

**Minute of the twentieth meeting of the Water Industry Commission
for Scotland
Held on 3 October 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 5.
Dr John Simpson (Director of Analysis) for item 6.
Dr Jeremy Atkinson (Director of Licensing) for item 7.

Chairman's opening remarks

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

The Chairman noted that a further two papers had been proposed for tabling at the meeting. These papers, relating to Scottish Water Business Stream's application for provisional licences could not be tabled prior to the meeting as they had yet to be received. The Commission agreed that the papers could be tabled, and that sufficient time had been allowed for the papers to be properly considered prior to a decision being made.

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

3. Update on current issues

Professor Simpson reported that a rejoinder to an article in the Fraser of Allander Economic Commentary would shortly be published.

Mr Coulthard reported that the Audit Committee had met on 27 September. He noted that the Committee had considered the Commission's suggestion that value for money assessments be carried out on the office's framework contracts. The Committee had agreed that an assessment of the ongoing management of the contracts would form part of the internal audit of the office. Mr Coulthard also reported that he had attended Scottish Water's public meeting and had found it a useful event.

The Chief Executive reported that he had recently met with Anglian Water.

The Chairman reported that he had met with the Head of the Environment and Rural Affairs department for his annual appraisal. He had also met with representatives from the Confederation of British Industry (CBI), Scottish Engineering, Glasgow City Council, and had a useful meeting with the Chairman of Ofwat.

The Chairman and Chief Executive reported they had held meetings with the Shareholder Executive, the Office of Rail Regulation and the Office of Utility Regulation, Guernsey.

Professor Banyard, Professor Simpson, Mr Coulthard and Dr Brooker reported that they had recently been on site visits arranged by Scottish Water. They reported that this had been a valuable experience and wished to extend there thanks to all of the Scottish Water staff involved. A letter would be sent to Scottish Water in this respect. **Action**

The Secretary to the Commission reported that she and the Chief Executive had continued to hold regular liaison meetings with Scottish Water. These were proving a productive means to enhance working relationships with Scottish Water.

4. Corporate Affairs

The Commission noted the update on the office workplan (CP165-06). The Commission discussed the target audiences for its annual performance reports. The Commission agreed that the key messages for the annual reports should be written for the generality of customers. A technical account of the Commission's assessment of Scottish Water's performance, designed for a specialist audience, would also be provided.

The Commission welcomed the update on the office's framework contracts (CP166-06). It noted its concern that there were some issues with the draft outputs produced by the contractors. The Commission encouraged its Directors to continue to take a firm stance with its framework contractors in order to deliver sufficiently high quality outputs in a timely manner.

The Commission noted the update on the office's performance appraisal system (CP167-06). The Chairman noted that the Remuneration Committee would consider the outcome of the appraisal system at its next meeting. The Commission also noted that the results of the employee questionnaire had been collated. The Commission wished to be updated on action taken in response to the results. **Action**

The Commission endorsed the proposed process for communicating with its external stakeholders (CP168-09). However, it emphasised the importance of feedback to the success of the system. This included both internal feedback, such as recording and disseminating the outcome of meetings, and external feedback, such as listening to the views of stakeholders. The Commission recognised the necessity of having a database to manage the process, but agreed that it should not become overly cumbersome.

The Commission approved the proposed high level workplan for the Strategic Review of Charges 2010-14 (SRC09) (CP169-06), subject to the inclusion of two additional issues to be considered.

The Commission approved the proposed key themes for its first consultation on the SRC09 (CP170-06). The Commission reiterated the importance of considering the target audience for the document.

5. Investment

The Commission noted the Output Monitoring Group's (OMG) report on Scottish Water's output delivery performance in the first quarter of 2006-07 (CP171-06). The Commission emphasised the importance on focussing on the outputs delivered as well as the expenditure used. The Commission commented that there may be value in assessing performance on an aggregated basis for all projects and focussing on the 50 largest in more detail. These views would be communicated to the OMG for consideration. **Action**

6. Costs, performance and levels of service

The Commission noted and welcomed CP172-06, an update on Scottish Water's financial performance for quarter 1 of 2006-07.

The Commission noted the update on the transfer pricing review of Scottish Water (CP173-06). The Commission noted some of the provisional conclusions of the review, and expected to receive the final conclusions of the review at the next meeting. **Action**

The Commission noted the update on the wholesale charges project (CP174-06). The Commission expressed its concern that there had been some delays to the project and reiterated the importance of its completion in sufficient time to allow a draft wholesale charges scheme to be published in January 2007.

