

**Minute of the twenty-seventh meeting of the Water Industry Commission
for Scotland
Held on 5 June 2007 in Stirling**

Present:

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

In attendance:

Mrs Katherine Russell (Director of Corporate Affairs and
Secretary to the Commission)
Miss Suzanne Baylis (Analyst)
Dr John Simpson (Director of Analysis) for item 7
Mr Ian Tait (Director of Investment and Asset
Management) for item 5
Mr Cesar Raffo (Analyst) for item 7.8
Mr Richard Khaldi (Analyst) for item 6
Mr Cameron McKean (Analyst) for item 6
Mr Craig Mackenzie (Analyst) for items 7.1- 7.5

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, subject to minor amendment, was an accurate account of proceedings.

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

3. Update on current issues

Professor Simpson reported that he had attended a CRI meeting with the Chief Executive and the Chairman on 23rd May. This had been a useful opportunity to meet with other regulators and discuss the frameworks in which they operate.

Mr Coulthard reported that he had attended a Regulation Policy Institute seminar, in May, on Airport Regulation. Mr Coulthard also reported that Iain Osborne, Chief Executive of the Northern Ireland utility regulator (NIAUR) would visit the Commission in October.

The Chief Executive reported that he had met with representatives from the Water Division of the Northern Ireland Executive. He noted that only very slow progress was being made with the development of water regulation in Northern Ireland.

The Chief Executive reported that considerable difficulty has been experienced in recruiting a Director of Competition at the salary level permitted by the Commission's current pay remit. Due to the delay in this process current members of staff have experienced a higher burden of work. The Chief Executive advised he would likely have to reduce his expectation of the level of person he could recruit. The post has also been advertised through the Government Information Service and two candidates have been identified. The Chief Executive would meet with them soon.

The Chief Executive updated the Commission on progress with the separation of Scottish Water Business Stream (SWBS) from Scottish Water. The Commission had set SWBS three tests that it would to meet if it is to be granted with permanent licences to supply water and sewerage services in the new retail market. It was noted that SWBS' provisional licences are due to expire on 1 April 2008, but that considerable work had yet to be done to meet its separation requirements. The Commission agreed its office should work with SWBS, clearly setting out its essential and desirable requirements for separation. **Action**

The Chief Executive also reported that he and the Chairman met with officials at HM Treasury to discuss the development of competition in the water industry. The Chairman and Chief Executive would meet with Ofwat to discuss these issues further in July. The Commission will be kept informed of progress.

The Secretary to the Commission reported that the Hay Review of staff salaries and gradings has finished and the draft report received. All staff will be informed individually of the outcome by email.

4. Corporate Affairs

The Commission noted CP70-07 an update on the office workplan.

The Commission noted the update on its framework contractors (CP71-07). The Commission welcomed the Chief Executive's view that improvements were being made in the management of these contracts, but noted that the Chief Executive considered that still more could be done in this respect.

The Commission welcomed the attendance at the second stakeholder workshop for the 2010-14 price review (CP72-07). It was particularly welcome that Waterwatch was represented by several panel members.

The Chairman of the Audit Committee and Chief Executive updated the Commission on the Commission's legal accountability for Waterwatch Scotland. The Chairman of the Audit Committee noted his concern that the Chief Executive, as accountable officer for the Commission and Waterwatch, did not yet have sufficient assurance that the requirements of the statement of internal control had been met.

5. Strategy

The Commission discussed CP73-07, the draft of Volume 4 of its methodology consultation for the 2010-14 price review. This document sets out its proposed approach to Scottish Water's capital expenditure. The Commission approved the document but requested that there be increased transparency on the delivery of Scottish Water's capital maintenance programme. The Commission welcomed the early start proposals but noted its concern with the slow start to the current investment programme. It confirmed that it wished to ensure that a longer term view of investment was taken in the future.

