the importance customers place on achieving an acceptable level of improved outcomes for an associated charge which represents value for money.

3.1.2 In considering whether the Draft Determination provides sufficient customer protection, we have also had regard to WICS' role in setting charge caps at the lowest reasonable overall cost required to enable Scottish Water to exercise its core functions and deliver Ministerial Objectives. Customer protection must therefore be considered as relating both to outcomes and to charge levels, ensuring that Scottish Water is sufficiently funded to deliver the services, resilience and outcomes customers have been promised within the customer charge. It must also consider the interests of future customers as well as customers during the SR27 period. Scottish Water strongly believes that customer protection should not just ensure charges are affordable, but that current and future customers receive the levels of service and outcomes they expect.

3.1.3 As research progressed and we refined the outcomes which could be delivered, some customers also raised concerns about the impact of delaying investment relative to the Draft Business Plan position, and the subsequent impact this could have on outcomes and costs in future periods. We achieved broad support for the balance of outcomes and costs in our Draft Business Plan in qualitative research and responded to the concern on affordability seen in the quantitative research by making double-sided adjustments (removing costs and scope to reduce the overall size of the programme and consequently customer bills). Consumer Scotland's phase 3 research on the Final Business Plan clearly showed that the overall package of outcomes and associated charges of the Final Business Plan command the support of customers.

3.1.4 As with Question One, we have reviewed each individual proposal under 'safeguards, risk and uncertainty' on its own merits and then considered the impact of the proposals on the overall balance of the Draft Determination to consider whether proposals provide sufficient customer protection.

3.2 Conclusions

3.2.1 Overall, we do not believe the Draft Determination provides sufficient protection for current and future customers against the risk of reduced investment and associated outcome impacts.

3.2.2 We are also concerned that the Draft Determination risks failing to make provision for protection to customers over future regulatory periods, in particular

the risk of charge increases to deliver the investment that is likely to need to be reprioritised out of SR27, against a backdrop of bill increases that will be needed to maintain the ageing network and address the rising challenges of climate change.

3.2.3 In this context, we have four specific areas of concern with regards to customer protection in SR27:

1. Insufficient funding which has been covered in our response to Question One.
2. The limited coverage of the Uncertainty Mechanisms for cost pressures that are outside Scottish Water's control, which is described below.
3. The proposed conditional charge cap for West Central Bioresources, which is covered briefly here, and more fully in our response to Question Six and detailed in Annex 6.
4. The proposed "hurdle" for Scottish Water to trigger an Interim Determination of charges which is that 'the relevant change must be 10% or more of Scottish Water's turnover in the year of the request over the SR27 period on a Net Present Value basis'.

Limited coverage of the uncertainty mechanisms

3.2.4 We agree that uncertainty mechanisms can play a useful role in the Strategic Review of Charges process. We note the regulatory precedents from the water and energy sectors and broadly support their introduction outside of the traditional process for interim redeterminations associated with a material change in circumstances.

3.2.5 Where material changes in costs over the period are possible but the timing and quantity of those costs arising is uncertain then such a mechanism protects customers by only increasing the customer charge if and when the costs pressures come to bear on Scottish Water. This is an appropriate approach for costs that are largely outside Scottish Water's control. Applying these mechanisms ensures that customers are not asked to fund costs that do not materialise, but also that the investment and operating activities required to deliver the outcomes customers have been promised are adequately funded.

3.2.6 Therefore, while we welcome WICS' proposal of an uncertainty mechanism to address potential operating cost items in energy and pension contributions, where we are not yet fully confident of scale or if these costs will be needed, we believe a broader and more comprehensive approach is required. Such an approach would aim to avoid material reductions in the capital programme due to costs materialising that Scottish Water cannot control, and to provide greater clarity about the trade-offs that may need to be made. Without that clarity, there is a risk that Scottish Water could be seen to under-deliver against capital investment and outcomes where the underlying issue is the unrealistic level of costs allowed during the period. This could affect confidence in delivery and in the regulatory framework in Scotland.

3.2.7 We recognise WICS' concern to ensure price stability for customers. We also note the potential concern that more extensive use of this type of uncertainty mechanism could undermine that. However, we observe that:

- the extent of the uncertainty mechanism could be limited in any given year to avoid material movements in prices for customers;
- there is a balance to be struck between limiting and smoothing price increases in the current period – to the extent that investment is deferred into future periods – and the impact on future customers who may consequently have to face steeper price increases and even greater volatility to enable a catch up in investment in the network to restore performance; and
- increased volatility in CPI in recent years has meant that customer charges are naturally more volatile than they were in the past, and we do not believe that the uncertainty mechanism we set out in detail in Annex 9b would materially add to that.

Conditional charge cap for West Central Bioresources

3.2.8 We are concerned that the Draft Determination's proposals for a conditional charge cap in relation to the West Central Bioresources (WCB) project creates a significant degree of funding uncertainty, may delay the delivery of this project with material consequential impacts on our ability to make operating cost efficiencies, and is contrary to the appropriate use of the Investment Planning and Prioritisation Framework (IPPF) process. Our response to Question 6 which is specifically related to conditional charge caps considers this in depth.

3.2.9 In short, we believe that the conditional charge cap for WCB is unnecessary:

- in terms of protecting customers;
- because it undermines the aims of i) having a dynamic investment programme and ii) ensuring a smooth profile of increasing investment over time to protect future customers from significant step changes in charges with the associated equity concerns; and
- as the process set out for the conditional charge cap risks introducing disproportionate planning and delivery uncertainty risk to the project, with potential impacts on overall costs and delivery timeframes.

10% "hurdle" for an Interim Determination

3.2.10 We recognise that the approach set out in the Draft Determination is consistent with that adopted by other regulators in the UK. However, Scottish Water's financial position, notably our inability to borrow other than from the Scottish Government, gives us less flexibility to manage in-period "shocks" than other regulated companies in the UK. As a result, there is a greater risk that any such external shocks will need to be addressed via a reduction in the capital investment programme with consequential effects on outcomes in the SR27 period and on the required level of charges for future customers.

3.3 Our Recommendations

3.3.1 To address these concerns, we propose a series of adjustments to the proposals in the Draft Determination:

- The expansion of the proposed uncertainty mechanism to:
    - provide protection for the full range of potential "real price effects" on costs that are largely outwith Scottish Water's control, across both operating and capital costs;
    - make adjustments for actual household growth rates; and
    - make adjustments for changes in cash collection rates.
- The mechanism should quantify the impacts of the above factors from the start of the SR27 period, and provide for certain limited adjustments to prices to be applied from year 3 (i.e. 2029/30) onwards. We propose that price adjustments within the uncertainty mechanism be capped at +/-0.5% to provide a reasonable level of price protection for our customers, with cost pressures beyond that level being addressed via changes to the scope of the capital investment programme and associated outputs, via the IPPF. Our reasoning and evidence for this proposal, and why it offers the best protection for customers is included in Annex 9b.
- We propose that the conditional charge cap for West Central Bioresources be removed, and that proposed performance and delivery monitoring mechanisms and the Investment Planning and Prioritisation Framework provide adequate protection to customers from the risks identified in the Draft Determination in relation to the West Central Bioresources project.
- We recommend that the Final Determination adjusts the “hurdle rate” for considering an interim redetermination of charges from changes which amount to 10% or more (on a Net Present Value basis) of Scottish Water’s turnover in the year of the request to 5%.

3.3.2 These amendments to the uncertainty mechanism would alter the potential charge impact from the (upwards only) 0.3% p.a. for the last 3 years of the SR27 period proposed in the Draft Determination to +/-0.5% p.a. for the last 4 years of the SR27 period. Our analysis that supports this position is provided in the documents in Annex 5.

4 Question Three - To What Extent Do You Consider That Our Proposed Targets for Outcomes Are Appropriate?

4.1 How We Have Reviewed the Proposal

4.1.1 The Draft Determination reviewed the 49[9] Outcome Measures in Scottish Water's Final Business Plan and concluded the following:

- Accepted: 15 service outcomes and 3 carbon emission outcomes
- Stretched: 16 service outcomes and 2 carbon emissions outcomes
- Questioned: 2 service outcomes and 3 carbon emissions outcomes
- Sought further development: 6 service outcomes
- Rejected as unnecessary: 2 service outcomes

Table 2: Outcome comparison Final Business Plan to Draft Determination

Outcomes: Final Business Plan (FBP) to Draft Determination (DD) – 2032/33 comparison

Customer Service

Metric description	Units	FBP	DD	Change	Group
Developer customer experience measure	Score	84.23	84.20	0%	A
Non-household customer experience measure	Score	90.17	90.20	0%	A
R-MeX (wholesale services)	Score	9.00	9.00	0%	A
Household customer experience measure	Score	88.35	88.40	0%	A
UKCSI	Score	77.90	77.90	0%	A
Communities measure (ABC measure)		-	-	-	D
Asset health		-	-	-	D
Strategic Tracker	%	23	-	-	E

Net Zero

Metric description	Units	FBP	DD	Change	Group
Net Zero Emissions	tCO2e	198,126	212,637	-7%	B
Operational emissions (W)	tCO2e	9,688	9,688	0%	A
Operational emissions (WW)	tCO2e	71,291	98,291	-38%	C
Baseline emissions	%	0.82	0.77	7%	C
Operational emissions (net)	tCO2e	54,529	81,529	-50%	C
Investment emissions	tCO2e	143,597	131,108	9%	B
Carbon capture/sequestration	tCO2e	-26,450	-26,450	0%	A
Biodiversity land-use		-	-	-	A
Biodiversity outcomes		-	-	-	D
Resource recovery		-	-	-	D
New net operational metric	tCO2e	92,816	92,816	0%	A
Investment Intensity	%	51	51	0%	A

A. DD Accepted: 15 service outcomes and 3 carbon emission outcomes
B. DD Stretched: 16 service outcomes and 2 carbon emission outcomes
C. DD Questioned: 2 service outcomes and 3 carbon emission outcomes
D. DD sought further development: 6 service outcomes
E. DD Rejected as unnecessary: 2 to be unnecessary

Water

Metric description	Units	FBP	DD	Change	Group
Total leakage	% Reduction	9.9	15.7%	59%	B
Zonal leakage in deficit zones	% Reduction	12.9	20.4%	58%	B
Business demand	% Reduction	14.9	14.9%	0%	A
Per capita consumption (PCC)	l/head/d	174	165	5%	B
Low pressure	Properties	26	20	23%	B
Unplanned interruptions	Properties	7,000	5,000	29%	B
Minutes lost	Minutes	15.00	10.40	31%	B
Repeat ITS	Postcodes	240	170	29%	B
Worst historic drought	Pop at risk	2,564,000	2,564,000	0%	A
Peak demand	Pop at risk	876,753	876,753	0%	A
Taste & odour	Contacts / pop	0.51	0.46	10%	B
Discolouration	Contacts / pop	1.90	1.33	30%	B
Lead SW networks	Number	25,154	25,154	0%	A
Lead customer pipes	Compliance	0.98	0.98	0%	A
Drinking water compliance	% Compliance	99.95	99.97	40%	B
WRAP	Score	4,568	4,568	0%	D
DWQR reported incidents	No. of incidents	25	25	0%	A
Lead pipes removed public network	Number	18,000	18,000	0%	A

Environment

Metric description	Units	FBP	DD	Change	Group
Annual internal sewer flooding	No/props	1.48	1.27	14%	B
Internal sewer flooding register	No/props	1.47	1.17	20%	B
Annual external sewer flooding	No/props	11.16	9.52	15%	B
External sewer flooding register	No/props	11.88	10.83	9%	B
WwTW discharge compliance	Fails / 580 works	96%	96%	0%	C
Serious pollution (EPI Cat 1/2)	Number	5	4	20%	B
Total pollution (all categories)	Number	34.8	31.5	9%	B
Sludge compliance	Compliance	0.0	0.0	0%	A
Network discharges (UIDs)	Number	712	712	0%	C
River water quality		-	-	-	D
UID removals in SR27	Number	150	-	-	E

4.1.2 It is important that the right balance between stretching but deliverable targets is achieved to avoid undermining the trust customers have in the water sector model in Scotland and creating detrimental impact to both our customers' experience and the wider water environment.

4.1.3 In completing this analysis for these outcomes we have:

1. rebased our SR27 starting position (usually 2026/27 forecast) using the latest available performance data for the last year;
2. engaged with the evidence provided in the Draft Determination; and
3. considered how the additional investment allocation of £168m proposed in the Draft Determination could be distributed across outcomes, should it be retained in the Final Determination.

[9] There are 44 measures within Table 1 of the Final Business Plan, a further 5 form part of the Final Business Plan submission.

4.1.4 We have focussed mainly on the start and end positions for the outcomes. Whilst we show annual outcome profiles in the tables within Annex 3, they should be considered as indicative only at this stage. The annual profile is highly dependent on many other factors in this Response to the Draft Determination and therefore we intend to fully analyse the specifics of the annual outcome profile as part of the Delivery Plan baselining exercise once we receive the Final Determination.

4.1.5 Please note that the increased outcomes beyond Final Business Plan baseline are contingent on:

1. the allocation of the £168m proposed in the Draft Determination being retained in the Final Determination; and
2. the Final Determination addressing the concerns we have raised in the Draft Determination regarding the proposed efficiency and/or cost challenges.

4.1.6 This section focuses on responding to the 23 “Stretched” and “Questioned” measures. Further detail of our analysis for each outcome is provided in Annex 3 of our submission.

4.2 Our Conclusions

4.2.1 The Draft Determination proposed particularly stretching outcomes relative to the Final Business Plan, some of which are beyond re-basing outcome projections to reflect our performance in recent years, particularly in the areas of:

- Leakage (total and deficit zones)
- Repeat Interruptions to Supply
- Drinking water quality
- Water aesthetics (Discolouration and Taste & Odour contacts)
- Environmental pollution incidents
- Sewer flooding
- Investment emissions

4.2.2 We agree that the areas identified by WICS are areas where customers and regulators would value further progress by 2032/33. We have therefore considered how the proposed £168m additional investment allocation could be used to support improvements in those areas, while noting that delivery of these outcomes remains dependent on the overall settlement being sufficient.

4.3 Our Recommendations

4.3.1 Following careful consideration of the proposals in the Draft Determination, Scottish Water proposes to:

- accept nine of the stretched service outcomes for 2032/33;
- extend seven metrics outcomes for 2032/33 beyond those proposed in the Final Business Plan but not as far as that in the Draft Determination as they are not achievable; and

- retain two service outcomes[10] and five carbon emission outcomes at our Final Business Plan outcome position as the Draft Determination positions are not economic, or achievable or within Scottish Water's control.

4.3.2 Table 3 below summarises the Final Business Plan, the Draft Determination and our Responses to the Draft Determination positions (including use of the proposed £168m additional investment) for each of the stretched and questioned service outcome measures (18 in total). It highlights in yellow where we accept the figure in the Draft Determination as stretching but achievable, and in white where we propose an alternative figure to be stretching and achievable.

4.3.3 Table 4 below summarises how the additional investment allocation of £168m proposed in the Draft Determination could be distributed should it be retained in the Final Determination. The rationale for this allocation is included in the individual sections of Annex 3.

4.3.4 The allocation of this investment creates a further dependency with the outcomes we are now proposing, and we show this interdependency in this annex. If this additional investment is withdrawn during the Final Determination, we expect to revise the outcomes being offered at the point of the Delivery Plan when the Baseline is established.

4.3.5 We consider that:

- Throughout the SR27 customer research, our customers have supported value-added outcomes.
- The extension of outcomes and funding could be interpreted as a bringing forward of investment that is needed in SR27 to attain outcomes sought by our customers, Independent Customer Group (ICG) and Consumer Scotland (in sewer flooding and leakage), DWQR (in water aesthetics and drinking water quality) and SEPA (in WWTW permits compliance and UIDs).
- The package of extended outcomes is across water quality, water continuity, water environment and wastewater flows and therefore well-balanced as extensions to the Final Business Plan outcomes.

4.3.6 Therefore, we consider the extension of outcomes proposed in our Draft Determination response to be stretching, achievable and in keeping with the progression from the original Final Business Plan and supported by our stakeholders for inclusion in SR27.

[10] Leakage in deficit zones and Per capita consumption – our proposed position reflects the evidence in Annex 3 on what is stretching, deliverable and within Scottish Water's control during SR27.

Table 3: Comparator of outcome positions which have been adjusted between Final Business Plan, Draft Determination and Draft Determination Response

		Final Business Plan			Draft Determination		Draft Determination Response		
Ref	**Short Description**	**Base (2026/27)**	**Position at 2032/33**	**% Change (Rounded)**	**Stretch at 2032/33**	**% Change**	**Position at 2032/33**	**% Change**	**Comment**
1.07	Total leakage (ML/d)	456	411	*10%*	385	*15.7%*	405	*11.1%*	*Extend with funding (£12m)*
1.08	Zonal leakage in deficit zones (ML/d)	233	203	*13%*	186	*20.4%*	203	*13.1%*	*Retain FBP*
1.10	Per capita consumption (PCC) (l/hd/d)	178	174	*2%*	165	*7.3%*	174	*2.2%*	*Retain FBP*
1.11	Low pressure (properties)	30	26	*13%*	20	*33.3%*	20	*33.3%*	*Accept DD*
1.12	Unplanned interruptions (properties)	7,000	7,000	*0%*	5,000	*28.6%*	5,000	*28.6%*	*Accept DD*
1.13	Minutes lost (mins)	15	15	*0%*	10.4	*30.7%*	10	*33.3%*	*Accept DD*
1.14	Repeat ITS (postcodes)	240	240	*0%*	170	*29.2%*	*221*	*7.9%*	*Extend*
1.17	Taste & odour (contacts/ pop)	0.51	0.51	*0%*	0.46	*10.2%*	0.46	*10.2%*	*Accept DD with funding (£15m)*
1.18	Discolouration (contacts / pop)	2.11	1.90	*10%*	1.33	*36.9%*	1.80	*14.7%*	*Extend with funding (£5m)*
1.21	Drinking water compliance (%fails/sample)	99.93%	99.95%	*29%*	99.97%	*57.7%*	99.96%	*42.9%*	*Extend with funding (£32m)*
1.24	Annual internal sewer flooding (No./prop)	1.57	1.48	*6%*	1.27	*18.8%*	1.27	*18.8%*	*Accept DD*
1.25	Internal sewer flooding register (No./prop)	1.47	1.47	*0%*	1.17	*20.5%*	1.17	*20.5%*	*Accept DD with funding (a proportion of the £50m)*
1.26	Annual external sewer flooding (No./prop)	10.43	11.16	*-7%*	9.52	*8.7%*	9.52	*8.7%*	*Accept DD*
1.27	External sewer flooding register (No./prop)	11.35	11.88	*-5%*	10.83	*4.6%*	10.83	*4.6%*	*Accept DD with funding (a proportion of the £50m)*
1.29	Serious pollution (EPI Cat 1/2) (No.)	8	5	*37%*	4	*50.0%*	4	*50.0%*	*Accept DD*
1.30	Total pollution (wastewater Cat 1-3) (no./length)	34.8	34.8	*0%*	31.5	*9.5%*	32.5	*6.6%*	*Extend with funding (£10m)*
1.28	WWTW permit compliance (fails/580works)	96.4%	96.4%	*0%*	96.4%	*0.0%*	96.7%	*9.5%*	*Extend with funding (£11m)*
1.32	Unsatisfactory Intermittent Discharges (No.)	862	712	*17%*	712	*17.4%*	686	*20.4%*	*Extend with funding (£33m)*

Highlighting in yellow where we accept the Draft Determination and in white where we propose an alternative outcome

Further details in relation to carbon emissions outcomes and the developing measures are contained in Annex 3.

Table 4: Proposed allocation of additional funding (£168m) across the main services.

Service	Change in outcome	Funding*
Sewer Flooding	To improve internal and external sewer flooding register positions	£50m
Leakage (total)	To reduce leakage to its sustainable economic level in SR27	£12m
Water aesthetics	To reduce both Discolouration and Taste & Odour contacts by 2032/33	£20m
Drinking Water quality	To become 99.96% compliant by the end of SR27	£32m
Unsatisfactory Intermittent Discharges (UIDs)	To increase the UIDS removals to 168 by 2032/33	£33m
Environmental pollution incidents (EPIs)	To reduce incidents in our wastewater system during SR27	£10m
Wastewater treatment works	To improve permit compliance by the end of SR27	£11m
Total		£168m

* Extra funding above Final Business Plan.

5 Question Four - To What Extent Do You Agree with Our Proposal for Capital Investment?

5.1 How We Have Reviewed the Proposal

5.1.1 To establish our response to this question we have considered the impact of the proposals on the overall balance of the Draft Determination as well as reviewing each individual proposal on its own merits. This is with a view to assessing whether Scottish Water can be confident that they allow sufficient funding for Scottish Water to be able to exercise its core functions, and to achieve the objectives set by Scottish Ministers and to meet the expectations of customers.

5.1.2 In our response below, we directly respond to the Draft Determination challenges by summarising:

- the further evidence that we are providing to support the need or outputs for specific projects and programmes;
- our views and evidence on areas of additional cost challenge;
- the further clarification we have provided to WICS in response to specific requests in the Draft Determination (e.g. asset management improvement plan); and
- our reassessment of our maintenance capital investment (AR3) needs for the returning PFI sites over the SR27 period.

5.1.3 Further details on these areas are included within Annex 4a (Capital Investment Evidence), Annex 4b (Cost Challenge), Annex 4c (AR3 Outputs), Annex 4d (Asset Management Improvement Plan) and Annex 6 (West Central Bioresource).

5.2 Our Conclusions

5.2.1 Customers have benefited from the approach WICS took in SR21 to begin a transition to increased investment to maintain the existing infrastructure, build new infrastructure to meet new demand for water and wastewater services, and improve performance.

5.2.2 We recognise that the Draft Determination seeks to continue the smooth transition towards increased investment, now and in the future. However, we do not fully agree with the Draft Determination's capital investment proposals. We recognise that WICS has broadly accepted the overall investment need, and we agree with some targeted reductions following further review. However, we do not agree with several of the capital cost challenges proposed, which we consider require further evidence, refinement or reinstatement in the Final Determination.

5.2.3 The Draft Determination allows for £7,946m of investment, and considers this at the upper end of the range of investments that could be delivered efficiently. Further analysis has been undertaken by Turner and Townsend on internal capacity and supply chain readiness against the Final Business Plan baseline of £8,093m, which has found that Scottish Water is "well positioned to deliver the SR27 capital programme", with internal capability, delivery partner capability

and market readiness all assessed positively. As requested in the Draft Determination Scottish Water's Board has signed a Delivery Capacity Board Assurance Statement to this effect which is included as part of Annex 7. The full SR27 Readiness Report, an Internal Capacity Paper and a Capacity Risk Board Summary are also provided as supporting evidence within Annex 7.

5.2.4 As mentioned in the response to Question Three, we can see the benefit of the additional allocation for investment for sewer flooding (£50m) and water quality, water continuity and water environment programmes (£118m) proposed in the Draft Determination, and have indicated where this could be invested to deliver improved outcomes in the areas customers and regulators prioritise should it be retained in the Final Determination.

5.2.5 The Draft Determination has, however, made some interventions where WICS believes that the investment is not well evidenced or where it believes there is scope for further efficiency, equating to a total of £315m difference between the Final Business Plan and the Draft Determination. We set out below the evidence that supports the need for these interventions to be reconsidered.

Evidencing the need or outputs for specific projects and programmes (Annex 4a)

5.2.6 The Draft Determination requested that Scottish Water submit further evidence in relation to specific projects and programmes to enable these to be retained in the Final Determination. Annex 4a provides the additional supporting evidence requested. In summary these are:

- Carron Valley WTW: confirming that the proposed investment is expected to increase removal of organic matter as well as address taste and odour.
- Glendevon WTW: confirming the investment needs as agreed with DWQR were linked to the microbiology, disinfection by-products and discolouration risks due to asset capability deficiencies.
- The Edinburgh, Lothians, Castle Moffat and Hopes: The project is one of a number of investment needs to address supply-demand balance deficits over the next 25 years, potentially totalling c£1bn. It is envisaged that many of these will require phased investment spanning a number of periods through an adaptive planning approach in response to the effects of climate and demographic change.
- Daer WTW: confirming that investment is required to complete the system appraisal, project investment appraisal and design development needed to identify the preferred long-term replacement solution for Daer and Camps, addressing water quality, resilience and asset risks and providing delivery readiness for implementation in SR33.
- Seafield WWTW: confirming the investment is required to plan and design future water treatment capacity needs to support growth in Edinburgh following return of the PFI-operated site in 2029, enabling delivery in SR33.

- Nigg WWTW and Persley WWTW: confirming the investment is for a delivery-ready investment proposal to address future wastewater treatment capacity constraints, with delivery of outputs in SR33.

5.2.7 As requested, additional information has also been provided to explain:

- Juniper House: We confirm further comprehensive cost benchmarking will be undertaken and shared once the scope is further developed.
- The requirement for a programme of investment to monitor and analyse Pass Forward Flow. A requirement for enhancement investment to address non-compliance may be identified and therefore may need to be prioritised within SR27. A working group has been established with SEPA to agree interim positions to support EPAS / inspection and, as we move into SR27, we would anticipate that the remit of this group will be expanded to consider Pass Forward Flow monitor deployment and performance assessment.
- The West Central Bioresource project, including a view on governance arrangements and a more in-depth assessment of how the project integrates with existing policies and plans at national, regional and local level (see Annex 6).

Additional cost challenge (Annex 4b)

5.2.8 The Draft Determination has made some interventions where WICS believes that the investment is not well evidenced or where it believes there is scope for further efficiency, equating to a total of £315m difference between the Final Business Plan and the Draft Determination, across three categories:

- Increasing the productivity improvement challenge from 0.8% to 1.0% (-£55m). As set out in detail in response to Question One and Annex 1, we disagree with the Draft Determination's approach to Frontier Shift as it assumes that an already efficient firm should be able to improve its productivity faster than the rate at which the evidence suggests the broader economy is expected to grow and is out of line with recent CMA precedent on this topic from its PR24 redetermination.
- The removal of Scottish Water's proposed labour Real Price Effects (RPEs)/ National Insurance increases (-£75m). As set out in detail in response to Question One and in Annex 1, we disagree with the Draft Determination's approach to RPEs (and National Insurance costs) as it effectively increases our on-going efficiency challenge by around a further 0.7%, despite Scottish Water demonstrating that it is broadly efficient. This approach is out of line with that of other UK regulators, such as Ofwat and Ofgem, and significantly increases the risks of Scottish Water having insufficient funding to deliver its investment programme.
- Targeted cost challenges to specific investment areas in Asset Maintenance, Enhancement and Growth (-£185m). Having carefully considered each of the specific areas we accept some of the challenges (-£53.9m) and have offered further reductions (-£32m). Having provided the evidence laid out in Annex 4b, we request a reinstatement of £99m as part of the Final Determination.

5.2.9 Annex 4b provides detailed evidence addressing each specific capital cost challenge raised in the Draft Determination.

