

**Minute of the thirty-fifth meeting of the Water Industry Commission for
Scotland**

Held on 3 and 4 March 2008 in Stirling

Present:

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

In attendance:

Mrs Katherine Russell (Director of Corporate Affairs)
Mrs Donna Very
Richard Khaldi, Cameron McKean and Suzanne Baylis
(Section 6)
Ian Tait (Section 7)
John Simpson and Cesar Raffo (Section 8)

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

2.1 Minute of last meeting (01/07)

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

2.2 Review of action points (AP01/07)

The Commission were updated on action points from the previous meeting.

The Commission noted that AP0907/4 was not a concern at this point as the approved Statement of Internal control covers this point.

3. Update on current issues

Competition and retail access issues

The Commission discussed the progress of the retail market which is due to go live on 1 April 2008. A number of points were raised:

- The Commission must define success appropriately. It needs to state very clearly that success is not solely about switching from one supplier to another but about the increase in level of service or reduced cost received by the customer.
- A survey should be carried out in 12 months to review the introduction of competition and benefits it has brought to customers.
- A state of the market report will be published in November this year.
- Professor David Simpson chaired the recent MEUC events which over 150 customers and suppliers attended. He advised that both Tesco and British Energy stated that price was not necessarily the main driver when deciding on which supplier they would use. Both wanted suppliers who understood their business and could offer different solutions.
- The Chairman advised that he had met with Brian Saunders, Chairman of the CMA and was pleased that the CMA were confident that they were prepared for the opening of the market.

He also advised that he had been asked to speak to the Water UK Council in May on the development of competition in Scotland.

- Dr Michael Brooker advised on the development of competition in England and Wales.
- The Chief Executive advised that DEFRA had recently announced that a review would be carried out by Professor Martin Cave of Warwick Business School on competition and innovation in water. A briefing paper has been prepared for Martin Cave on the development of competition in Scotland. Commission members were asked for comments.

The Chief Executive also advised that a Steering Group was to be established and that there may be a request from Martin Cave for a member of the Commission to participate.

A meeting had also been held with OFT to discuss working together in the future and also the lack of concurrency powers for the Commission and the implications of this.

The Chief Executive had attended a Water UK City Conference in London.

Other current issues

- Professor Banyard thanked the Commission for their support during his wife's recent illness.
- The Chief Executive reported that he had given a presentation at a recent Holyrood conference and that the Minister for Transport, Environment and Climate Change, Stewart Stevenson MSP also gave a presentation.

3.1 Update on the Central Market Agency (CMA)

The Commission noted CMA's progress.

The Chief Executive updated the Commission on the issue of complex meter sites. He advised that the office had investigated this with both the CMA and Gemserv. The office was now satisfied that procedures have been put in place to ensure all customers can participate in the market from the 1 April 2008.

4. Corporate Affairs

4.1 Update on the office workplan and strategy for the price review (CP20/08)

The Commission noted the update to the office's workplan.

4.2 Update on framework contracts (CP21/08)

The Commission noted the paper and were pleased that the Regulatory training provided by Oxera was well received by WICS staff.

4.3 Update on project planning/Consultancy approval (CP22/08)

The Commission noted the new approvals process.

4.4 Recruitment update (CP23/08)

The Commission noted this paper and noted that this would not result in additional costs to the budget

The Director of Corporate Affairs updated the Commission on recruitment of analysts and engineers. The Commission noted that the office is also looking to recruit a part-time qualified financial controller. This should reduce Scott Moncreiff's involvement with quarterly accounts.

4.5 Schedule for strategy day (CP24/08)

The Commission noted this paper.

Action Point:

4.6 Update on new website (CP25/08)

The Commission noted the launch of the new website.

It was also noted that the new bespoke website for competition, as agreed at the December Commission meeting was progressing well and would go live on 12 March.

The Commission noted this paper.

5. Strategy

5.1 Scottish Futures Trust Consultation response (CP26/08)

The Commission approved the response to the SFT consultation subject to the following drafting changes.

- The Scottish Water industry has a positive contribution to make to the SFT
- Scottish Water built greater in-house expertise and that this appears to have resulted in improved efficiency in the delivery of its investment programme.
- The SFT requires to be adequately resourced to ensure it meets its obligations

Action Point:

5.2 Turning the Tide, The Future of Scotland's Water Conference (CP27/08)

The Chief Executive presented this speech on 3 March.

The Commission noted this paper and were pleased it was well received.

Action point:

6. Competition

6.1 Update on Osprey (sent to members via email on 22 Feb) (CP28/08)

The Commission approved this paper and its recommendations.

6.2 Update on new application (CP29/08)

The Commission noted this update.

