

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

Held 3 March 2009 in Stirling

Present:

Sir Ian Byatt (Chairman)
Professor David Simpson (Deputy Chairman)
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 (Analyst) (item 5)
Mr Ian Tait (Director of Investment) (item 6)
Dr John Simpson (Director of Analysis) (item 7)

Chairman's opening remarks

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

1. Apologies for absence

Mr John Banyard

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 (01/09)

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

2.3 Review of action points (AP01/09)

The Commission noted it was in a satisfactory position.

3. Update on current issues

3.1 Working with stakeholders

- The Commission noted CP19/09, an update on the work of stakeholders and significant external events.
- The Chief Executive, Chairman and Director of Corporate Affairs met with Nick Herbert MSP, Shadow Secretary of State for Environment, Food and Rural Affairs to discuss the introduction and success of competition in Scotland.
- The Chairman and Chief Executive participated in a special roundtable held at the European Policy Forum on 27 January 2009 to discuss the Independent Review conducted by Professor Martin Cave. A set of papers arising from this roundtable have now been published.
- The Chairman and the Chief Executive reported that they had met with Stella Manzie, Director General of Finance and Corporate Services at the Scottish Government.
- The Chief Executive and Mrs Russell reported that they had attended Water UK's 9th Annual City Conference.
- Professor Simpson reported that he had attended an IEA Seminar on the state of the economy.
- Professor Simpson and Mr Coulthard attended a CRI Seminar: 'Facing the Regulatory Challenges of a changed world – are new approaches, structures and institutions required?'
- The Director of Corporate Affairs confirmed that the regular liaison meetings with Scottish Water's Regulation Manager, Belinda Oldfield were progressing well.

3.2 Update on the Central Market Agency (CMA)

The Chief Executive of the CMA, Jeremy Atkinson, provided a written update on the company's activities over the last month.

The Commission noted this update.

3.3 Audit Scotland Paper (CP20/09)

The Commission welcomed this study and agreed they are happy to assist Audit Scotland where required.

The Commission noted this paper.

4. Corporate Affairs

4.1 Update on the office workplan and strategy for the price review (CP21/09)

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

4.2 Update on framework contracts (CP22/09)

The Commission noted this paper.

4.3 Update from Audit Committee (CP23/09)

The Director of Corporate Affairs reported that a revised risk register will be submitted to the Commission at the May meeting.

The Commission noted this paper.

4.4 Finance Report (CP24/09)

The Commission noted this paper.

4.5 Record of discussion at the second stakeholder workshop (CP25/09)

The Commission noted this paper and welcomed the summary of its second stakeholder information day for the 2010-14 price review.

5. Competition

5.1 Oral update on licensees

Mr Khaldi provided the Commission with an update on the progress being made with the Aimera Ltd licence application. The licence application was now at the penultimate stage and Mr Khaldi did not foresee any issues arising.

Mr Khaldi reported that he had held useful meetings with two companies who were interested in the licence application process. Mr Khaldi also reported that he is scheduled to meet a further interested party this month.

The Commission noted this update and look forward to a progress report at the May Commission meeting.

5.2 Update on communication strategy (CP26/09)

The Commission noted this update and were pleased with developments.

5.3 Update on progress in amending wholesale/retail split (CP27/09)

Mr Khaldi updated the Commission on the progress being made on refining the separation of wholesale and retail activities. Mr Khaldi informed the Commission that its consultants had carried out a review in relation to the five potential areas to be transferred to retail. The Commission noted that in three of the five areas considered, a transfer to retail would be possible and could bring substantial benefits to customers and retailers. A further two areas could be easily transferred, but it was thought that the impact of this transfer would not be material.

Mr Khaldi reported that he had held a useful meeting with Ofgem to discuss the scope for competition in connections in the gas and electricity market.

Mr Khaldi also reported that he had also held meetings with Gemserv to discuss smart metering within the gas and electricity markets.

The Commission noted this update and looked forward to a report with final conclusions in May.

5.4 Update on default tariffs (CP28/09)

The Commission noted this paper.

5.5 Oral update on schedule 3

The Commission noted that negotiations were still underway to resolve issues relating to two customers.

