

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

**Held on 4 and 5 December 2007 in Stirling**

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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)  
Dr John Simpson (Director of Analysis) for items 5.3 and  
5.4  
Mr Cesar Raffo (Analyst) for item 5.3  
Miss Suzanne Baylis (Analyst) for item 6  
Mr Cameron McKean (Analyst) for item 6  
Mr Richard Khaldi (Analyst) for item 6  
Mr Ian Tait (Director of Investment) for item 7  
Dr Jeremy Atkinson (Chief Executive of the Central  
Market Agency Scotland Limited) for item 3.3.  
Mrs Julie Fourcade (3 Monkeys Communications) for  
item 6.7.  
Mr Tony Brown (3 Monkeys Communications) for item 6.7

**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 (10/07)

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

II. Review of action points (AP10/07)

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

**3. Update on current issues**

I. Working with stakeholders

II. Other current issues

The Chief Executive reported that:

- Members of the office continued to have regular liaison meetings with Scottish Water, the Scottish Environment Protection Agency (SEPA) and the Drinking Water Quality Regulator (DWQR).
- Water UK had sought legal advice on the application of the costs principle.
- He and the Chairman had hosted a useful discussion on competition at the European Policy Forum.
- He had attended a Chartered Institution of Water and Environmental Management (CIWEM) conference.
- Recruitment for engineers to join the office continued.

The Chief Executive also reported that he had received a letter from an organisation interested in applying for licences to operate in the new retail market. The letter indicated that this application could be received in January when there was no Commission meeting scheduled. The Commission agreed that should an application be received in January, it could be considered by the Commission via written procedure.

Professor Banyard reported that he had attended a useful briefing on Metronet from the Chief Executive of the Office of Rail Regulation.

Professor Simpson reported that research conducted by the David Hume Institute, and sponsored by the Commission, on how the regulatory framework of Scottish Water could be applied elsewhere in the Scottish public sector, had been well received.

Dr Brooker updated the Commission on progress with Ofwat's consultation on competition in the English and Welsh industry.

Mr Coulthard reported that a report being undertaken in Northern Ireland on governance structures had been delayed, and would be presented to the Minister in the New Year.

III. Update on the Central Market Agency (CMA)

The Chairman welcomed Dr Jeremy Atkinson, Chief Executive of the CMA, to the meeting. Dr Atkinson reported that the establishment of the CMA was going well, and that its technical panel would shortly meet for the first time to discuss the market code. Dr Atkinson also reported that both Satec and Aquavitae were going through market entry data testing which should be completed early in the New Year.

**4. Corporate Affairs**

I. Update on the office workplan (CP149-07)

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

II. Update on framework contracts (CP150-07)

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. Proposal to TUPE staff to Waterwatch Scotland Limited (CP151-07)

The Commission noted that Waterwatch Scotland would shortly be created as a company limited by guarantee. The Commission were updated that its staff based at Waterwatch could now be transferred to Waterwatch Scotland Limited.

The Commission approved the transfer of undertakings of employment protection (TUPE) of its staff currently deployed at Waterwatch in Alloa to a new company, Waterwatch Scotland Limited.

The Commission agreed to delegate authority to the Chief Executive to finalise these arrangements using the process set out in CP151-07.

The Commission welcomed the resolution of this staffing issue, but noted that there would be on-going accounting issues until the end of the current financial year.

**5. Strategy**

I. Strategic Review of Charges 2010-14 methodology consultation: The Commission's response (CP152-07)

The Commission considered a four volume response to its consultation on the methodology that should be followed for the next price review. The Commission approved the documents subject to minor amendment and drafting changes.

**Action:**

II. Principles underpinning the business plan guidance (CP153-07)

The Commission welcomed the steps being taken to ensure that Scottish Water is fully engaged in the business planning process. The Commission noted that whilst the business plan guidance was substantial in length, it was necessarily so, and that steps had been taken to minimise the information required from Scottish Water.

The Commission noted this update and welcomed the work being undertaken by staff to deliver the guidance to Scottish Water on schedule.

III. Update on the financial model (CP154-07)

The Commission noted that work on the financial model for the next price review was progressing well, and that a draft version of the model would shortly be issued to Scottish Water for comment.

IV. Menu regulation: issues to consider (CP155-07)

The Commission noted that Ofwat had recently completed a consultation programme on the introduction of menu regulation. The Commission discussed whether such a framework would be applicable to Scotland. The Commission noted that such an approach assumed that the regulated company sought to profit maximise at all times.

The Commission agreed that as Scottish Water was a publicly owned organisation that did not distribute profit, the application of menu regulation in the Scottish water industry would not be appropriate at this time.

V. Gilts buffer: information notes (CP156-07)

The Commission noted and welcomed the four information notes that had been produced on the gilts buffer. The Commission requested that a minor drafting amendment be made to Note 1.

**Action:**

VI. Investment options for the gilts reserve (CP157-07)

The Commission considered the investment options for the gilts reserve. The Commission noted the rationale for proposing that

Scottish Water invest the proceeds of any out-performance in index-linked gilts.

