

**Minute of the forty-seventh meeting of the Water Industry Commission
for Scotland**

Held 2 June 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)
Mrs Donna Very
Mr Richard Khaldi (Competition - Analyst) item 5
Mr Ian Tait (Director of Investment) item 6

Chairman's opening remarks

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

1. Apologies for absence

Nil

2. Minute of previous meeting and review of action points

2.1 Declaration of conflicts of interest in relation to the Agenda

No conflicts of interest reported.

2.2 Minute of last meeting (03/09)

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

2.3 Review of action points (AP04/09)

The Commission noted it was in a satisfactory position.

3. Update on current issues

3.1 Working with stakeholders and other current issues (CP66/09)

- The Commission noted CP66/09 an update on the work of stakeholders and significant external events.
- The Chairman reported that he had recently visited Orkney and met with Orkney Council and Orkney Housing Association.
- The Chairman also reported that he had met with the Minister for Transport Infrastructure and Climate Change.
- The Chairman reported that he and the Chief Executive had met with Stella Manzie, Director General of Finance and Corporate Services and Alistair Brown Deputy Director Finance at the Scottish Government.
- The Chief Executive and Director of Corporate Affairs met with Jo Aston and Ian Osborne from the Northern Ireland Utility Regulator.
- The Chief Executive gave a speech at the Institute of Economic Affairs entitled, 'Assessing the financial implications of vertical separation'.
- Dr Brooker met with the Chairman of Scottish Water's Remuneration Committee.

3.2 Oral update on CMA/GEMSERV

3.3 Update on the Central Market Agency (CMA)

The Commission noted the written update provided by Dr Jeremy Atkinson.

3.4 Competition Appeals Tribunal (CP67/09)

The Commission noted this paper.

4. Corporate Affairs

4.1 Update on the office workplan and strategy for the price review (CP68/09)

The Commission noted there were no exceptions to report this month.

4.2 Update on framework contracts (CP70/09)

The Commission noted this update.

4.3 Record of discussion at the stakeholder workshops (CP71/09)

The Commission noted this paper and welcomed the summaries provided at recent stakeholder days for the 2010-14 price review.

4.4 Annual Report 2008-09 (CP72/09)

Subject to minor amendments, the Commission noted this paper and delegated authority to the Chief Executive to finalise the document.

5. Competition

5.1 Oral update on licensees

Mr Khaldi provided an oral update on licence providers.

Mr Khaldi reported that Aimeria would soon be fully operational and had received a number of enquiries from customers.

Mr Khaldi also reported that he had met with Osprey who are expecting to sign several new customers in the near future.

5.2 Update on communications (CP73/09)

The Commission noted this paper.

5.3 Compliance Audit of Business Stream (CP74/09)

The Chief Executive reported that he had met with the Chief Executive of Business Stream, Mark Powles, and discussed the issues outlined in the draft statement of case. Mr Powles recognized that these issues needed to be addressed and had provided a helpful response to our concerns.

The Commission noted this paper and will monitor the situation closely.

6. Investment

6.1 Oral update on investment delivery including the overhang

6.2 Investment update (CP75/09)

The Director of Investment provided the Commission with an oral update on the latest information available on Scottish Water's progress with delivering its investment programme. The Commission noted that there had been dramatic improvement at the 'project acceptance' stage from previous reports but that output sign-off remained behind target.

The Director of Investment informed the Commission that investment spend at the close of the 2008-09 financial year had been £687m. This was at the top of the year end forecast range of £650-£690m. The Commission was disturbed to learn that Scottish Water's forecast of the investment 'overhang' into the next regulatory control period is now predicted to be £187.2 million – this is an increase of £8.2 million from

that included in Scottish Water's March 09 business plan. This increase was not highlighted at the joint board meeting on 6 May.

The Commission is concerned that unless investment expenditure is reduced below current forecasts it will not be within the finance available through the regulatory settlement. The Commission agreed that the Chief Executive should write to Richard Ackroyd to explain its concerns with regard to programme overspend and seek Scottish Water's view. As any shortfall in available financing is a matter for the Scottish Government, the letter will be copied to Bob Irvine at the Scottish Government.

The Commission commented that it was extremely important to establish the breakdown of the overhang into 'overspend' and 'late delivery'. It was noted that this could impact on the determination and, while there was insufficient time to include these considerations in the draft determination, it was a matter for consideration in the final determination.

6.3 Update on CIR (CP76/09)

The Director of Investment reported that Scottish Water had provided an explanation of the errors contained within the Capital Investment Return for Quarter 4. Scottish Water reported that the problem had arisen due to an administration error and had submitted a corrected version.

The Commission noted the dramatic improvement in outputs achieving 'project acceptance' in Quarter 4 2008-09. It was noted that the movements in outputs included very large increases in population equivalents receiving better water quality and in the provision of strategic capacity. The Commission noted that it looked forward to seeing this progress reflected in output sign-offs next quarter. It was also noted that the improvements in strategic capacity should be reflected in Scottish Water's web-based facility for reporting the available strategic capacity on the network.

6.4 SMC progress report (CP77/09)

The Director of Investment updated the Commission on the work carried out by Strategic Management Consultants (SMC) to review Scottish Water's Quarter 4 2008-09 Capital Investment Return (CIR). SMC have carried out phase one of their investigation involving an analysis of the documentation supporting the CIR.

SMC reported that the CIR is comprehensive and robust but involves a great deal of manual intervention which could lead to errors. SMC have recommended more automation of the process.

SMC also noted that output delivery targets had been achieved in some areas by 'bringing forward' outputs which were not due for delivery until later in the programme to replace outputs that were delayed.

In particular, the Commission expressed concern over the practice of 'splitting' of projects into enhancement and capital maintenance elements to allow the enhancement element to be claimed ahead of completion of the overall project. The Commission agreed to hold discussions with the quality regulators on the possibility of introducing a 'conditional' sign-off.

The Commission were also concerned that they had not been informed at the joint Board meeting of how the output targets had been met – specifically both the advancement of new projects and the splitting of projects into enhancement and maintenance elements. There were some signs that easier projects were being undertaken whilst more difficult ones were being postponed.

The Commission approved the proposal that further analysis work on the CIR should be carried out.

The Commission thanked the Director of Investment and his team for all their hard work on investigating delivery of Scottish Water's investment programme.