6. Competition

The Commission discussed the process that should be followed to assess whether licence applications contain sufficient information to be determined by the Commission (CP86-07). The Commission approved the recommended process, but requested that additional information also be sourced by the office to aid the determination process. This would include information from Companies House. The Commission agreed that an updated process would be presented at its next meeting. **Action**

The Commission noted that an application for licences to supply water and sewerage services to eligible customers under the Water Services etc (Scotland) Act 2005 had been received from Satec Ltd. The Commission agreed that it was unable to make a final decision as to whether to grant licences (subject to representations from third parties) until it received the supporting information noted above. The Commission agreed that this information should be circulated to members via-electronic mail following the meeting. Members agreed, provided that this information was in order, that they could be minded to approve the licence application, subject to

representations by stakeholders. The Commission agreed that, providing no member had any concerns about the additional Companies House information, the Chief Executive should write to notify Satec Ltd that the Commission was minded to grant licences subject to representations by stakeholders. Satec Ltd would then be required to publish notification its licence application.

The Commission further agreed that authority should be delegated to the Chairman and Chief Executive to grant licences to Satec Ltd should no representations which the Chairman and Chief Executive considered to be material to a decision be received. Should any material representations be received, these would be presented to the Commission for consideration.

The Commission noted the minutes (CP74-07) of the Licensing Framework Implementation Group (LFIG).

The Commission welcomed the update on activity by potential licensed service providers (CP75-07).

The Commission discussed CP76-07 and approved the recommendation that specialist licenses be available to those seeking to identify opportunities to seek departures from the wholesale scheme of charges. The specialist licence should not allow for any further involvement in the market.

The Commission noted the cost justification for the application fees and annual levy to be charged to licence providers of retail water services and sewerage services (CP 77-07).

7. Costs, performance and levels of service

The Commission noted CP78-07. The Commission welcomed progress with the wholesale charges scheme and thanked staff for their efforts.

The Commission noted how Scottish Water's proposed wholesale charges will impact on customers (CP79-07).

The Commission noted issues arising from its consultation on Scottish Waters draft wholesale charges scheme for 2007-08 (CP82-07). The Commission agreed that, in the light of the consultation response received Scottish Water's current interim wholesale charges should be extended for the period 1st July 2007 to 31st March 2008. The Commission considered and approved a revised draft Wholesale Charges Scheme for 2008-09. The Commission noted that this scheme had yet to be approved in principle by Scottish Water's Board. The Commission agreed that should Scottish Water wish to make substantive changes to the scheme, they would need to be revisited by the Commission. However, the Commission agreed that in the event of Scottish Water wished to change the tariffs by only a small amount, authority should be delegated to the Chief Executive to approve the Scheme.

The Commission noted the incidence effects (CP80-07) on the 300 largest customers that may arise from the implementation of Scottish Water's proposed wholesale charges scheme.

The Commission noted the incidence effects (CP81-07) on the Commission's standard customers that may arise from the implementation of Scottish Water's proposed wholesale charges scheme.

The Commission noted Scottish Water's request that it approve its Overall Performance Assessment (OPA) score for 2006-07. This would enable Scottish Water to pay performance related staff bonuses in July (CP83-07). Scottish Water had requested that the Reporter audit its score for 2006-07. The Commission noted that the Reporter's report had raised concerns with Scottish Water's reported leakage score for that year. The Commission agreed that the Reporter's concerns should be taken into account, and that Scottish Water's reported OPA score of 234 should be correspondingly reduced to 229. The Commission approved a score of 229 for 2006-07 and welcomed Scottish Water's outperformance the regulatory target of 195 for that year. This would be communicated to Scottish Water. **Action**

The Commission discussed the course of action for leakage that should be taken in the light of the Reporter's report noted above (CP84-07). The Commission agree to wait for the annual return in order to understand the detailed information and any mitigating factors.

The Commission noted CP85-07 on Scottish Water's financial performance for 2006-07. The Commission noted that Scottish Water's capital expenditure for 2006-07 was at its lowest level since its creation. The Commission welcomed the apparent return on capital employed that was available on the retail element of the business.