The Commission noted that should Scottish Water Business Stream (SWBS) be licensed, a charges scheme would need to be approved in order for Scottish Water to charge SWBS for wholesale services (CP175-06). The Commission agreed to delegate authority to the Chief Executive to approve (or determine) an interim wholesale charges scheme for Scottish Water to levy on SWBS until April 2007.

The Commission considered CP176-06 on the development of the use of the Overall Performance Assessment (OPA) in Scotland. The Commission had previously agreed to enhance the comparability of customer service performance by more closely aligning the OPA in Scotland with Ofwat's version. Before doing so, the Commission requested that analysis, which supported its underlying assumption that customer preferences in England and Wales were substantially the same as those of Scottish customers, be updated. The Commission agreed that on the basis of the outcome of such analysis presented in CP176-06, that this assumption remained valid. As such, the Commission agreed that there was no requirement to update the OPA to take account of customers' preferences in Scotland. However, this decision would be subject to the presentation of the detailed analysis supporting the outcomes presented in CP176-06, at the next Commission meeting. **Action**

7. Licensing

The Commission noted the draft minutes of its Licensing Framework Implementation Group's (LFIG) meeting of 20 September (CP177-06). The Commission noted its gratitude to the LFIG for its commitment to date.

The Commission noted the process by which it will consider the application by SWBS for provisional water and sewerage services licences (CP178-06).

The Commission reviewed a draft letter to request that the relevant sections of the Water Services etc. (Scotland) Act 2005, be commenced to enable the Commission to licence entrants into the new retail market (CP179-06). The Commission agreed that this was important to enable it to fulfil its duty under the Act to facilitate the orderly opening of the market. The Commission agreed that, following minor amendment, and following the commencement of the Act with regard to the licensing of SWBS, the letter should be sent to the Deputy Minister for the Environment and Rural Affairs. **Action**

The Commission considered an assessment of SWBS' draft application for provisional licences to supply water and wastewater services to non-household customers (CP180-06). The Commission considered the recommendations made, and reached the following decisions regarding the suitability of the applicant.

- The Commission agreed that SWBS had submitted an application that is properly made (that is in accordance with the guidance issued by the Commission) and that the application contained sufficient information

to allow a proper assessment for the purpose of deciding whether to grant a provisional licence to be made.

- The Commission agreed that SWBS has demonstrated sufficient knowledge and experience to undertake the activities authorised by provisional licences.
- The Commission agreed that SWBS has demonstrated the necessary financial capacity to meet its working capital requirements by securing a guarantee of financial support from Scottish Water. The Commission, minded of its statutory duty to facilitate participation in the retail market without detriment to the exercise of Scottish Water's core functions, agreed that this arrangement would not, in its view, be of detriment to Scottish Water. However, in the light of this duty, the Commission rejected the recommendation that a change of wording of the letter be made, removing the end date for the guarantee.
- The Commission agreed that SWBS has demonstrated a proper understanding of the legal and regulatory framework.
- The Commission agreed that SWBS has demonstrated how it will comply with the provisions of the provisional licence.

The Commission considered the appropriateness of granting a provisional licence in light of its section 11 requirement to facilitate participation in and orderly manner and without detriment to the participation of Scottish Water's core functions. The Commission agreed the following.

- That the grant of provisional licences would encourage further distance and therefore separation between Scottish Water and SWBS.
- That greater separation would provide comfort and clarity to new entrants.
- And that, grant is therefore consistent with the section 11 requirement to secure participation in an orderly manner.

Therefore, the Commission agreed that it was minded to award SWBS with provisional licences, upon submission of a formal application on or soon after 5 October 2006, providing that:

- The retail undertaking has been established.
- The transfer agreement is signed at the point of grant.
- The formal application submitted by SWBS is materially the same as the draft application.

- That there has been no material changes in circumstances between the Commission decision and submission of the formal application.

Furthermore, the Commission agreed to delegate authority to its Chairman and Chief Executive to make any further decisions concerning the grant of such licences and the issuing of any related directions, waivers and consents.

The Commission noted CP181-06, an update on the current overall licensing position.

Minute approved on:

Minute authorised by: