

**Minute of the sixteenth meeting of the Water Industry Commission for
Scotland
Held on 6 and 7 June 2006 in Stirling**

Present:

Sir Ian Byatt (Chairman)
Professor David Simpson (Deputy Chairman)
Professor John Banyard
Dr Michael Brooker
Mr Charles Coulthard
Mr Alan Sutherland (Chief Executive)

In attendance:

Mrs Katherine Russell (Director of Corporate
Affairs and Secretary to the Commission)
Miss Harriet Towler (Corporate Affairs Manager)
Mr Ian Tait (Director of Investment and Asset
Management) for item 6.

Chairman's opening remarks

The Chairman welcomed everyone to the meeting and thanked them for attending.

1. Apologies for absence

None

2. Minute of previous meeting and review of action points

The Commission agreed that the minute was an accurate account of proceedings.

The Commission were updated on actions from the previous meeting and noted it was a satisfactory position.

3. Update on current issues

The Commission noted information papers CP72-06, CP73-06, CP74-06, CP76-06, CP78-06 and CP79-06.

The Commission were informed that a final version of Scottish Water's delivery plan had been submitted by Scottish Water to the Scottish Executive (CP75-06). The Commission noted that since it had assessed a draft of the

revised plan against the requirements of the Final Determination, Scottish Water's planned response to development constraints had been modified. The Commission believed it was now more consistent with its understanding of legislative requirements. A letter would be written to the Scottish Executive on this subject. **Action**

The Commission noted that there had been a restructuring of Scottish Water's senior management team (CP77-06). The Commission agreed that Scottish Water assigning a director at board level to be responsible for the provision of regulatory information, could help to ensure greater accuracy and consistency of data. This responsibility could fall to an existing director or consideration could be given to a new position being created for that purpose.

Charles Coulthard, Chairman of the Audit Committee noted that he had recently met with Audit Scotland. Mr Coulthard reported that Audit Scotland had suggested consideration should be given to using shared services. The Commission noted that this issue had previously been investigated, and concluded that currently, no substantial savings, nor efficiency gains, could be made from the use of shared services.

Dr Brooker noted that he had recently attended a Glas Cymru 5-year anniversary event. A paper written marking the event would be made available to members.

The Chief Executive noted that the office would be holding an away day in July to plan for the 2009 Strategic Review. He invited Commission members to attend.

4. Corporate Affairs

The Commission noted that they were pleased with the progression of the office workplan, and wished to be kept informed about future progress (CP80-06). The Commission noted that the performance appraisal system had been implemented, and extended its thanks to Mr Coulthard and his working group for designing the system.

The Commission discussed the launch of their Annual Report on 21 June (CP81-06). The Commission agreed that the press notice for the event should focus on how customers benefit from the economic regulation of the industry. In particular, it would focus on charge caps for the next four years, the opportunity for better service to be delivered to business customers through retail access, the release of development constraints and targets for the reduction of leakage. The Commission agreed that it would like to hold an event at the Scottish Parliament on the day of the launch. **Action**

The Commission noted paper CP82-06 on the future recruitment strategy for the office, and CP83-06 on the current position of the office's Management Statement.

5. Licensing

The Commission discussed how best to communicate its work to develop a licensing framework for the new retail market and how it responded to the requirements of the Water Services etc (Scotland) Act 2005 (CP84-06). The Commission agreed a short note should be placed on the website explaining these legislative requirements and how they would be implemented in practice by the Commission. **Action**

The Commission discussed the financeability test that should be applied to both Scottish Water's retail entity and new entrants into the retail market (CP85-06). The Commission noted that it had a statutory duty to ensure that the participation in the market by retailers would not be to the detriment of the exercise of Scottish Water's core functions. It agreed that any test should be applicable to all entrants, and to avoid being a barrier to entry, should be simple and straightforward. The Commission concluded that requiring participants in the market to make payment in advance of the receipt of wholesale services would fulfil these. A payment should be made 40 days in advance for 30 days service. Interest should be paid at 0.5% less than the base rate. The Commission understood that this decision would be consistent with the Competition Appeals Tribunal's recent decision in the case of Albion Water.

The Commission noted analysis of the financial viability of Scottish Water's retail business under different ownership and commercial structures (CP86-06). The Commission discussed issues arising from this analysis (CP87-06). It concluded that it wished to press ahead with the implementation of the statutory duty placed on it by the 2005 Act, and noted its belief that a joint venture would be the best way forward. Though the Commission recognised that there may be other options that could be explored. The Commission agreed that fundamental issues to consider in this respect would be the management of working capital, the management costs (either directly, or through the expansion into other business areas), and securing a variable cost base.