5.2.10 In assessing the targeted unit costs our concerns are grouped into four main categories:

1. The basis on which cost adjustments have been applied is, in many instances, unclear to Scottish Water. This has limited our ability to respond effectively. This is because the expert report (prepared by WSP) is not explicit about how the proposed cost reductions have been estimated in the context of the benchmarking analysis it has carried out.
2. Misinterpretation of the unit rate derived from the Final Business Plan tables (which they were not designed to enable) resulting in inappropriate cost benchmarking comparisons.
3. Inappropriate application of benchmark derived efficiencies across whole Management Approach allocations rather than relevant components of allocations.
4. Scope challenge.

5.2.11 We also make a general point that the Draft Determination has applied the unit cost challenge efficiencies (derived from comparison to our pre-efficient costing) to our post-efficient allocations thus resulting in a double efficiency hit on our allocation.

5.2.12 We conclude that the Draft Determination unit cost challenge is unrealistic and would ultimately disadvantage customers by reducing the amount of outputs that can be delivered for the reduced allocation leading to the under delivery of outcomes.

5.2.13 Table 5 below summarises the conclusions from our analysis of each specific capital cost challenge raised in the Draft Determination.

Table 5: Summary of £185m Capital Cost Challenges and Conclusion of Our Analysis

Challenge Area	WICS Stated Applied efficiency %	WICS Reduction (£m)	SW Restored Position (£m)	Funding reduction (£m)	Position Response
MA004 Dams & Reservoirs (MIOS)	5	-14	+14	0	Rejected. WICS challenges the composition of the MIOS dataset rather than demonstrating inefficiency. Applying a programme-wide efficiency adjustment based on exclusion of selected projects is not evidenced.
MA017 WWTW Inlet Works	0	0	0	0	WICS requested further information on how the unit costs were developed which we have provided.
MA029 Property & Estates	20%	-13	+13	0	Rejected. WICS' benchmarking is not like-for-like and applies a challenge across the full Management Approach despite concerns relating principally to the offices and depots element.
MA034 Customer Meters (Smart Metering)	15%	-9	+9	0	Rejected. Scottish Water does not agree that the benchmark comparison is like-for-like and considers the challenge not

Challenge Area	WICS Stated Applied efficiency %	WICS Reduction (£m)	SW Restored Position (£m)	Funding reduction (£m)	Position Response
					reflective of the nature of this programme of work.
MA041 Lead Communication Pipes	7%	-3	+3	0	Rejected. The challenge is based on a unit rate comparison that includes non-comparable project scope, resulting in an overstated benchmark position.
MA043 Secondary Treatment Processes	10%	-11	+11	0	Rejected. Benchmark concerns relate to a small subset of cost models representing approximately 5% of programme costs. Applying efficiencies across the full Management Approach is disproportionate and unsupported
MA058 Water Pumping Stations	10%	-5	+5	0	Rejected. WICS has derived an average unit rate using Business Plan expenditure and a limited output count that does not reflect the full volume and range of interventions within MA058. The resulting comparison is not like-for-like and does not demonstrate inefficiency in Scottish Water's forecast costs. Full reinstatement of the £5m challenge is sought.
MA073 Leakage Management Equipment	10%	-4	+4	0	Rejected. The challenge is based on misinterpretation of intervention volumes and resulting unit rates. The apparent variance does not reflect the actual expenditure profile.
MA077 Carbon Capture	27%	-8	+8	0	Rejected. The challenge relies on high-level cost-per-hectare benchmarking which does not demonstrate comparable scope, delivery environment or programme requirements.
MA108 PFI Capital	0	0	0	-22	A review of PFI capital allocations has allowed a reduction in the investment projection (Daldowie AR3 -£17m and Ayrshire -£5m).
MA119 Treated Water Storage	10%	-29	+29	0	Rejected. WICS relies on benchmarking evidence that lacks sufficient transparency regarding comparator scope, normalisation and challenge derivation, preventing a robust like-for-like assessment.
MA119 Chlorine Contact Tanks	10%	-13	+13	0	Rejected. The challenge is based on assumptions regarding tank size and TWS-derived costs that are inconsistent with the underlying Scottish Water evidence and revised dataset analysis.
Daer WTW Project-Specific Challenge	Design fees	-13.4	+6	-7.4	Partially Accepted. Scottish Water recognises potential economies of scale but does not agree that a detailed-design benchmark should be applied to a broader Gate 90 development and maturation scope. A balanced reinstatement of £6m is proposed.
Allanfearn Digester Project-Specific Challenge	Scope	-19.5	0	-19.5	Accepted. Scottish Water agrees the allowance should be removed as the scope is already incorporated within the wider Allanfearn WWTW Treatment and Bioresources project, avoiding double counting.
Pathhead WWTW Project-Specific Challenge	Scope	-6	+6	0	Rejected. Scottish Water has provided the additional evidence requested, demonstrating the investment need and the maturity of the cost estimate. WICS'

Challenge Area	WICS Stated Applied efficiency %	WICS Reduction (£m)	SW Restored Position (£m)	Funding reduction (£m)	Position Response
					challenge therefore reflects a difference in the presentation of needs and options evidence, rather than any absence of investment need or weakness in the cost basis.
Infrastructure Investment		-27	0	-27	Accepted. This is not part of the primary charges model - further details on the proposed uplift in charges are available in Annex 2 – Specific Modelling and Funding Adjustments.
Service Relocations		-10	+10	0	Rejected. The SR27 allowance is a prudent and necessary provision to ensure Scottish Water can meet statutory diversionary obligations driven by Roads and Rail Authorities, with visible schemes alone potentially requiring £33m–£35m and further demand likely to emerge during the period.
Additional review of broader Aberdeen Strategy (inc Persley and Nigg WWTW)	Scope	0	0	-10	Review of the SR27 scope for Aberdeen Strategy resulting in reduced allocation
Total		**-184.9**	**+131.0**	**-85.9**	**Net reinstatement of £99m**

Further clarifications needed (Annex 4c and Annex 4d)

5.2.14 The Draft Determination requests further evidence on the forecast number of responsive maintenance interventions and inspections. Annex 4c outlines the reporting options discussed with WICS during July 2026 to improve the reporting granularity and completeness of AR3 outputs, setting out the proposed approach for this Draft Determination response, for the SR27 Delivery Plan and for a potential maturity route.

5.2.15 As agreed with WICS, for the Draft Determination Response, we have reported inspections separately from a grouped repair, refurbishment, replacement total and outputs are calculated at a Management Approach level. Whilst this is a good first step towards better representing the outputs associated with the AR3 investment of the plan, Scottish Water recognises the scale of work required to continue to break this out to provide an appropriate level of regulatory information to enable monitoring, analysis and learning for this critical investment area. AR3 output tables are included in Annex 4c as requested.

5.2.16 The Draft Determination also requested a consolidated list of actions from Scottish Water's various asset management improvement plans to allow WICS to monitor progress.[11] In TA008, our Investment Planning Technical Appendix, which was submitted alongside the Final Business Plan we set out a number of milestone commitments and actions (Annex 4d provides a table outlining

[11] WICS, Strategic Review of Charges 2027-33: Draft Determination, Section 5.4.9, p.128

these). We consider this to be a summary consolidation of the key components that will form the refreshed Asset Management Transformation Routemap. Annex 4d confirms it remains our intention that detailed work to refresh and consolidate all asset management improvement plans will be complete by and laid out in our Delivery Plan.

5.3 Our Recommendations

5.3.1 Scottish Water welcomes the focus in the Draft Determination on the quality of evidence and analysis underpinning our investment plan, which forms the basis of how we plan to meet Ministerial Objectives and deliver outcomes for customers. WICS is asked to consider the additional evidence provided which supports specific projects within our investment programme.

5.3.2 As set out in our response to Question One and in more detail in Annex 1, we believe that the Final Determination should:

- remove the additional Frontier Shift efficiency challenge, i.e. move it back to 0.8%; and
- enhance the uncertainty mechanism to cover more areas of uncertain operating costs, including Real Price Effects, changes to household growth levels and changes to cash collections from Councils.

5.3.3 Scottish Water's position on additional cost challenges is that any further efficiency adjustment must be supported by clear benchmarking evidence which shows that our costs are above those of comparator companies. They must also be applied appropriately, i.e. to the relevant portion of costs where a benchmark inefficiency has been identified. In several areas, the challenge in the Draft Determination appears to be based on post-efficient values despite the benchmarking having been undertaken on our pre-efficient unit costs, or on high-level average unit rates that do not reflect the scope, intervention mix, cost model or delivery conditions underpinning the Final Business Plan allowance.

5.3.4 In summary, we recommend that the Final Determination makes the following adjustments as detailed in Table 6 below.

Table 6: Final Determination Adjustment Recommendation

Challenge to the capital programme	Draft Determination adjustment (-£315m)	Proposed Change for Final Determination
Frontier shift efficiency challenge	Increased from 0.8% per year to 1.0% (equates to £55m)	Reduce to 0.8% per year (reinstate £55m)
National insurance (NI) costs	£15m removed from allowed costs	Reinstate £15m of NI costs to the capital programme
Real Price Effects	£60m of labour RPEs removed from allowed costs No cost provision made for other RPEs (energy, materials etc). WICS has indicated any RPEs to be addressed via the Investment Planning and Prioritisation Framework (IPPF) process, i.e. via changes to the investment programme	Provide for labour, energy and materials RPEs via a combination of an uncertainty mechanism of +/-0.5% per year and the IPPF process, i.e. changes to the investment programme. See Question 2/Annex 1 & Annex 9b materials.

Challenge to the capital programme	Draft Determination adjustment (-£315m)	Proposed Change for Final Determination
Disallowance of £185m capital	Enhancement and Growth (-£75.9m) - Daer (-£13.4m) - Allanfearn (-£19.5m) - Pathhead (-£6m) - Infra Investment (-£27m) - Service Relocations (-£10m)	Reinstate £22m - Daer – restore £6m - Allanfearn – accept removal - Pathhead – restore £6m - Infra Investment – accept removal - Service Relocations – restore £10m
	Specific unit cost challenges in Management Approaches (-£109m)	Reinstate £109m of costs
Further Adjustments	AR3 investment on returning PFI assets – No adjustments made but Draft Determination indication this may be revisited Query on scope of Persley and Nigg WWTW	Reduce allocations by £32m - Daldowie (-£17m) - Ayrshire (-£5m) - reduce allocation (-£10m)

6 Question Five - To What Extent Do You Agree with Our Proposal for Operating Expenditure?

6.1 How We Have Reviewed the Proposal

6.1.1 We have reviewed each of the proposed adjustments in the Draft Determination on its own merits, as well as considering the overall level of efficiency challenge set for Scottish Water for the SR27 period in the context of its current level of operating cost efficiency as benchmarked against English and Welsh water companies.

6.1.2 Along with considering the frontier shift, Real Price Effects and National Insurance costs assumptions set out in the Draft Determination, we have considered:

- the opex benchmarking undertaken and how WICS has interpreted the results of that benchmarking (see Annex 5a);
- the approach to setting an operating cost allowance for returning PFI assets (see Annex 5c);
- the assumed level of bad debt costs / cash collections from Councils, in light of new evidence in this respect (see Annex 5b); and
- a number of other, smaller operating cost adjustments including, energy (commodity) cost increases, RBMP3-related chemical cost increases and the indexation of PFI contract costs (see Annex 5d).

6.1.3 In addition, we have provided the evidence requested by WICS to support an increase in energy non-commodity costs that we included in our Final Business Plan (also in Annex 5d).

6.2 Our Conclusions

6.2.1 We have provided evidence to show that the Draft Determination provides an insufficient allowance for Scottish Water's reasonable operating costs and expenditure. This is likely to result in Scottish Water having to reduce materially its capital programme over the SR27 period with a consequent reduction in the outcomes that customers say they want to see delivered. Detailed analysis and evidence is provided in Annex 5a on Operating cost benchmarking, Annex 5c, which specifically addresses the PFI Cost Adjustment, Annex 5b, which addresses an arising bad debt / cash collection issue and Annex 5d, which addresses the other operating cost adjustments set out in the Draft Determination.

On-going efficiency challenge

6.2.2 As set out in our response to Question One above and in more detail in Annex 1, while we recognise that it is appropriate for a regulator to set an on-going efficiency challenge to even the most efficient businesses, we do not agree that the overall level of on-going efficiency challenge on operating costs arising from the Draft Determination’s positions on frontier shift efficiency, Real Price Effects and indexation for inflation is reasonable. We consider that an effective on-going efficiency challenge of around 2% per year for an efficient business is

unsupported by evidence, significantly out of line with generally accepted regulatory practice in the UK and risks compromising Scottish Water's ability to exercise its core functions and the delivery of outcomes consistent with achieving the Ministerial Objectives:

- The most recent and most relevant precedent in terms of the level of frontier shift challenge comes from the CMA's PR24 redetermination, where it decided that the economic evidence supports a frontier shift challenge of 0.7% for water companies. These findings from the Scottish water industry's appeal body should be given due weight.
- Table 7 below sets out recent treatment of inflation and Real Price Effects from UK regulators. This highlights the extent to which WICS is out of line with current regulatory thinking.

Table 7: Recent treatment of inflation and labour RPEs from UK regulators

Regulator, Review	Year	RPE
WICS, SRC27	2026	CPI + 0% (provisional)
Northen Ireland Utility Regulator, RP7	2024	CPIH + 1.0%
Ofwat, PR24	2024	CPIH + 0.7%
Ofgem, RIIO-GD&T3	2025	CPIH + 0.1% to 1.5%
CMA, PR24	2026	CPIH + 0.7%

PFI operating costs – significant area of challenge

6.2.3 The Draft Determination has reduced Scottish Water's returning PFI operating cost allowance from £391m to £291m over the SR27 period. This £100m adjustment was based primarily on econometric benchmarking of wastewater and bioresource opex against English & Welsh water companies, with WICS also noting:

- Observed cost reductions from previously returned PFI sites (Highland & Aberdeen) of c.50% versus PFI service fees; and
- Evidence of current cost of sites in PFI partner company statutory accounts.

6.2.4 We agree with the broad approach to benchmarking the costs for our returning PFI sites and recognise the forecast level of operating costs are above the longer-term efficient level. However, the approach in the Draft Determination assumes that this level of efficiency can be achieved at site handover. In reality, Scottish Water will be tied into the operating models chosen by PFI partners for sites, at least until it can deliver capital investments that allow them to move to a more efficient model. For example, at Daldowie, we will need to operate the gas driers, with the associated considerable energy costs, until the new West Central Bioresource site has been commissioned. Similarly, at Dalmuir, we will need to continue incurring significant chemical and staff costs to operate that site due to the design choices that were made when the site was built. It is therefore not reasonable to assume that the efficient level of operating costs

can be achieved immediately from the point of PFI return. Instead, an allowance should be made for the reasonable costs of operating the actual sites we have as they are, with a glide path to the efficient level of costs.

6.2.5 Our investment in West Central Bioresources is key to realising greater operating cost efficiency at both Daldowie and some of our other PFI sites. We have, therefore, reviewed our latest business case (Gate 70) for West Central Bioresources to identify potential operating cost savings. Once the site is fully operational, we believe that we should be able to achieve a combination of operating cost reductions and incremental revenue of around £21.7 million per year, which is in line with WICS' efficient benchmark across all returning PFI sites. These savings can be made incrementally from August 2031 onwards, assuming the West Central Bioresources project is delivered on time and were not included in our Final Business Plan due to uncertainty over the timing of them given the size and complexity of the project. Overall, therefore, we estimate that it would be reasonable for WICS to apply an operating cost challenge of £27.1 million to our forecast operating costs for the returning PFI sites over the SR27 period (with these savings applying to the last year and a half of the period). Full details of how these savings have been estimated are set out in Annex 5c.

6.2.6 Up until August 2031, however, we believe that WICS should allow Scottish Water to recover the actual costs that it is likely to incur in operating these sites. We highlight that once the analysis contained in the Draft Determination is corrected to take into account costs relating to these sites that Scottish Water rather than our PFI partners were incurring (even prior to the sites transfer to us), our forecast operating costs are comparable to those incurred by our PFI partners.

Operating cost benchmarking and energy catch-up efficiency challenge

6.2.7 While we broadly agree with the assessment of our operating efficiency as set out in the Draft Determination, we believe that a more appropriate approach to allowing for the increased costs we face from operating a large number of small water treatment works (due to the distribution of Scotland's population) demonstrates that we are even more efficient than the upper quartile benchmark used by WICS. We note that this is important context in which to consider the Draft Determination's increased on-going efficiency challenge as well as a specific cost challenge it imposed on energy costs.

6.2.8 The Power Purchase Agreement Scottish Water entered at the start of SR21 comes to an end in 2027, with Scottish Water forecasting a £10 million increase in energy costs from 2027/28 onwards as a result of the business needing to purchase energy at market prices going forward. In the Draft Determination, £3.5 million per year (or £21 million over the SR27 period) has been disallowed in relation to increased energy commodity costs that Scottish Water will incur due to higher market prices.

6.2.9 We do not agree that this approach is reasonable as it effectively imposes a catch-up efficiency challenge on a business that continues to reach upper

quartile efficiency even when the full £10 million increase in energy costs is included, i.e. pushes Scottish Water to move beyond upper quartile opex efficiency. As set out in Annex 5a and Annex 5d, we believe this adjustment is based on flawed reasoning on the part of WICS.

Bad debt costs / cash collection of billing

6.2.10 In the Draft Determination, WICS has suggested a small change in the bad debt charge to reflect the logic adopted in the Final Business Plan, adjusted for the lower assumed level of revenues. In response to this adjustment, we reviewed our bad debt charges and identified that we should refresh the forecasts around the rate that Scottish Water expects to receive cash from local Councils, which in turn impacts upon the cash that we expect to have available to invest in the SR27 period.

6.2.11 Recent history had shown an improving outlook on overall collection, however, our latest collection data highlights falling first year collection rates, coinciding with larger customer price increases, and consequently near-term collection indicators appears to be deteriorating. Therefore, the overall cash collection shortfall is likely to worsen.

6.2.12 Our analysis indicates that a further £81 million allowance may be required to cover these costs over the SR27 period. We provide further explanation of this point, as well as supporting evidence, in Annex 5b.

Other operating cost adjustments

6.2.13 The Draft Determination provides an insufficient allowance for a number of other, smaller operating costs, including RBMP3-related chemical costs, and on-going PFI contract costs, which should be indexed to RPI until 2030 and CPIH thereafter, rather than CPI throughout, as WICS assumes. These are also addressed in more detail in Annex 5d.

6.3 Our Recommendations

6.3.1 In relation to operating costs, we have a number of recommendations for the Final Determination:

- Return to a frontier efficiency challenge of 0.8% pa as previously recommended.
- Provide for Scottish Water's expected actual costs on the returning PFI assets – as set out in the forecasts included in our Final Business Plan – until mid-2031 as the business does not have the opportunity to make material savings before then due to design decisions made by our PFI partners. From this date, we believe it would be reasonable to reduce our operating cost allowance for the returning PFI assets to reflect the cost savings that we expect to be able to achieve from the West Central Bioresources investment. This would result in a reduction in returning PFI operating costs of £27.1million over the SR27 period as a whole, with these being achieved in the last year and a half of the regulatory period.

- Provide the full allowance for the £10 million forecast increase in energy costs from 2027-28, as well as reinstating a further £4.6m of costs in relation to RBMP3 chemicals.

6.3.2 Furthermore, as set out in our response to Questions One and Two, we believe that WICS should introduce an expanded uncertainty mechanism into the charge control, with this mechanism allowing for up to a +/-0.5% increase in charges in any given year for the last 4 years of the SR27 period, with further cost pressures above this level being tracked and addressed through adjustments to the capital programme (via the Investment Planning and Prioritisation Framework process). This mechanism should include an allowance for any net increased working capital requirements arising from changing rates of customer cash collection over the SR27 period.

7 Question Six - To What Extent Do You Agree with Our Proposal to Introduce a Conditional Charge Cap?

7.1 How We Have Reviewed the Proposal

7.1.1 The response to this question focusses on the conditional charge cap in relation to West Central Bioresources, we have outlined our considerations of the 0.3% uncertainty mechanism, and how we believe uncertainty mechanisms should be used, in response to Question Two on customer protections.

7.1.2 The Draft Determination sets out to protect customers from the following risks in relation to the West Central Bioresources project:

- The risk that, during the development of the project, costs escalate to a point that the project is no longer in the customers' interests; and
- The risk that, if the project is delayed then the allocated funding may either be used to fund other investments or to cover cost over-runs, leaving customers potentially "paying twice" for the project due to further funding being requested in SR33.[12]

7.1.3 The West Central Bioresources project has a forecast cost of around £560 million in SR27 and is the largest single project since Scottish Water was established in 2002. It will serve around 3 million people by processing bioresource from over 270 wastewater treatment facilities using advanced anaerobic digestion technology. This will replace old systems, cut emissions, recover energy and ensure regulatory compliance.

7.1.4 The Draft Determination proposes a conditional allowance and conditional charge cap, with the West Central Bioresources element of the charge cap (on an assumed 60:40 borrowing-to-charges split, with around £225 million funded from customer charges, and around £335 million of borrowing attached) applies only in the final three years. WICS also considered, and accepted as reasonable, Scottish Water's decision not to deliver WCB through a Mutual Investment Model.

7.1.5 The conditions include a final investment appraisal confirming scope, cost and outcomes, completion of the environmental impact assessment and necessary consents, and addressing the outstanding requirements of the Scottish Ministers' policy position. The Draft Determination states that Scottish Water has met the majority of requirements but that several areas require further evidence, therefore further information on the proposed governance model and integration with existing policies and plans at the national, regional and local level have been provided in Annex 6.

[12] Draft Determination, para 8.3.7.

7.2 Our Conclusions

Conditional charge cap for West Central Bioresources

7.2.1 We are concerned that the Draft Determination's proposals for a conditional charge cap in relation to the West Central Bioresources (WCB) project creates a significant degree of funding uncertainty, and may delay the delivery of, and increase the costs of, this flagship project.

7.2.2 The conditionality mechanism creates significant planning and delivery uncertainty for a project of the scale noted above. We are also concerned that the proposal contains a potential circularity: Scottish Water may be unable to commit to procurement without funding certainty, but unable to evidence costs without procurement. If the conditional charge cap is too narrowly drawn or too difficult to trigger, Scottish Water could bear construction cost risk beyond its reasonable control, increasing the costs of the project.

7.2.3 Furthermore, any delay to the delivery of the project, which may be caused by the design of the conditional charge control, will reduce the operating cost efficiencies that Scottish Water is able to achieve during SR27, with consequential impacts on capital available to invest in the rest of the programme.

7.2.4 Finally, we note that by making £225 million of our funding contingent on proceeding with the West Central Bioresources project, if this is not commenced in SR27 (for reasons either in or out of Scottish Water's control) this funding will be removed as opposed to reprioritised via the Investment Planning and Prioritisation Framework (IPPF) process. This is contrary to customers' desire for smooth and steady price increases, and will create future funding shortfalls as West Central Bioresources will need to be managed on top of other future investment priorities in SR33.

7.2.5 We therefore do not agree with WICS that there should be a conditional charge cap for the West Central Bioresources project. As mentioned previously, additional evidence in relation to this project is in Annex 6.

7.2.6 In summary, we believe that the conditional charge cap for West Central Bioresources is unnecessary:

- in terms of protecting customers;
- because it undermines the aims of i) having a dynamic investment programme and ii) ensuring a smooth profile of increasing investment over time to protect future customers from significant step changes in charges with the associated equity concerns; and
- as the process set out for the conditional charge cap risks introducing planning and delivery uncertainty to the project, with potential impacts on overall costs.

Protecting customers

7.2.7 As we have described previously, Scottish Water's Board already discharges its duties to ensure customers receive excellent services and value for money. Moreover, Scottish Water does not pay dividends to shareholders and operates tightly circumscribed performance related pay schemes. Scottish Water has neither the incentive nor the means to divert funds intended for investment, to purposes that do not benefit our customers.

7.2.8 We also provide WICS and other stakeholders with a high level of transparency over our financial performance and investment programme, as well as a specific mechanism (the IPPF) to discuss how investment should be re-prioritised if required.

Dynamic investment

7.2.9 We are concerned that by making around £225 million of funding contingent on this specific project, the Draft Determination effectively reduces the flexibility of Scottish Water's investment programme, as this means that specific funding cannot be repurposed during the period even if all stakeholders were to agree that it is in the best interests of customers or the environment that funding be delayed.

7.2.10 We do not believe our customers are ever at risk of paying twice for the same investment. The dynamic investment planning approach may result in the re-prioritisation of projects but this means that customers receive something different in return for the funding they provide, with Scottish Water actively consulting its stakeholders to ensure that this alternative investment should be at least as beneficial to customers, communities and the environment, if not more so, than the original proposed investment. Scottish Water is under a general duty to use its resources economically, efficiently and effectively.

7.2.11 With respect to concerns raised in the Draft Determination about Scottish Water using funds to cover cost over-runs elsewhere, we note that if this were to happen, it would be clear through our performance reporting to WICS and other stakeholders that this has happened, and we would expect the resulting reputational impacts. We do not believe that having funding for the West Central Bioresources project contingent on meeting specific conditions associated with that project, reduces the risks of cost over-runs on unrelated projects.

7.3 Our Recommendations

7.3.1 We do not agree that there should be a conditional charge cap for the West Central Bioresources project.

7.3.2 We have considered Draft Determination feedback on the governance and assurance arrangements for West Central Bioresources and agree that the route to the next major investment decision should be made more explicit. In Annex 6 we have provided further information in relation to the governance arrangements of this project, including providing clarity that the Investment

Decision Maker function is discharged through Scottish Water's Board's established approval route, with named roles beneath the Board providing clear ownership for delivery, assurance, evidence closure, escalation and reporting, but not displacing the Board's ultimate investment authority. Stakeholders will be updated through the Water Industry Investment Group, with a standing West Central Bioresources agenda item to report progress as the programme moves towards Gate 80/90. An Independent "Red Team" will also be stood up with external experts who will scrutinise the Gate 80/90 plan before Board approval.

7.3.3 In addition, we have also provided a more in-depth assessment of how the West Central Bioresources project integrates with existing policies and plans at national, regional and local levels, including against Scotland's current Infrastructure Investment Plan (IIP), planning policy, National Planning Framework 4 (NPF4), Regional Economic Strategy, Local Development Plan and wider national policy connections including the UK Climate Change Committee advice.

7.3.4 We propose that the proposed performance and delivery monitoring mechanisms and the Investment Planning and Prioritisation Framework provide adequate protection to customers from the risks identified in the Draft Determination in relation to the West Central Bioresources project.

