

**Minute of the twenty-first meeting of the Water Industry Commission
for Scotland
Held on 7 and 8 November 2006 in Stirling**

Present:

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.
Dr John Simpson (Director of Analysis) for item 8.
Mr Craig Mackenzie (Analyst) for item 8.2.
Mr Dan Elliot (Frontier Economics) for item 8.2
Mr Martin Marsden (SEPA) for item 6.1

Chairman's opening remarks

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

1. Apologies for absence

Sir Ian Byatt (Chairman)

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 action points from the previous meeting and noted it was a satisfactory position.

3. Update on current issues

The Chief Executive reported on his recent liaison meeting with the Finance Director of Scottish Water.

The Chief Executive noted that he and his senior executive team had met with various staff at Ofwat. This meeting had proved informative ahead of undertaking the next strategic review of charges.

The Commission noted that it looked forward to meeting with the Scottish Environment Protection Agency (SEPA) later that day. The Commission hoped to discuss the impact of the Water Framework Directive on Scotland, progress with the Glasgow Strategic Drainage plan and future opportunities to work together.

The Chief Executive updated the Commission on the status of its legal obligation towards Waterwatch, and its staff. It was noted that as the accountable officer for Waterwatch, the Chief Executive had requested that an internal audit, using the Commission's internal auditors, be carried out. The Commission expressed its concern that it had not been possible for this internal audit to be carried out to date. This issue should be raised with the appropriate parties. **Action**

Mr Coulthard reported that he had recently attended a CRA occasional lecture on the role of ombudsmen in the utility industries.

The Deputy Chairman reported that he and the Chief Executive had had a useful meeting with representatives from the United Nations Educational, Scientific and Cultural Organisation (UNESCO).

4. Strategy

The Commission discussed CP182-06 on the proposal to adopt a staged approach to the methodology consultation for the Strategic Review of Charges 2010-14. The Commission recognised the importance of engaging stakeholders in this process. The Commission approved the approach, noting that it would allow the consultation to be comprehensive and make it accessible to as wide a range of stakeholders as possible.

The Commission noted CP183-06, a schedule of strategic issues that it would consider ahead of its methodology consultation.

The Commission discussed a summary of its current strategy for the Strategic Review of Charges 2010-14 (CP184-06). The Commission agreed this strategy, subject to minor amendment, reflected its current understanding of how the Review would progress. The Commission recognised, however, that it was only at the early stages of the Review process, and that as such, this strategy would change and evolve as the process progressed.

5. Corporate Affairs

The Commission noted the update on the office workplan (CP185-06) and that its Costs and performance report for 2003-06 would be published on 14 November 2006.

The Commission noted CP186-06, an update on the office's framework contractors.

The Commission welcomed the action taken in response to its employee opinion survey (CP187-06) and encouraged staff to make use of these new initiatives.

Mr Coulthard, Chairman of the Commission's Audit Committee, introduced the minutes of the last Audit Committee meeting (CP188-06). The Commission noted this update.

The Commission discussed the Executive summary of its first consultation on the Strategic Review of Charges 2010-14, relating to the process the review would follow (CP189-06). The Commission welcomed the steps proposed to encourage stakeholders to take part in the process. The Commission approved the Executive summary, subject to minor amendment.

6. Investment

The Deputy Chairman welcomed Mr Martin Marsden of SEPA to the meeting. Mr Marsden updated the Commission on the progress made to implement the requirements of the Water Framework Directive in Scotland. The Commission were reassured that in formulating Quality and Standards III, the requirements of the framework directive, particularly regarding the definition of "good ecological status", had been taken account of as comprehensively as possible (given the information available at the time). As such, the Commission understood there was limited risk that additional costs would be incurred in the 2006-14 investment programme as a result of the requirements of the Water Framework Directive.

The Commission noted CP190-06 an update on the progress made to define a method of measuring leakage. The Commission welcomed the initial work carried out, but noted that further in-depth work should be carried out in order to ensure that a clear methodology is agreed, and one that can be used to make accurate and consistent measures of leakage over time. The Commission recognised that in order to complete this work, some reprioritisation of the existing work programme for the investment directorate may be required over the next six months. **Action**

7. Licensing

The Commission noted the minutes of the last meeting of its Licensing Implementation Framework Group (LFIG) (CP191-06).

The Commission noted the update on the Customer Service code to be adopted by Scottish Water Business Stream in compliance with its provisional licence (CP197-06).

The Commission welcomed the work undertaken to appoint a Central Market Authority (CMA) services provider (CP193-06). The Commission noted that

following an extensive negotiated tender process, Gemserv had emerged as the preferred bidder. The process to appoint a Chief Executive for the CMA Company (which would manage the CMA on behalf of licensees) would now begin.

8. Costs, performance and levels of service

The Commission noted CP194-06, an update on progress with the wholesale charges project.

The Deputy Chairman welcomed Mr Dan Elliot of Frontier Economics to discuss the preliminary findings from Scottish Water's submissions on wholesale costs (CP195-06). The Commission noted the preliminary views of Frontier Economics on its analysis of cost drivers, the balance of fixed and variable costs and the current balance of revenue and costs. The Commission requested an update on the project in December which indicated the likely impact of different wholesale tariff structures on standard customers' bills.

Action

The Commission noted that regardless of the final tariff structure adopted, there could be instances where there may be justifiable departures from the standard tariffs. The Commission would consider such instances under Section 29e of the Water Services etc (Scotland) Act 2005.

The Commission discussed the outcome of the transfer pricing review of Scottish Water (CP196-06). The Commission noted that a number of important issues had been raised by the review. The Commission agreed that Scottish Water should be informed of these issues, and asked to detail the action it would be taking in response to them. **Action**

The Commission reviewed the outcome of the consultation on trade effluent charging (CP197-06). The Commission agreed that, having reviewed consultation responses, its proposed transition arrangements for moving all trade effluent customers onto paying published tariffs should be modified. It was agreed that where applicable, phased increases should start in 2008-09 following a "grace year". Charges should then increase by equal percentages (as opposed to equal monetary increases as had originally been proposed) for a period of 3 years following the grace year. The Commission noted that in doing so, it was important to emphasise that the transitional arrangements would span two regulatory control periods. As such, the cash value of the percentage increase in the third year could be greater than anticipated depending on the outcome of the 2010-14 strategic review. The outcome of the consultation would be published on the Commission's website. **Action**

The Commission noted CP198-06, an updated information note on the Overall Performance Assessment (OPA) for the website.

The Commission noted the outcome of a review of non-household customer numbers in Scotland (CP199-06). The Commission noted that Scottish Water had made a large downward adjustment to its non-household of customer

base as part of a data-cleansing exercise prior to the 2006-10 Strategic Review. The Commission's framework contractors, Oxera, had been commissioned to provide an independent estimate of non-household customer numbers in Scotland. Oxera estimated that there could be at least c.11% more non-household customers than had been allowed for in the Final Determination. The Commission agreed that this report should be sent to Scottish Water, and its views sought. **Action**

The Commission noted CP200-06, an update on the process for approving household charges for 2007-08.

The Commission agreed that the process for determining default tariffs for 2007-08 and beyond should be instigated (CP201-06). The Commission agreed that default tariffs should be determined unilaterally, after seeking views from retailers.

The Commission noted that Scottish Water's interim wholesale charges scheme for 2006-07 had been formally approved (CP202-06).

9. Any other business

The Commission requested that a graphical representation of Scottish Water's progress at completing the Quality and Standards II overhang be included in future investment updates. **Action**