6.3 Update on Schedule 3 (CP30/08)

The Commission noted that on the basis of information available to it at the current time, at least two Schedule 3 agreements should be referred to the OFT for further review. This is necessary because the Commission does not have concurrency powers under the Competition Act 1998.

The Commission agreed that having received the LRMC information due from Scottish Water on 14 March 2008, if these concerns remained, the Chief Executive would write to the OFT.

The Commission agreed to delegate authority to the Chief Executive to finalise any determinations (where there were no concerns) following the provision of the LRMC information by Scottish Water and to publish details of the same.

The Commission agreed that for wholesale charge calculation purposes, the CMA would be informed of the percentages to be applied for all determined Schedule 3 agreements and that the current arrangements (as set out in the Wholesale Charges Scheme) would apply to the remaining agreements.

6.4 CMA Letter (CP31/08)

The Commission noted the correspondence and observed that suggestions from the Technical Panel should be dealt with by due process and policy matters should be dealt with by WICS.

6.5 Update on fee scheme (CP32/08)

The Commission noted paper.

6.6 Update on Section 29E (CP33/08)

The Commission noted this update and look forward to discussing it further at the May Strategy Day.

6.7 Update on Communications Strategy (CP34/08)

The Commission noted this paper and stressed the importance of the need to provide proper bills which will enable businesses to run more efficiently and become more environmentally friendly. The Commission also noted that the communication strategy will continue after 1 April.

Action Point:

6.8 Cost Benefit paper (CP35/08)

The Commission noted this paper and were pleased that the response had been favourable.

6.9 Update on MEUC event (CP36/08)

The Commission noted this paper and were glad to see the involvement of Tesco.

7. Investment

7.1 Oral update on investment delivery

The Commission noted that Scottish Water's capital expenditure in January had risen to £68.5m and welcomed this increase in activity. The Commission however noted that output delivery remained behind target in a number of areas.

7.2 Progress on investment programme to end of January 08 (CP37/08)

This paper provided detailed information on investment programme to the end of December 2007. The Commission noted the significant delivery challenge remaining if Scottish Water's forecasts for 2007-08 are to be met. The Commission emphasised the importance of regulatory sign off that outputs had been delivered. The Commission welcomed recent confirmation from SEPA and DWQR that they also place a high importance on output sign off.

The Commission noted that there has been an increase of £1.4m in the forecast of the Quality and Standards 2 overhang.

7.3 Update on Quality and Standards 3B (CP38/08)

This paper outlined the work being carried out by the OMG on finalising objectives for the 2010-2014.

The Commission noted this paper but expressed disquiet that the additional revisions appear to be major rather than minor additions. It was also emphasised that any changes in the priorities established for

the 2010-2014 period should be subject to consultation and should be properly costed.

7.4 Update on leakage (CP39/08) and

7.5 Leakage targets for 2008-09 (CP40/08)

The Commission noted their disappointment at the prospect of Scottish Water missing their leakage target 07-08 by an even greater margin than for 06-07. It would be concerned if any improvement resulted from further changes to the baseline.

This is disappointing given the importance being assigned to leakage reduction contributing to environmental improvement and reducing carbon emissions. The Commission also noted that a substantial allowance for leakage reduction had been made in the final determination.

The Commission also noted its concern with regard to Scottish Water's initial assessment of ELL and noted that the approach being adopted by Scottish Water did not appear consistent with the recent review of consumption measurement in England and Wales.

The Commission agreed to delay setting a target for 2008-09 until the May meeting to allow further discussions to take place and for representations to be received from Scottish Water. The Commission noted that it may see wider representation on the 2008-09 target.

Action Point:

7.6 Approval of UID studies (CP41/08)

The Commission noted the progress on the strategic UID studies and the importance of ensuring that Scottish Water's investment appraisal is consistent with best practice.

The Commission agreed to provide delegated authority to the Chief Executive to approve stage 4 of the 7 stage process for the specified UID schemes once a satisfactory response on its approach to investment appraisal had been received from Scottish Water.

8.1 Update on Scottish Waters financial performance (CP42/08)

The Commission noted the paper. They observed that the revenue position indicates an increase in the customer base, which is consistent with the assumptions for growth in the last Strategic Review of Charges. The Commission also noted that the slow start to the investment programme had resulted in Scottish Water repaying debt. However, Scottish Water has recently accelerated its investment programme and this would increase the use of Government borrowing.

The pressure on Government funding would increase if there was any inefficiency in this accelerated programme, as customers would not pay twice for the same output.

8.2 Trade effluent charging (CP43/08)

This paper provided an update on the arrangement to standardise wholesale charges for discharge points previously capped trade effluent arrangements.

The Commission noted this paper.