5.6 Update on Section 29e (CP29/09)

The Chief Executive informed the Commission that Scottish Water continues to move forward with the Strategic Asset Capacity and Development Plan (SADCP). This plan should assist licensed suppliers and customers with identifying opportunities to reduce Scottish Water's wholesale costs and apply for wholesale charge departures under Section 29e of the Water Services etc. (Scotland) Act 2005.

The Chief Executive reported that at a recent meeting with Scottish Water and the Drinking Water Quality Regulator (DWQR) the issue of information security was discussed. The Centre for the Protection of National Infrastructure (CPNI) raised some concerns that the information contained within the SADCP should not be in the public domain. The SADCP provides prospective users of the water and wastewater networks with information on the availability of strategic network capacity at water and wastewater treatment works. The Chief Executive informed the Commission that a meeting with CPNI had been proposed but no date had yet been set.

The Commission noted this paper and welcomed further direction from the Centre for the Protection of National Infrastructure (CPNI).

5.7 Workplan for next 12 months (CP30/09)

The Chief Executive provided the Commission with a summary of the proposed workplan during 2009 and 2010. The Commission agreed that the proposed workplan is a sensible approach subject to comments on communication costs. The Commission advised that a meeting should be arranged with Ofwat to discuss the principles of equivalence.

5.8 Introduction of Guarantees (CP 31/09)

The Commission considered proposed changes to the Market Code and the template Wholesale Services Agreement to choose to either prepay their wholesale charges or provide a guarantee from a company with a designed investment grade credit rating. The Commission approved the issue of a consultation on these proposed changes.

The Commission also agreed to delegate authority to the Chief Executive to determine an appropriate credit rating for guarantors; and liaise with the CMA and make any minor changes that may be required to the market framework documents to implement the use of a guarantee rather than prepayment.

6. Investment

6.1 Oral update on investment delivery

6.2 Update on investment progress (CP32/09)

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 expressed concern that Scottish Water remains significantly behind target in a number of areas.

6.3 Accuracy of Scottish Water's catch-up forecasts (CP33/09)

The Commission has previously expresses its concern about the apparent consistent shortfall in Scottish Water's output delivery against its forecast position. The Commission considered previous delivery forecast with actual out-turn. It noted that whilst programme delays are not uncommon in an investment programme of the size and complexity of Scottish Water's, it is clear that there is consistent over-forecasting of output delivery across many areas of the programme.

The Commission also noted its concerns about growing evidence of cost escalation. Any additional costs incurred will not be financed in the next price review.

6.4 Forward looking analysis on possible overhang at 2010 (including overspend and deferral) (CP34/09)

The Commission noted that Scottish Water's latest forecasts suggested that it was on target to deliver the investment programme within +/-£30m of the final determination allowance. However, the Commission noted that significant uncertainties remain in the estimates of the costs of completing the required programme of work and the likely out-turn in the financing available. The Commission also noted that there had been discrepancies between Scottish Water's forecast progress and actual delivery. The Commission expressed its concern that there was the potential for even greater delays in the delivery of outputs from both the 2002-06 and 2006-10 investment programmes.

6.5 Leakage target (CPCP35/09)

The Commission approved a leakage target of 710-750 (with a mid point of 730) for Scottish Water in the final year of the 2006-10 regulatory period. This pragmatic target takes account of the further development required to Scottish Water's estimate of economic level of leakage and the level of performance achieved by similar companies in England and Wales.

7. Finance

7.1 Prospects for Scottish Water's opex (CP36/09)

The Commission noted this update on factors that had the potential to affect Scottish Water's operating costs in the next regulatory period.

7.2 Prospects for Scottish Water's OPA improvement (CP37/09)

The Commission noted this paper.

8. Strategy

8.1 Revised draft executive summary of the draft determination (CP38/09)

The Commission welcomed this revised draft and looked forward to seeing a further revision in the light of Scottish Water's second draft business plan.

8.2 Format and structure of the draft determination (CP39/09)

The Commission approved the proposed structure subject to minor amendment.

8.3 Outline of draft determination (CP40/09)

The Commission approved the proposed outline as an acceptable starting point from which to progress the draft determination.

8.4 Unwinding of trade effluent cross-subsidies (CP41/09)

The Commission discussed some of the potential implications of unwinding cross-subsidies for trade effluent customers.

8.5 Principles of charging statement (CP42/09)

The Commission noted this latest update.

8.6 Revised basecase (CP43/09)

The Commission discussed a range of different scenarios.