8 Question Seven - To What Extent Do You Agree with Our Proposals for Monitoring Scottish Water's Performance Over SR27?

8.1 How We Have Reviewed the Proposal

8.1.1 We have reviewed WICS' proposals for monitoring our performance as set out in section 10 of its Draft Determination. We believe that the flexibility with respect to investment planning and prioritisation that was introduced in SR21 and that WICS is proposing to continue into SR27 is useful in helping to deliver the best outcomes for our customers as it allows for changes to be made to the investment programme in response to new information and priorities. However, it cannot repair the consequences of systemic underfunding which could only result in a diminution of the outcomes that customers would otherwise receive.

8.1.2 Over the last year we have been working with WICS and other stakeholders, where appropriate, to review the Investment Planning and Prioritisation Framework (IPPF) to ensure that it, and the associated reporting to the Water Industry Investment Group (WIIG), is fit for SR27. In addition, we are working with WICS to agree the detail of the Delivery Plan and Annual Return tables for the SR27 period.

8.1.3 Though engagement in the Investment Planning and Prioritisation Framework, the Delivery Plan and Annual Return for SR27 it is essential to find the right balance of reporting burden. Producing the information required by WICS and other stakeholders to monitor the progress of investment and manage changes to the investment programme is important, but this shouldn't become overly onerous on Scottish Water. The reporting and change requirements must not risk creating delays to the investment programme and needs to be cognisant of the costs and administrative burden of data provision and reporting which are ultimately borne by customers.

8.1.4 Scottish Water operates under the principles of Ethical Business Practice and Regulation, providing a high-level of transparency to stakeholders and customers on its operations and decision-making. We propose to continue providing significant information on large projects and regulatory commitments through SR27 to allow our regulators and the Scottish Government to understand what we are delivering and how.

8.2 Our Conclusions

Flexible investment prioritisation

8.2.1 In response to a Scottish Water clarification question, WICS has indicated that the Investment Planning and Prioritisation Framework process could be used to address uncertain costs that come about but which were not reflected (ex ante or ex post) in the Draft Determination. We accept this position, and believe that the Investment Planning and Prioritisation Framework, the oversight of the Water Industry Investment Group and associated formally agreed rules-based change process should be used as one of the uncertainty mechanisms to manage the risk of insufficient funding being provided for investment should

cost pressures arise. In addition to this process being used to ensure that Scottish Water is able to respond to changing priorities and adjust its investment programme to maximise the benefits to customers, taking into account the expert advice of its key stakeholders.

8.2.2 The formal agreement of this rules-based framework will require strong governance steps as they can effectively re-set outcome targets (for example) to reflect changes to the investment programme.

Performance-related pay

8.2.3 We broadly welcome the Draft Determination's proposed principles for Scottish Water's performance-related pay (PRP) framework. However, we would highlight the following points.

8.2.4 It was previously agreed with WICS and the Scottish Government that it is beneficial for Scottish Water to have variable pay schemes in order to motivate employees and support successful delivery for customers. To do this, it is important that any variable pay approach creates a genuine incentive. To do so, it must balance providing employees with stretching goals linked to customer priorities, with a credible prospect of these being achieved.

8.2.5 In this context, we are concerned that WICS has both proposed a broad and highly stretching set of outcome targets for the business and proposed a principle of variable pay being awarded on the basis of "outperformance of targets rather than simply achieving them"[13]. We consider that the level of stretch contained in our revised proposed targets as set out in response to Question three and Annex 3 is very significant and will represent a significant improvement in performance for customers that will require Scottish Water employees to work both hard and innovatively to achieve. We believe that it should be for Scottish Water to determine whether and to what extent its employees should be rewarded for achieving that level of performance, through the usual approval mechanisms with Scottish Government. Decisions on what is proposed here must ultimately be for the Scottish Water Board and its Remuneration Committee to make, although we welcome WICS' advice to Scottish Government on these matters.

8.2.6 Further, we would emphasise the importance of transparency, clarity and certainty for Scottish Water employees regarding the terms of our variable pay schemes if they are to motivate successful delivery of outcomes. We note WICS' statement that it plans to "make an in-the-round assessment of performance ahead of PRP payments" which "would mean confirmation of PRP payments... takes place after Annual Return submission"[14]. To the extent that WICS is proposing an element of judgement in its assessment of Scottish Water's performance and making Scottish Water's variable pay schemes dependent on this assessment, that would significantly undermine the certainty

[13] Section 10.4.5 of the Draft Determination
[14] Section 10.4.8 of the Draft Determination

of the scheme and consequently its incentive properties. Again, the final decisions on these matters should be for Scottish Water's Remuneration Committee and Board, not for WICS.

8.2.7 Finally, while a baseline will be set with the first Delivery Plan, as noted above, a rules-based framework (IPPF) will be introduced for Scottish Water to bring forward any material changes to the baseline. Annual performance-related pay will therefore be considered and confirmed against the agreed revised baseline.

8.2.8 There is a very real risk that the approach proposed in the Draft Determination means that variable pay will become a demotivator and potentially disenfranchise employees, with them feeling it has been designed to rarely enable the incentive to be realised.

8.3 Our Recommendations

8.3.1 The Investment Planning and Prioritisation Framework should be used to ensure customers are protected on price. Should additional costs outside of Scottish Water's control materialise in a way that cannot be absorbed by the proposed uncertainty mechanisms, the gap in funding should be managed through the IPPF process. Workably robust and agreed governance through a rules-based framework is needed to ensure customers and key stakeholders are satisfied with any resulting changes to outcome targets as a result of reprioritisation.

8.3.2 We welcome the continued engagement with WICS on reporting and the importance of a baseline to monitor progress against. As noted above, the reporting and change requirements must not risk creating delays to the investment programme and needs to be cognisant of the costs and administrative burden of data provision and reporting which are ultimately borne by customers.

9 Question Eight - To What Extent Do You Agree with Our Proposals for Monitoring Delivery of Scottish Water's Investment Programme?

9.1 How We Have Reviewed the Proposal

9.1.1 Scottish Water welcomes WICS' proposals to strengthen monitoring during the SR27 period. We will prepare a Delivery Plan which is entirely consistent the Final Determination before the start of the period. The first Delivery Plan will form the baseline, and we will follow the guidance WICS provides with its Final Determination, subject to any referral to the Competition and Markets Authority (CMA).

9.1.2 We will then provide an annual update to the Delivery Plan and associated tables in advance of each year showing how any changes will be managed. We will also continue to provide WICS with our Annual Return at the end of each year, reporting the outcomes, outputs and detailed investment plan completed for the year to allow WICS to reconcile the Delivery Plan for the corresponding year.

9.2 Our Conclusions

9.2.1 We agree that effective monitoring of Scottish Water's investment programme will be essential during the SR27 period. The investment programme is central to delivering the outcomes that customers value, meeting Ministerial Objectives and protecting the environment. Transparent monitoring can therefore play an important role in maintaining confidence among customers, stakeholders and regulators that investment is being delivered efficiently and in line with agreed priorities.

9.2.2 However, our agreement is subject to the monitoring framework being proportionate, outcome-focused and aligned with the Investment Planning and Prioritisation Framework (IPPF). The IPPF is the appropriate mechanism for reviewing delivery progress, considering changes in circumstances and funding, and enabling stakeholders to influence prioritisation decisions during the period. Monitoring should therefore support this process rather than duplicate it or create a parallel governance framework.

9.2.3 It is also important that monitoring recognises the reality of delivering a large, complex and long-term investment programme. Some re-prioritisation of investment will be necessary as new information emerges, costs change, regulatory requirements develop and delivery constraints arise. This should not automatically be treated as underperformance. Instead, monitoring should focus on whether Scottish Water is making well-evidenced, transparent and customer-focused decisions about how investment is prioritised to maximise outcomes within the funding available.

9.2.4 As set out elsewhere in this response, the Draft Determination includes material efficiency challenges, limited protection against real price effects and conditional allowances that may create delivery uncertainty. If these risks materialise, Scottish Water may need to re-prioritise investment to remain

within the available funding envelope. The monitoring framework should therefore be capable of identifying where delivery risks are caused by factors outside Scottish Water's control and should support constructive engagement on the implications for outcomes, timing and funding.

9.3 Our Recommendations

9.3.1 We support monitoring arrangements that provide clear visibility of progress, risks, costs and outcomes, while avoiding unnecessary duplication with existing Board assurance, regulatory reporting and IPPF governance. In our view, the most effective approach would be a proportionate framework that tracks delivery against agreed outcomes, explains material changes to the investment programme, and enables timely discussion with WICS and other stakeholders where trade-offs or re-prioritisation decisions are required.

10 Question Nine - Please Use This Space to Share any Additional Comments on Our Draft Decision

10.1 Further Information

10.1.1 WICS asked Scottish Water to provide further information on a number of areas in the Draft Determination, many of these have been answered directly in response to the consultation questions, where these have not been answered we have provided the additional information below.

10.1.2 We have covered here some important points on:

- Affordability
- Regulatory alignment with SEPA
- Strategic Environmental Assessment

10.1.3 We have also provided additional clarification on three areas: changes to process emissions factors, how we are dealing with changes to the investment planning scenario and changes in the timing of the annual charges scheme.

10.2 Affordability

10.2.1 Developing a plan that was affordable for customers was a key consideration in the development of our Final Business Plan. In response to feedback on the Draft Business Plan, we reconsidered the scale and phasing of our investment programme and made difficult choices to reduce the proposed customer charge profile from CPI+4% p.a. to CPI+3.3% p.a. This was not achieved by reducing ambition lightly, but by carefully balancing affordability for current customers with the need to maintain services, protect the environment and avoid storing up greater costs for future customers.

10.2.2 The customer evidence supports the view that the Final Business Plan struck a reasonable balance. Consumer Scotland's phase 3 research "found support for, and acceptance of, Scottish Water's Final Business Plan, which was broadly considered to be balanced and sensible by household and non-household consumers"[15]. This is important because customers were not simply seeking the lowest possible bill; they expected the outcomes associated with the plan to be delivered and were concerned that higher-than-forecast costs could put those outcomes at risk.

Our recommendation

10.2.3 In that context, we are concerned that the Draft Determination places too much weight on short-term charge reduction without sufficient protection for delivery of the outcomes customers have supported or consideration of intergenerational equity. If the funding envelope is set too low, Scottish Water may need to re-prioritise or defer investment during SR27, weakening outcomes for current customers and increasing the risk of much higher bills for future customers. True affordability therefore needs to be considered over both

[15] Consumer Scotland's Letter to WICS – Final phase 3 outcomes for SRC27 – findings – 20/4/26

the current period and the longer term, taking account of service quality, environmental performance, resilience and intergenerational fairness.

10.3 Regulatory Alignment

10.3.1 Scottish Water has been engaging constructively with both DWQR and SEPA throughout development of our response to the Draft Determination, particularly on areas where there have been changes proposed to outcome measure targets or where there appears to be misalignment on priorities. We recognise that quality regulators expect full compliance and appreciate the risk-based approach being taken.

10.3.2 We continue to work with DWQR in relation to drinking water quality metrics and appreciate the pragmatic approach to ensuring that improvements are stretching but achievable within a tight funding envelope whilst maintaining the independent regulatory duties of DWQR. We understand that DWQR are broadly supportive of the adjusted outcomes proposed in our response to the Draft Determination.

10.3.3 Conversations are ongoing with SEPA on a number of areas.

- A working group has been established with SEPA to agree interim positions to support Environmental Performance Assessment Scheme (EPAS) / inspection and, as we move into SR27, we would anticipate that the remit of this group will be expanded to consider Pass Forward Flow monitor deployment and performance assessment. Consideration should be given to the potential for the creation of a new shadow metric during SR27 that adequately reflects the new EPAS regime such that it becomes a key metric for SR33.
- We strive for full compliance operationally every day, yet the capability of our assets, the impact of third parties and the climate make this challenging. We have revised the wastewater treatment works permit compliance upwards to 96.7% following challenge from WICS and SEPA. Attainment of this target is linked to £11m of the proposed £168m additional funding to seek to identify and respond to risks to compliance earlier.
- We have undertaken work to update the number of Unsatisfactory Intermittent Discharges (UIDs) which require investment, and are now proposing to remove 168 from the register in SR27 (compared to 150 in the Final Business Plan). We have revised this to better align to SEPA's expectation that 25% of the remaining UIDs will be delivered across the period. Delivery of the updated UID outputs requires £33m of the proposed £168m additional funding provisioned for in the Draft Determination.
- WICS also set a requirement for Scottish Water and SEPA to develop and agree a river water quality measure ahead of the 2027-33 period. We do not believe this measure is required: in the development of proposed measures for SR27 Scottish Water explained that this measure is in use in England and Wales to measure progress against the WINEP (Water Industry National Environmental Programme). There is no equivalent programme in SR27. Scottish Water understands that SEPA agrees that this measure is not required for SR27.

- SEPA supports the 'Study First and Invest Later' approach but has raised concerns that SR27 does not include specific allocations for investment that may emerge from studies, such as pass forward flow compliance or implementation of the recast Urban Wastewater Treatment Directive (rUWWTD). While we have been asked whether a range of potential investment could be estimated, our experience shows this is not possible with any meaningful level of confidence. At this stage we do not know the scale, complexity or timing of any interventions that may be identified through the studies, creating uncertainty not only around the cost of future investment, but also what can realistically be developed, started or delivered within the SR27 period. For example, if 10% of pass forward flow sites required investment, costs could range from £200m to £1.3bn. However, the range of potential outcomes across different catchments is so significant that any estimate would be highly speculative and potentially misleading. Based on our experience of environmental studies in previous regulatory periods, forecasting SR27 expenditure before the studies are completed would imply a level of certainty that simply does not exist.

Our recommendation

10.3.4 There may be changes to water quality or environmental regulations, the investment required to meet regulators' expectations or new demand emerging from studies during the SR27 period. The Investment Planning and Prioritisation Framework and the Water Industry Investment Group provides the mechanism to update outcome measures and required investment – recognising that all prioritisation will require trade-offs to be made.

10.4 Strategic Environmental Assessment

10.4.1 The Draft Determination requested that Scottish Water provide further information on when it will complete the full Strategic Environmental Assessment (SEA). We have considered our approach to Strategic Environmental Assessment requirements throughout the development of the SR27 Final Business Plan.

10.4.2 A Strategic Environmental Assessment Pre-Screening was completed for the SR27 Final Business Plan in accordance with the Environmental Assessment (Scotland) Act 2005. Given the high-level strategic nature of the Final Business Plan, and the absence of project or programme-level detail, Scottish Water's view was that the plan was unlikely to result in significant environmental effects requiring a full assessment. A Pre-Screening was therefore undertaken and submitted to the SEA Gateway to provide notification of this position.

10.4.3 A similar assessment has been made by Scottish Government, determining that the Ministerial Objectives and Principles of Charging do not require consideration under the Strategic Environmental Assessment requirements.

10.4.4 As the SR27 Delivery Plan is developed, Scottish Water is applying the same approach and is in the process of completing a Pre-Screening for the Delivery

Plan. The Delivery Plan will provide further detail on how Scottish Water will deliver the outcomes and commitments set out in the SR27 Final Business Plan and Final Determination, in alignment with our legislative requirements as set out in the Water Industry (Scotland) Act 2002, Water (Scotland) Act 1980, Sewerage (Scotland) Act 1968, Water Resources (Scotland) Act 2013 and The Public Water Supplies (Scotland) Regulations 2014.

Our recommendation

10.4.5 Scottish Water will continue to comply with the requirements of the Environmental Assessment (Scotland) Act 2005, whilst also ensuring all capital investment projects during the SR27-33 period are subject to environmental due diligence and comply with all relevant planning and environmental legislation.

10.5 Changes to Process Emissions Factors

10.5.1 A material change has occurred in the wastewater process emission factors used by the water sector in the UK. These factors were adopted by the UK Greenhouse Gas Emissions Inventory from January 2026, and the UK Water Industry Research (UKWIR) Carbon Accounting Workbook used by all companies was amended in April 2026 to reflect the change.

10.5.2 Previously, it was agreed with WICS we would “fix” emission factors at 2024/25 values to manage external impacts across a range of areas thus allowing a focus on Scottish Water performance only in SR27. However, the updated carbon accounting guidance has increased process emission (nitrous oxide) carbon values by four to five-fold. This has implications for carbon outcomes in SR27 and increased the challenge of achieving Scottish Water’s Net Zero by 2040 ambition.

10.5.3 We have raised this issue with WICS ahead of our response to the Draft Determination. The impact on Scottish Water’s Net Zero 2040 ambition will be addressed through the refresh of the Net Zero Routemap (Autumn 2027 publication) and WICS are invited as an Advisory Panel member to develop this.

10.5.4 We have agreed with WICS to undertake further discussions outwith the SR27 Draft Determination process with various stakeholders, including discussions with the Scottish Government and further engagement with WICS on how this change should be managed within SR27 reporting.

Our recommendation

10.5.5 We will look to discuss and agree how this is handled with WICS and other stakeholders to maintain confidence in Scottish Water's commitment to Net Zero, while clearly communicating the additional work needed to identify and deliver process emissions mitigation measures through the Net Zero Routemap refresh to be published in Autumn 2027.

10.6 Changes to the Investment Planning Scenario

10.6.1 The Draft Determination response has not taken account of known shifts and adjustments that are happening in the Investment Planning Scenario as a result of dynamic planning of the SR21 portfolio.

Our recommendation

10.6.2 We will take account of these as part of the normal Investment Planning Scenario refresh cycle and present in fully recast Delivery Plan tables.

10.7 Changes to the Timing of Charges Scheme

10.7.1 During SR21, October CPI was used to set charges for the coming year's Charges Scheme. As a result, to meet WICS and Scottish Water governance, the earliest the Charges Scheme can be publicly released is late January of the coming financial year. Feedback from customers and Licenced Providers is they would like to know the new year's charges sooner. By using September CPI, this can bring forward the timing of the public release of the Charges Scheme to early January.

10.7.2 The change has the added benefit that it will align with the annual uplifts for various welfare benefits that are adjusted in April each year using the CPI for the previous September. This includes Universal Credit, disability benefits (e.g. PIP and DLA), Carer's Allowance, tax credits payment and State Pensions.

Our recommendation

10.7.3 Move to using September CPI for annual charge setting so that the Charges Scheme can be publicly released in early January.