

**Minute of the fifteenth meeting of the Water Industry Commission for
Scotland
Held on 2,3 and 4 May 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)
Dr John Simpson (Director of Analysis) for item 7.
Mr Ian Tait (Director of Investment and Asset
Management) for item 6.
Dr Jeremy Atkinson (Director of Licensing) for item
5.
Mr Craig Mackenzie (Analyst) for CP70-06
Mr Rob Francis (Frontier Economics) for CP70-06

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.

Mr Coulthard, Chairman of the Audit Committee, requested that any relevant excerpts from the Commission meeting minutes be circulated to the Audit Committee. **Action**

The Commission were updated on actions from the previous meeting and noted those yet to be actioned.

3. Update on current issues

The Chief Executive updated the Commission on the status of the three monthly accounts of the office of the former Commissioner. The Commission noted the position.

The Commission discussed the progression of non-household metering. The Commission agreed they would welcome the progressive use of non-household metering on the basis of the following:

- all new properties should be metered;
- any existing properties missing from Scottish Water's billing system should be billed on a metered basis should they later be added to the system;
- if there is a change to the owner/occupier of an existing metered property, then the new occupier should be billed on a measured basis; and
- where any property has a meter, the customer should have the option of being billed on a measured basis. Surrogate measured bills should be sent to the customer to better inform their choice of billing method.

The Commission noted that progressing the extent of non-household metering would be particularly important given its intention to establish a default retail tariff for the new market on a measured basis. A letter would be sent to Scottish Water (extending CP54-06) to that effect. **Action**

Professor Simpson reported that he had had an informal meeting with the Customer Services Director of Scottish Water and Mr Neil Menzies.

Mr Coulthard reported that he had arranged a meeting with Audit Scotland to discuss the proposed Audit plan for the office.

The Chairman reported that he and the Director of Corporate Affairs had recently met with the Convener of Waterwatch Scotland and its Head of Corporate Services to discuss the future working of the two organisations.

The Chairman noted that he had held an informal meeting with the new interim Chairman of Scottish Water.

The Chief Executive reported that he had discussed the potential role of a Regulatory Director at Scottish Water with the Scottish Executive.

The Chief Executive also reported that he had met with the Managing Director of Scottish Water Business Stream

4. Corporate Affairs

The Commission noted the update on the office workplan (CP59-06) and the importance of the work of the Commission being aligned with that of the day-to-day work of the office.

The Commission welcomed the progress with its Annual Report (CP60-06).

5. Licensing

The Chief Executive noted that a Licensing Implementation Framework Group (LFIG) was being formed. Mr Clive Sparrow of Pareto Management Limited had been asked to chair the group. The Commission welcomed an update once membership of the group had been finalised and its first meeting had been held. **Action**

The Commission discussed how the legal structure of Scottish Water's retail entity could affect its consideration of the entity's financiability (CP61-06). The Commission noted that whichever structure is opted for by Scottish Water and its owner, the Scottish Executive, it should ensure that the situation where the retail entity either is, or is perceived to be, in receipt of State Aid is avoided. Furthermore, it must be a structure that enables the entity to operate successfully in the new retail market.

The Commission noted that, in its view, the structure most likely to achieve these requirements would be a Joint Venture (JV) where Scottish Water has a minority share. Whilst this form of JV was the Commission's preferred option, it noted that a Company Limited by Guarantee could also achieve the above criteria. The Commission agreed a ring-fenced subsidiary could be acceptable, but the difficulty of demonstrating its independence would make this the least preferred structure even if the Commission was satisfied as to its independence. These issues should be raised with Scottish Water and the Scottish Executive. **Action**

The Commission discussed a draft application form for licences and associated material (CP62-06). The Commission agreed that, subject to the inclusion of a self-supply option, the draft pack proposed should be included in its forthcoming licensing consultation. Furthermore, the Commission agreed that a request should be made to amend the draft Statutory Scottish Instrument which specifies the information that must be contained in the licensing application pack. These amendments would include; the requirement that the licence applicant provide contact and biographical details for company directors; the requirement that the applicant set out the purpose of the application; and allow the Commission to develop its thinking on the appropriate financeability test that should be required. **Action**

The Commission noted that its forthcoming licensing consultation was due to include drafts of Scottish Water's Wholesale Services Agreement and operational agreement (CP63-06). The Commission noted that it had previously communicated to Scottish Water the principles that should

underpin both agreements. It also noted that the timescale for Scottish Water to produce agreements that could be included in the forthcoming consultation was becoming increasingly tight.