The Commission discussed the mechanism by which customers' decisions to change supplier will be recorded and processed in the retail market (CP88-06). The Commission agreed that an independent entity, a Central Market Authority (CMA), should be established (option 2 presented in the paper). This entity would manage both the aggregation of retail customers' bills and record information on changes in supplier. The Commission noted that this role should be simpler than that performed in the electricity markets. The Commission agreed that the entity must be, and must be seen to be independent, and that the governance arrangements would be crucial in this respect. As such, the Licensing Framework Implementation Group (LFIG) would be asked to develop these arrangements. Members of the CMA would be asked to contribute to running costs on the basis of their market share. The Commission noted that it would be important that this system did not become unduly bureaucratic.

The Commission agreed that this decision should be communicated to Scottish Water, and that Scottish Water should now begin work on establishing the entity. A letter drafted (CP89-06) would be amended to reflect the Commission's decision, and would be sent to Scottish Water. **Action**

The Commission discussed the future work of the LFIG, and noted its approval of the proposed membership of the group (CP90-06). It agreed that should wider customer related issues be discussed by the group, Waterwatch Scotland would be informed. The Commission requested that it received minutes of the meeting for information. **Action**

The Commission noted the update on the status of the Wholesale Services Agreement and Operational Code (CP91-06). The Commission noted that satisfactory versions of both documents should be on place by the end of the month.

The Commission considered if the draft disconnections code for the market should allow for sewerage service providers to request the disconnection of water supplies, and should set out the permitted grounds for disconnection initiated by Scottish Water (CP92-06). The Commission noted the logic behind the proposed approach with regards to the disconnection of water supplies for non-payment of sewerage charges, but concluded that this issue should be explored in the upcoming consultation. **Action**

The Commission noted the update on progress with Scottish Water Business Stream's (SWBS) customer service code (CP93-06). It commented that it was disappointed that more progress had not been made at that time, and that this should be discussed with SWBS' Managing Director. **Action**

The Commission noted that the workplan for the licensing project had been revised to ensure that the Commission had fulfilled its statutory requirements by 30 September in anticipation of the relevant sections of the Water Services etc (Scotland) Act 2005 being commenced by that time (CP94-06). The Commission noted its gratitude to the members of the office who had contributed to the licensing project, and the progress that had been made.

6. Investment

The Commission discussed analysis of Scottish Water's investment programme delivery position at the end of the Quality and Standards II (Q&SII) period (CP95-06). The Commission noted that, based on information contained in Scottish Water's Capital Investment Return (CIR), the size of the overhang of investment from Q&SII was £13.5 million larger than that allowed for in the 2005 Strategic Review of Charges. The Commission noted that this figure was provisional, and would be verified once the Annual Return had been received from Scottish Water in June.

The Commission agreed that the projects which made up the overhang should be closely monitored until their completion. **Action**

Furthermore, once the Annual Return had been received, and the size of the overhang verified, a letter would be written to the Scottish Executive informing them of the size of the overhang, and the potential implications for funding.

Action

The Commission noted that some Q&SII outputs related to the first time provision of sewerage services had yet to be delivered. The Commission understood that Scottish Water had reported that the high unit costs associated with providing this service had made the projects uneconomic. The Commission suggested that some projects could be reconsidered where lower unit cost solutions could be provided. It was also noted that undelivered Q&SII outputs would result in a future adjustment to funding. These points would be communicated to Scottish Water. **Action**

The Commission noted how appeals received under the reasonable cost regulations would be administered by the office (CP96-06).

7. Costs, performance and levels of service

The Commission were updated on progress with establishing a pro-active approach to leakage reduction (CP97-06). The Commission had previously agreed that in the interim period prior to determining the economic level of leakage, Scottish Water should deliver the progress on leakage reduction set out in its second draft business plan. The Commission noted that a letter had been set to Scottish Water setting out pragmatic leakage targets, however, no definite response had yet been received.

The Commission delegated authority to the Chief Executive to agree targets with Scottish Water for 2006-07 and 2007-08, noting that they should be consistent with the progress proposed in the second draft business plan. The Commission agreed this target should be announced at the launch of its Annual Report

The Chief Executive agreed with the senior management of Scottish Water that from a baseline of 1139 MI/d in 2004-05, it would be required to make a reduction in leakage to 855 MI/d by 2007-08. This target would be recommended to Scottish Water's board.

The Commission considered a proposed structure for its pending consultation on trade effluent charging (CP98-06). The Commission approved the structure.

The Commission noted the update on progress with its wholesale charges project (CP99-06).

The Commission considered plans for a review of the regulatory information collected by the office (CP100-06). This review would ensure that the information requested from Scottish Water continued to be fit for purpose. The Commission endorsed the proposed plan.

8. Any other business

The Commission agreed that future meetings should, wherever possible, last for two days. Meetings would continue to be held on the first Tuesday and Wednesday of every month. Meetings would start at 11.30 on the Tuesday.

Minute approved on:

Minute authorised by: