

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

Held on 2 and 3 October 2007 in Birmingham

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)
Miss Harriet Towler (Corporate Affairs Manager)

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

I. Minute of last meeting (08/07)

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

II. Review of action points (AP08/07)

The Commission were updated on action points from the previous meeting. The Commission noted it was a satisfactory position.

The Commission agreed that the on-going register of action points should continue to be completed, but did not need to be submitted to the Commission at meetings.

The Commission also discussed the future format of Commission meetings. The Commission agreed that future meetings should be carried out on the first Tuesday of every month with a pre-meeting dinner to discuss current issues. Formal proceedings would be carried out in one day in general. On occasion, Commission meetings will be extended to two days, with the second day dedicated to discussing future strategy.

3. Update on current issues

I. Working with stakeholders

The Chief Executive reported that:

- He had recently met with the Scottish Environment Protection Agency's Director of Environment Protection and Improvement to discuss Scottish Water's progress with delivering its investment programme.
- He had held a useful meeting with the Royal Mail.
- He had attended the CBI's annual dinner.
- He was in the process of organising a two day forum to discuss the development of competition. A number of stakeholders and advisors had been invited to attend.

II. Other current issues

Dr Brooker noted that Ofwat were currently consulting on the possibility of using 'menu' regulation in the future. The Commission requested an update on Ofwat's proposals and the potential impact on any comparative information used by the Commission.

Action:

Mr Coulthard reported that the independent review panel of water and sewerage services in Northern Ireland (of which he was a member) had submitted its first report to the Northern Ireland Regional Development Minister.

The Chief Executive reported that staff appraisals for 2006-07 had been completed. He also reported that the office away day had been well received by staff, and he thanked those who attended for their contributions.

III. Update on the Central Market Agency (CMA)

The Commission noted a written summary of developments with the CMA, submitted by its Chief Executive, Dr Jeremy Atkinson (who was unable to attend the meeting in person).

4. Corporate Affairs

I. Update on the office workplan (CP122-07)

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

II. Update on framework contracts (CP123-07)

The Commission noted the update on its framework contractors. The Commission welcomed the action that the office was taking to manage effectively its contractors.

III. Update on stakeholder workshop 7 (CP124-07)

The Commission noted and welcomed the summaries of its seventh stakeholder workshop for the next price review. The Commission expressed its thanks to Waterwatch for hosting the event.

IV. Update on the Audit Committee (CP125-07)

The Chairman of the Audit Committee updated the Commission on the Committee's last meeting. The Chairman reported that the Committee requested that management of external framework consultants be added to the Commission's risk register.

The Commission also discussed the future provision of internal audit services and requested a future update from the Chief Executive.

Action:

The Commission noted the minutes of the last Audit Committee meeting, and that its risk register would be updated to reflect the Committee's suggestion.

V. Chief Executive's role as accountable officer (CP126-07)

VI. Update on Waterwatch

The Chief Executive reported that on his appointment, he assumed the role of accountable officer for the Commission. However, had no record of receiving formal written notification of his responsibilities from the then Scottish Executive. The Chief Executive reported that an accountable officer letter was being drafted, and would reflect recent developments regarding Waterwatch, but his accountability for Waterwatch had yet to be fully resolved.

The Commission expressed its concern that the Chief Executive still remained unclear as to his responsibilities towards Waterwatch. The Commission requested the Chief Executive seek further advice in this respect.

Action:

5. Strategy

I. Gilts buffer implementation (CP127-07)

The Commission noted that at the Strategic Review of Charges 2006-10, the Scottish Government had agreed that a gilts buffer should be established to protect customers. The Commission discussed how this gilts buffer be implemented. The Commission emphasised the importance of the gilts buffer focussing on customers. The Commission noted that it would be important to ensure that the gilts buffer was of a sufficient size to protect customers from operational shocks that were beyond the control of Scottish Water's management. However, the Commission agreed that the gilts buffer should not be allowed to grow too large, and that in some circumstances a rebate to customers would be appropriate.

The Commission approved the recommendations set out in CP127-07, subject to minor amendment. The Commission requested that its decisions be converted into four simplified briefing notes.

Action:

II. The financing of Scottish Water Business Stream (CP128-07)

The Commission considered the proposed arrangements for the financing of Scottish Water Business Stream. The Commission welcomed the creative approach to the financing of Scottish Water Business Stream in particular, it was pleased to note that there was a clear incentive on Scottish Water Business Stream to operate in a commercial manner. Having considered the key performance indicators carefully, the Commission concluded that the proposed financial indicators were appropriate and covered all foreseeable eventualities.

The Commission was pleased to approve this proposal.

6. Investment

I. Update on Scottish Water's leakage performance (CP129-07)

The Commission expressed its increasing concern at the apparent lack of progress in addressing leakage. In particular it noted the need for the real underlying performance in leakage to be assessed rather than comparing numbers based on different assumptions. The Commission requested the office develop a method for setting targets on a like for like basis.

The Commission agreed to discuss with the Board of Scottish Water the importance of linking management incentives to improvement in the real underlying level of leakage. The Commission considered that these two steps are possible without any adverse affect on moving towards an appropriately robust economic level of leakage.

II. Update on the Output Monitoring Group (OMG) and the Quality and Standards II overhang (CP130-07)

The Commission considered the latest report from the OMG. The Commission were pleased to see a more balanced report on performance. However, the Commission remained concerned over the slow delivery of the capital programme. The Commission agreed to discuss its concerns with the board of Scottish Water.

Furthermore, the Commission continued to express its concern about the apparent rapidly increasing cost of delivering the Quality and Standards II investment overhang, in particular, it noted with some concern that over the last 16 months the final date for delivery of the overhang had gone back two whole years to September 2010.

The Commission also requested an update on the extent of commercial metering in Scotland.

Action:

III. Investment report 2006-07 (CP131-07)

The Commission considered a draft of its Investment report for 2006-07. The Commission approved the draft.

7. Competition

I. Governance Code and Section 11 direction (CP132-07)

The Commission discussed a draft code to regulate the governance arrangements between Scottish Water Business Stream and its holding company Scottish Water Business Stream Holdings. The Commission agreed further clarification should be included in the code with regard to the Finance Director of Scottish Water's interests in Scottish Water Business Stream Holdings. This would help to ensure that Scottish

Water Business Stream did not enjoy, or appear to enjoy, a competitive advantage in the new market.

The Commission agreed that, subject to the above amendment, the Governance Code could be issued. The Commission further agreed to delegate authority to the Chief Executive to make any other amendments which may prove necessary and to issue a direction under Section 11 of the Water Services etc (Scotland) Act 2005 to Scottish Water to enforce its compliance with the Code.

II. Consultation on publication of tariffs by Scottish Water Business Stream (CP133-07)

The Commission noted the update on responses received.

III. Separation of Scottish Water Business Stream from Scottish Water (CP134-07)

The Commission noted this update and welcomed the progress being made with separation.

8. Costs, performance and levels of service

I. Customer Service report 2006-07 (CP135-07)

The Commission considered a draft of its Customer service report for 2006-07. The Commission approved this draft subject to minor amendment.