The Commission agreed that if Scottish Water failed to submit a Wholesale Services Agreement consistent with the aforementioned principles by 1 June 2006, it would issue guidance for the Agreement in its forthcoming consultation. This would be consistent with the Commission's powers under Section 16 of the Water Services etc. (Scotland) Act. The Commission also agreed that if Scottish Water did not submit an operational agreement consistent with its principles by 1 June 2006, then it would prepare a draft for the consultation. This would be consistent with the Commission's powers under Section 11 of the 2005 Act. The Commission would be updated as to the status of both agreements following 1 June 2006. **Action**

The Commission noted that the licensing project was required to progress at a quick pace, and at times this meant that it could not always be consulted in full. However, much could be achieved under the powers delegated to the Chairman and Chief Executive, and in the absence of the Chairman and deputy Chairman, Mr Coulthard would take on their responsibilities.

6. Investment

The Commission noted the timetable for monitoring and reporting on the completion of the Quality and Standards II investment programme (CP64-06).

The Commission noted the update on progress with the creation of an Output Monitoring Group (OMG) (CP65-06). It also discussed the importance of integrating the work of the Group with the setting of ministerial objectives and the short amount of time available to do this before the next Strategic Review of Charges. The Chief Executive would write to the Scottish Executive setting out a proposed timetable for the next review. This draft timeline would be circulated for the OMG's information. **Action**

The Commission considered its duty under the Water Services etc (Scotland) Act 2005, to make reasonable cost contribution determinations (CP66-06 and CP66-06 (2)). The Commission noted that it is simultaneously required to issue a statement on the process it will use to make determinations and consult on it. The Commission agreed that the draft process tabled, subject to minor amendment, would be issued as an interim statement, and placed on the Commission's website for a period of three weeks for comment. After that time a final statement would be issued. **Action**

The Commission agreed that the authority to make reasonable cost determinations should be delegated to the Chairman and Chief Executive. The rules of procedure should be amended accordingly. The Chief Executive should consider forming a specialised working group to analyse cases. The Chief Executive would report to the Commission on the number, and outcome, of determinations. **Action**

7. Costs, performance and levels of service

Following its agreement at the April meeting that Scottish Water should be set pragmatic interim leakage targets, the Commission discussed the form these targets should take (CP67-06). The Commission considered the reductions projected in Scottish Water's 2nd draft business plan, and the reductions achieved by companies in England and Wales in response to targets set by Ofwat. The Commission noted that the final determination provides sufficient funding for Scottish Water to achieve reductions in leakage consistent with those observed south of the border. The Commission agreed the targets tabled at the meeting, which had been devised on this basis, should be issued to Scottish Water. **Action**

The Commission considered an information note on the Overall Performance Assessment (OPA) which would be made publicly available (CP68-06). The Commission agreed that, subject to amendment, the note should be placed on its website. **Action**

The Commission considered how its use of the OPA could be developed in the future (CP69-06). The Commission agreed that the final determination OPA should be retained to monitor performance, but separating retail measures from 2008. It also agreed that for the 2009 Strategic Review, the OPA should be brought, as far as possible, into line with Ofwat. This would include discussing with Scottish Water's other regulators the possibility of using measures consistent with their counterparts in England and Wales. The results of customer research in England and Wales and Scotland would be compared in further detail to confirm that customer priorities north and south of the border are consistent. **Action**

The Commission discussed the progress of its study into wholesale charging with Frontier Economics (CP70-06). It expressed its current view that tariffs for water should primarily reflect the volume of water used. However, regard should be given to the position on the network and potentially the extent of service provided. In this regard, it would be important not to create a perverse incentive for Scottish Water such that it may be disadvantaged if it connected a property to the network. It would also consider evidence that tariffs should reflect other drivers of cost apart from volume.

The Commission noted its current understanding that foul sewage charges should relate to volume and that trade effluent charges should reflect the factors that have material impact on costs (potentially as set out in the Mogden formula). The Commission noted that the Ministerial Principles of Charging envisioned tariffs based on surface area drained from 2010. From 2008, this principle could only be applied to wholesale charges.

The Commission agreed the following outputs and next steps proposed by Frontier Economics:

- During May, Frontier Economics would meet with Scottish Water to discuss tariff structures and the availability of information.
- During August, information received from Scottish Water would be analysed.
- In September, indicative findings and a draft wholesale charges scheme would be presented to the Commission.
- In November, a final wholesale charges scheme would be presented to the Commission.

A letter would be written to Scottish Water noting these preliminary discussions. **Action**

The Commission noted that, depending on the outcome of the study, some rebalancing of tariff baskets may be required in April 2007. The Commission would receive regular updates on the progress of the study. **Action**

8. Scottish Water's delivery plan

The Commission welcomed Scottish Water's revised delivery plan. The Commission noted that the delivery plan was consistent with the requirements of the final determination. In the absence of the Chairman, the Chief Executive would write a letter to Scottish Water to that effect. **Action**

The Commission also agreed some specific points of detail it wished to discuss with Scottish Water regarding the plan. These points did not affect the milestones in the plan by which progress would be monitored.

Minute approved on:

Minute authorised by: