

**Minute of the fourteenth meeting of the Water Industry Commission for
Scotland
Held on 4 and 5 April 2006 in Stirling**

Present:

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

In attendance:

Dr John Simpson (Director of Analysis)
Miss Harriet Towler (Corporate Affairs Manager)
Mr Ian Tait (Director of Investment and Asset
Management) for Item 7.
Mr Craig Mackenzie (Analyst) for Item 8, CP51-06.

Chairman's opening remarks

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

1. Apologies for absence

Mr Alan Sutherland (Chief Executive)
Mrs Katherine Russell (Director of Corporate Affairs and Secretary to the
Commission)

2. Minute of previous meeting and review of action points

The Commission agreed that the minute was an accurate account of proceedings, subject to minor amendment.

The Chairman noted that he had completed a paper on "frequently asked questions" and these would be circulated with the minutes of the present meeting. [*This paper has been converted into an information note, and is available at <http://www.watercommission.co.uk/Documents/InfoNote6.pdf>*]

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

3. Update on current issues

The Commission noted paper CP32-06 on the application process that had been used for the Office's framework agreements, and CP33-06, the minutes of the March Audit Committee meeting.

Mr Coulthard updated the Commission about the March meeting of the Audit Committee and the likely timetable for the audit of the Commission's annual accounts. The Commission noted their concern about the timetable, and the absence of a representative from the office's auditors at Audit Committee meetings. Mr Coulthard undertook to raise these issues with the appropriate parties. **Action**

The Commission noted letters CP34-06 to CP40-06, which had been issued following the last Commission meeting, and were updated where responses had been received. The Commission noted that helpful responses had been received from Scottish Water to letter CP34-06 regarding future investment monitoring, and CP36-06 on leakage.

The Commission noted that responses had been received to letter CP37-06 regarding Scottish Water's operational code, and CP39-06 regarding a "strawman" for the future retail market. These responses were being considered internally, and any issues arising would be referred to the Chief Executive. **Action**

The Commission were informed that following the issue of letter CP40-06 regarding reasonable cost contributions, a useful meeting had been held with Scottish Water and the Scottish Executive, and a written response sent by Scottish Water. The Commission were comforted that there was general agreement on the approach that should be taken. The Commission noted that letter CP40-06 had been converted into a publicly available information note and placed on the Commission's website.

It was noted that the Commission had been individually invited to an informal meeting with Water UK.

The Commission were updated on a number of Freedom of Information (FOI) requests received by the Office. The Commission noted the importance of transparency, but recognised that the Office should be mindful of the statutory time limit placed on answering FOI requests and should not exceed it. The Commission agreed the office should endeavour to highlight where information is already publicly available.

Mr Coulthard and Dr Brooker noted that they had attended Ofwat's City Briefing in Edinburgh.

The Chairman noted that he and the Chief Executive had met with David Gray, Ian McMillan and Graeme Crombie of Scottish Water in the absence of a Chairman for the organisation.

The Chairman noted that he had recently attended meetings with Sarah Boyack MSP and Des McNulty MSP.

Professor Banyard noted that he and members of the office had met with Scottish Water to discuss drainage area studies and leakage. He noted that he had agreed to help Scottish Water, in conjunction with the Scottish Environment Protection Agency (SEPA), to discuss possible approaches to addressing these issues with Scottish Water staff.

Professor Banyard noted that he had also had an informal meeting with Paul Jowitt of Scottish Water to discuss better working relations between the two organisations.

Dr Simpson noted that Scottish Water's strategic capacity report had been received by the office, and was being considered internally.

The Chairman noted that he and the Chief Executive had met with the Managing Director of Scottish Water Business Stream to discuss structural arrangements. This had proved a useful discussion about the business consequences of separation from Scottish Water.

4. Corporate Affairs

The Commission noted the information paper on the office workplan (CP41-06).

The Commission reviewed the tabled draft Rules of Procedure (CP42-06), and noted their gratitude to the Audit Committee for previously reviewing and recommending the document. The Commission approved and adopted the Rules of Procedure and asked that they be circulated to all staff. **Action**

Mr Coulthard, Chairman of the Audit Committee, commended a risk register to the Commission (CP43-06). He noted that this register had been reviewed by the Audit Committee who regarded it as accurately reflecting, to the extent possible, the risks faced by the Commission, and the steps taken to mitigate those risks. The Commission approved the tabled register, subject to minor amendment, and noting the following:

- only the highest 13 risks have been identified and management action taken to mitigate them documented;
- other risks have been identified;
- a net risk of 12 or above should be the trigger point for management action to be taken and documented; and
- the register would be resubmitted to the Commission on an annual basis, but reviewed by the Audit Committee on a quarterly basis.

The Commission requested that the register should be circulated to all staff for information. **Action**

The Commission reviewed the structure and key messages for its Annual Report (CP53-06). It noted that the Report should emphasise how better value for money would be delivered to customers, and the environmental benefits that would be delivered following the Final Determination. The Commission agreed the following mission statement should be included in the report:

“To encourage Scottish Water to deliver a high quality service and value for money incentivised by an effective regulatory framework.”

The Commission noted their disappointment, but agreed that, in order to publish the report in a timely way, unaudited accounts would have to be used in the Annual Report. It should be clearly documented in the Report that this was the case. **Action**

5. Licensing

The Commission noted the information paper and the work being done regarding the mechanics of separation of Scottish Water Business Stream from Scottish Water (CP44-06). The Commission noted the importance of progressing work on agreements to be used in the market, and welcomed a future update. **Action**

6. Monitoring performance

The Commission considered an overall approach to monitoring performance against a set baseline (proposed in CP45-06), but noted the specific issues of investment and operating costs at a later point on the agenda.

The Commission reiterated that it would be monitoring Scottish Water’s performance against the Overall Performance Assessment (OPA) end target of 250 set out in the Final Determination, and the interim equal milestones to this target, irrespective of any changes in data that may be proposed by Scottish Water. This target would be subdivided into wholesale and retail in order to take account of the future separation of Scottish Water’s non-household retail activities into a new entity. **Action**

The Commission agreed that Scottish Water should be set required installation rates for non-household meters. It was agreed that in year one of the regulatory control period, Scottish Water would be required to achieve an installation rate of 10,000 meters, rising to 20,000 meters per annum thereafter until the requirements of the Final Determination had been met. This should be communicated to Scottish Water and copied to the Scottish Executive. **Action**

The Commission agreed that Scottish Water would be required to provide information on accrued reasonable cost contributions and actual contributions made. **Action**

The Commission noted that it was the role of Scottish Water to manage leakage, but that the Commission had a role in auditing, advising and ensuring that there is a well defined and effective methodology for measuring leakage. The Commission noted the importance of the Office employing recognised expertise in this respect. The Commission agreed that progress by Scottish Water towards meeting the requirements of the Final Determination in leakage should be monitored by:

- setting an agreed measurement of leakage for regulatory purposes. This measurement should fall within the envelope of Ofwat measures;
- requiring Scottish Water produce an early set of figures on this basis, recognising what is practical in a short timescale ; and
- working to set Economic Level of Leakage targets, but setting immediately some interim pragmatic targets.

Scottish Water would be asked to provide a methodology for defining leakage and a set of pragmatic leakage targets would be devised for the Commission to approve, recognising that the regulatory control year 2006-07 had already advanced. **Action**

The Commission endorsed the high level approach recommended for assessing Scottish Water's financial performance, but discussed the issue in more detail later in proceedings. (CP50-06).

The Chairman noted that he expected to receive proposals from Scottish Water for the remuneration of its senior staff (CP46-06). The Commission agreed that it does not consider it to be its function to approve the remuneration policy of Scottish Water, but simply to state if it is consistent with regulatory objectives. A letter would be written in response to Scottish Water's proposals to that effect. **Action**

The Commission reiterated its belief that Scottish Water should operate within a governance and incentive framework that allows it to attract, reward and retain high quality staff throughout its organisation. Any bonuses awarded within this framework should be self-financing, that is, funded through the proceeds of outperformance.

7. Investment

The Commission noted that the glossary of terms (CP47-06) had proved helpful and should be circulated to the Output Monitoring Group (OMG)¹.

The Commission accepted the methodology proposed for defining the status of Quality and Standards II investment at the close of the 2002-06 period (CP48-06). A timetable would be produced detailing when necessary analysis could be carried out, and once this analysis had been carried out, a letter

¹ The OMG is also referred to, on occasion, as the high level monitoring group. The two should be regarded as synonymous.

would be sent to the Scottish Executive detailing the extent of the Quality and Standards II overhang. **Action**

The Commission considered the work priorities for the Office's engineering consultants (CP49-06).

The Commission noted that leakage was a priority, but that some additional external expertise should be employed to assist with this specialised issue.

The Commission considered the use and implementation of indicators of serviceability to customers. It noted that it believed that Scottish Water might not be in a position to apply the common framework in full for the 2009 Strategic Review. However, the Commission would need to develop its approach further from that used in the 2005 Strategic Review. Therefore, it should be a priority to introduce Ofwat's indicators and consider the information required to further the approach used in 2005.

The Commission noted that monitoring Scottish Water's progress on drainage area/water resource studies could be resource intensive and should be regarded as a priority.

The Commission did not consider that an investment appraisal audit was a priority.

The Commission agreed that engineering input into the office's work on procurement was a priority, but noted that it would only be a small element of the entire study.

The Commission agreed that it was a priority to assess the extent of duplicate schemes between Quality and Standards II and Quality and Standards III investment programmes, and later produce a paper highlighting its findings on how future programmes could be made more effective.

Overall, the Commission accepted all but one of the proposed projects, but noted that the work should be kept within reasonable bounds. The Commission commented that resources should be retained for additional work that may arise during the year. **Action**

The Commission noted that the OMG would be meeting shortly (CP52-06), and that it would be important that the previously agreed protocol, and also the "7 stage process", were a focus for the group. It noted that Scottish Water had proposed a change mechanism. The Commission agreed that any such process should not prejudice the statutory obligations of members of the group, and that terms of reference for the group should first be agreed. However, it noted the document proposed by Scottish Water had been useful in stimulating discussion. A letter would be written to members of the group to this effect. **Action**

8. Costs, performance and levels of service

The Commission considered the approach that should be taken to assessing Scottish Water's financial performance and in particular, operating costs. They were informed that historically, assessments of Scottish Water's performance had been based on its statutory accounts, however, going forward, regulatory accounts could be used. The Commission agreed that statutory accounts (with no adjustments) would be used to report past performance against previously published 2002-06 targets and regulatory accounts would be used to discuss the baseline going forward (option three of CP50-06). They noted that the difference between the two approaches should be explained with the help of numerical examples.

The Commission considered the appropriate use of interim determinations (IDOKs) and how this could be communicated to stakeholders (CP51-06). It agreed that as a careful allowance had been made for future costs in the Final Determination, IDOKs should be exceptional and used only in extreme events. This view should be reflected in a publicly available information note which would be circulated to Commission members for comment, and then placed on the Commission website. A letter would be sent to Scottish Water, and other members of the OMG enclosing a copy of this note. **Action**

Minute approved on:

Minute authorised by: