

**Minute of the twenty-third meeting of the Water Industry Commission
for Scotland
Held on 6 and 7 February 2007 in Stirling**

Present:

Sir Ian Byatt (Chairman)
Professor David Simpson (Deputy Chairman)
Professor John Banyard
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)
Dr John Simpson (Director of Analysis) for items 4 and 8.
Mr Ian Tait (Director of Investment and Asset
Management) for items 4.5 and 7.
Mr Cesar Raffo (Analyst) for items 4.3

Chairman's opening remarks

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

1. Apologies for absence

Dr Mike Brooker

2. Minute of previous meeting and review of action points

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

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

3. Update on current issues

The Secretary to the Commission reported that Shepherd + Wedderburn were in the process of arranging breakfast briefings to discuss retail competition.

Professor Simpson reported that following last year's Comiston lecture given by the Chairman, that a group had been formed to discuss the regulation of

public utilities. In particular, the group hoped to address the question of whether the lessons learned from the regulation of water in Scotland could be applied to other utilities.

Professor Simpson also reported that he and the Chief Executive had visited the UNESCO (United Nations Educational, Scientific and Cultural Organisation) Centre for Water Law, Policy and Science at the University of Dundee. The Commission welcomed the opportunity to work with the Centre in the future.

Mr Coulthard reported that he had discussed the Commission working with the Northern Ireland Authority for Energy Regulation with its new Chairman.

The Chief Executive reported that an assessment centre for analysts at a senior level would take place shortly. He also reported that the process to recruit interns was underway.

The Chief Executive updated the Commission on Scottish Water's progress with recruiting a new managing director for Scottish Water Business Stream, following the resignation of the present holder of that position.

The Chief Executive also reported that he and the Chairman had held a useful meeting with representatives from the Better Regulation Executive.

The Chairman reported that his programme of meetings with non-household customers and their representatives was progressing well. An update would be tabled at the next Commission meeting.

4. Strategy

The Commission discussed possible approaches to strategic issues that would be presented in its consultation on the methodology for the Strategic Review of Charges 2010-14. The Commission discussed potential approaches to calculating the cost of capital. The Commission noted that an alternative approach, which placed greater importance on financial ratios could be used. The Commission agreed that such an approach should be further explored and preliminary work commissioned on financial ratios. This approach would also be discussed with Ofwat. **Action**

The Commission discussed different scenarios for the future financing of Scottish Water (CP02-07). The Commission agreed that its preferred outcome for the next Strategic Review would be a stable profile of prices, and noted that there was the potential for Scottish Water's investment programme to be up to £500 million per annum over the next review period (given current ministerial objectives). The Commission noted that in such a scenario, and under the present financial framework, likely borrowing required from the Scottish Executive would be £200 million per annum.

The Commission discussed how financial modelling at the next Strategic Review should be carried out (CP03-07). The Commission agreed that the methodology consultation would propose that the financial model used for the Strategic Review of Charges 2006-10 should be enhanced and adopted for the 2010-14 Review. The model would be required to go through a process of external review and audit.

The Commission discussed how the Regulatory Capital Value of Scottish Water should be adjusted for each year of the review (CP04-07). The Commission agreed that a simple and transparent process should be proposed, based on regulatory practice elsewhere.

The Commission approved the proposed methodology approach to water resources presented in CP05-07. The Commission emphasised the importance of adopting a consistent method of measuring leakage over time, so that progress against its leakage targets could be accurately assessed.

The Commission discussed issues relating to the financing of Scottish Water's Public Private Partnership (PPP) contracts. The Commission agreed that the issue of whether PPP contracts should be subject to efficiency targets, and what form they could take, should be discussed in its methodology consultation.

5. Corporate Affairs

The Commission noted CP07-07, an update on progress with the office workplan and key deliverables to the Commission.

The Commission noted CP08-07, an update on its framework contracts. The Commission expressed its disappointment with the issues surrounding the work of its economic consultants on the wholesale charges project.

The Commission noted that an internal audit of Waterwatch had taken place. The Commission requested that the corresponding internal audit report be passed to the Chairman of the Audit Committee for review. The Chairman would respond with comments to the Chief Executive, as the accountable officer of Waterwatch. **Action**

6. Investment

The Commission expressed its concern about progress with both the Quality and Standards III investment programme, and the overhang from Quality and Standards II (CP09-07 and CP10-07). The Commission noted the report issued at the last Output Monitoring Group (OMG), and requested that this report should be regarded as the final and definitive view of Scottish Water's output delivery performance for the second quarter of 2006-07. It is important to be clear about the increased output delivery challenge faced by Scottish Water in the light of the slow start to output delivery in this regulatory control period.

The Commission discussed methods to enhance the illustration of progress with the Quality and Standards III investment programme, and the overhang from Quality and Standards II. These would be developed and presented at the next Commission meeting. **Action**

7. Licensing

The Commission noted CP11-07, an update on the licensing project. The Commission noted that Scottish Water was still in the process of hiring a new managing director for Scottish Water Business Stream, but that the planned review of the separation of the two entities should go ahead.

The Commission noted that now that commencement of the relevant sections of the Water Services etc (Scotland) Act 2005 had taken place, it should be communicated to interested parties that the Commission had the necessary powers to grant licences. **Action**

The Commission noted CP12-07, the minute of the last meeting of its Licensing Framework Implementation Group (LFIG).

The Commission discussed CP13-07 a draft position statement on the development of the retail market. The Commission welcomed the useful comments made by the LFIG on this draft statement. The Commission endorsed the statement as an accurate reflection of its policy for the retail market, subject to minor amendment.

The Commission welcomed the appointment of Dr Brian Saunders, former Chief Executive of Elexon, as the new chairman of the LFIG, and the new CMA Company once established (CP14-07).

The Commission noted the process followed to appoint a Chief Executive for the new CMA (CP15-07). The Commission extended its congratulations to Dr Jeremy Atkinson, the successful candidate.

8. Costs, performance and levels of service

The Commission noted CP16-07, an update on its wholesale charges project with Scottish Water. The Commission noted its disappointment that progress had been hampered by the lack of transparency in the modelling supporting this project, but welcomed news that a draft wholesale charges scheme was expected to be put before the Board of Scottish Water shortly.

The Commission requested an update on the incidence effect of the scheme that would be proposed, particularly with regard to trade effluent charging. **Action**

The Commission considered and approved Scottish Water's charges scheme for household customers for 2007-08 (CP17-07).