

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

Held on 7 October 2008 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)
Ms Judy Tait (Analyst)
Mr Richard Khaldi (Analyst) (item 6)
Mr Ian Tait (Director of Investment) (items 4 and 7)
Mr John Simpson (Director of Analysis) (item 4)
Mr Colin McNaughton (Analyst) (item 4)
Mr Maynard Xu (Analyst) (item 4)
Mr Craig Mackenzie (Analyst) (item 4)
Mr Gordon Downie (item 4)
Mr Tom Sharpe QC (item 4)

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 Minute of last meeting (07/08)

The Commission agreed that the minute was an accurate account of proceedings subject to the inclusion of a record of the Commission's discussion of value for money audits.

2.2 Review of action points (AP70/08)

The Commission noted it was in a satisfactory position.

3. Update on current issues

3.1 Working with stakeholders

Professor Banyard reported that he was assisting the Cave Review of water markets as a member of its Strategic Advisory Group.

Dr Brooker reported on the progress of Ofwat's current consultation on competition in the English and Welsh water industry.

Mr Coulthard reported that he had recently chaired the Scottish Competition Law Forum's autumn event on competition and regulated utilities. Professor Simpson and the Chief Executive had also attended this event.

The Secretary to the Commission reported on recent events that had taken place at the Scottish Parliament, and progress with the Commission's contact programme with Scottish Water, the Scottish Environment Protection Agency and the Drinking Water Quality Regulator.

The Chief Executive reported:

- He had met with Scottish Water's Finance Director.
- He had given a speech at the Regulatory Policy Institute.
- He had attended a UNESCO Centre for Water Law, Policy and Science meeting as a member of its governing board.
- Staff appraisals had been completed.

The Chairman reported that he had met with Scottish Water's Chairman and had had a useful discussion with John Kay.

The Commission noted these updates.

3.2 Other current issues

Mr Coulthard, Chairman of the Audit Committee, provided an update on actions from the last Commission meeting. He reported that training had been organised for Audit Committee members and that the Commission's internal auditors would carry out annual appraisals of the effectiveness of the Committee.

The Commission noted this update.

3.3 Update on the Central Market Agency (CMA)

The Chief Executive of the CMA provided a written update on the company's activities over the last month, including progress in appointing a customer representative to the CMA's Technical Panel.

The Commission noted this update.

4. Discussion on current regulatory framework

4.1 Presentation from Tom Sharpe QC and discussion of correspondence.

The Commission noted with interest Mr Sharpe's presentation.

5. Corporate Affairs

5.1 Update on the office workplan and strategy for the price review (CP110/08)

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

5.2 Update on framework contracts (CP111/08)

The Commission welcomed the continued improvements being made to the management of, and reporting mechanisms about, contractors in the office.

The Commission noted this update.

5.3 Key messages for the costs and performance report (CP112/08)

The Commission discussed the key messages for its 2007-08 report on Scottish Water's costs and performance. The Commission requested that a greater distinction be made between Scottish Water's operating costs and its capital costs. The Commission agreed that it was important to clarify in the report that the proceeds from any annual outperformance by Scottish Water would be held in a reserve account. Only if Scottish Water sustains this outperformance to the end of the regulatory control period would the proceeds be placed in a gilts buffer for future use to the benefit of customers.

The Commission approved this paper subject to the amendments noted above.

5.4 Key messages for the competition report (CP113/08)

The Commission discussed the key messages for its first report on the performance of the competitive water and sewerage market for business customers and public bodies in Scotland. The Commission

requested that consideration be given to the environmental benefits of competition, particularly with regard to water efficiency and sustainability, and that this be emphasised in the report. The Commission also noted that it had set default tariffs with the expectation that suppliers would better this deal. The Commission agreed that the report should assess the extent to which this had occurred.

The Commission approved this paper subject to the amendments noted above.

6. Competition

6.1 Oral update on licensees

The Chief Executive updated the Commission on the activities of licensees in the market and reported that he would shortly meet with Ondeo Solutions to discuss pre-payment requirements.

The Commission noted this update.

6.2 Update on communication strategy (CP114/08)

The Commission noted this update.

6.3 Update to the market framework (CP115/08)

The Commission considered a draft consultation paper regarding updates to the market framework. The Commission noted that whilst the market framework had responded robustly to the withdrawal of Aquavitae, the experience had highlighted a number of improvements to the framework that could be made.

The Commission approved the proposed consultation document, subject to minor amendment. The Commission also agreed to delegate authority to the Chief Executive to consult with stakeholders on the proposals and amend (if necessary) the proposals in light of stakeholders' comments and then implement them as soon as practicable.

7. Investment

7.1 Oral update on investment delivery

7.2 Update on investment progress (CP116-08)

The Commission considered the Output Monitoring Group's report for the first quarter of 2008-09. The Director of Investment also provided an oral update on the latest information available on Scottish Water's progress with delivering its investment programme for 2006-10.

The Commission expressed its concern at further evidence of slippage in the delivery of the investment programme. The Commission noted that although expenditure had increased, Scottish Water was behind sign-off targets.

The Commission also expressed its concern at the slow progress with, and increase in, the overhang from the 2002-06 investment programme. Work was yet to begin on 18% of the overhang and costs appeared to be rising, despite current inactivity in the construction industry.

The Commission noted that should Scottish Water overspend on its investment programme, funds that had been accumulated in Scottish Water's reserve account as a result of outperformance on operating costs would need to be used to compensate. Should this occur, Scottish Water would be unlikely to be able to make a payment into its gilts buffer at the end of the regulatory period. The Commission requested that its concerns about the potential for Scottish Water to overspend on capital investment, and the resulting impact on the gilts reserve and buffer, be brought to the attention of the Scottish Government.

7.3 Overall measure of delivery (CP117-08)

The Commission noted that work on developing an overall measure of delivery (OMD) for Scottish Water's investment programme was progressing well. The OMD provides a high level indicator of progress against the targets set in Scottish Water's business plan. The single score generated is a simple and transparent measure of progress that could be easily understood by stakeholders.

The Commission welcomed the progress being made and noted that the measure would be trialled at the March 2009 meeting of the Output Monitoring Group.

7.4 Water Resource Studies Letter (CP118-08)

The Commission had previously expressed concerns about Scottish Water's approach to water resource studies. It understood that the Scottish Environment Protection Agency (SEPA) shared these concerns.

The Commission noted that a letter had been sent to Scottish Water in this regard and that the Commission's engineers were discussing with Scottish Water how its concerns could be allayed.