VII. Response to local income tax (CP158-07)

The Commission understood that the present administration had indicated its intention to abolish council tax and replace it with a local income tax. As household water and sewerage customers in Scotland are currently billed for services through their council tax, an alternative means of charging would need to be found.

The Commission agreed that, following minor amendment, the draft letter set out in CP158-07 explaining this issue and possible options going forward, should be sent to the Cabinet Secretary for Finance and Sustainable Growth.

**6. Competition**

- I.I Scottish Water Business Stream licence application: three tests (CP159-07)
- I.II Scottish Water Business Stream's permanent licence application (CP160-07)
- I.III Ordinary licence conditions for Scottish Water Business Stream (CP161-07)

The Commission had previously required Scottish Water Business Stream to meet three tests. These tests were designed to ensure that Business Stream is demonstrably separate from Scottish Water and enjoys no unfair advantage in the market. The Commission noted that Business Stream had now made sufficient progress to meet these three tests.

The Commission considered Scottish Water Business Stream's application for permanent water and sewerage licences. The Commission agreed, subject to representations from third parties, to propose the grant of water and sewerage licences to Scottish Water Business Stream Limited. The Commission also agreed to delegate authority to the Chairman and Chief Executive to make any further and final decisions concerning the grant of such licences and the issuing of any notices, related directions, waivers or consents.

The Commission noted that when granting a licence, it may impose ordinary conditions that apply only in one case. The Commission agreed that additional ordinary conditions should be imposed on Business Stream, given its special status as the incumbent provider, and subsidiary of the wholesaler. The Commission agreed to delegate authority to the Chief Executive to finalise the ordinary conditions following consultation and in line with those amendments proposed in CP161-07.

## II. Service agreements: Scottish Water and Scottish Water Business Stream (CP162-07)

At its November meeting, the Commission considered and approved the terms of five service agreements proposed between Scottish Water and Business Stream on the condition that the parties seek further consent to any extension to any of those agreements beyond 31 March 2008.

The Commission considered two further agreements relating to the provision of services for information technology and trade effluent. The Commission approved the terms of both agreements on the condition that the parties seek further consent to any extension to the information technology agreement beyond 31 March 2008.

## III. Options for Schedule 3 agreements (CP165-07)

The Commission understood that advice had been sought from Leading Counsel on the Commission's responsibilities under Schedule 3 of the Water Services etc (Scotland) Act 2005. Schedule 3 requires the Commission to consider commercial agreements concluded by Scottish Water with customers that departed from its approved charges scheme prior to the 2005 Act.

The Commission noted Counsel's view that Scottish Water may not charge at below long-run marginal cost in these agreements as to do so would expose Scottish Water to possible Chapter II proceedings for abuse of a dominant position (under the Competition Act 1998). Accordingly, the Commission cannot make a determination in relation to a relevant agreement where the lesser amount (the wholesale charge) is below the long-run marginal cost of those activities.

The Commission agreed that a letter should be sent to Scottish Water (enclosing a copy of Counsel's draft opinion) requesting that it reviews each of the relevant agreements and formally confirm to the Commission whether the wholesale charge is above long-run marginal cost on a cross-Scotland basis. The Commission requested that the Office of Fair Trading be kept up to date with these developments.

### **Action:**

## IV. Amendments to standard licence conditions (CP164-07)

The Commission noted that following issues raised from potential new entrants to the market, changes to the standard licence conditions should be considered. The Commission agreed that a requirement to ensure all licensees make potential customers aware of default tariffs should be inserted. The Commission also agreed that a condition

requiring licensees to comply with the disconnections code also be inserted.

The Commission agreed to delegate authority to the Chief Executive to finalise the updates following the necessary consultations and make corresponding amendments to the Codes and Services Directions.

V. Disconnections Code (CP165-07)

The Commission considered a new disconnections document, which following consultation, had been created from the merger of the disconnections code and disconnections guidance. The Commission approved this document, and agreed it should be published along with the responses to the consultation.

VI. Amendments to default standards (CP166-07)

In October 2007, the Commission consulted on proposals to revise the default standards of service that should be offered by all general licence holders to customers. This consultation proposed changes in two areas; the way in which a breach in the default standards may give rise to payment by the relevant licensee to the affected customer; and the standards of service that apply in an emergency.

The Commission approved the proposed revised default standards and agreed they should be published with the response to the consultation.

VII. Media relations campaign for competition

The Chairman welcomed Julie Fourcade and Tony Brown to the meeting to present their proposed media strategy for effectively communicating the introduction of competition to business customers. The Commission noted and welcomed the strategy. The Commission also requested that consideration be given to setting up a bespoke website aimed at business customers to illustrate their supplier options objectively.

**Action:**

**7. Investment**

I. Update on Scottish Water's investment performance (CP167-07)

The Commission noted the update on Scottish Water's investment performance for Quarter 2 of 2007-08. The Commission noted its disappointment in the further slippage in delivering the remaining outputs from the 2002-06 investment programme and associated increases in costs. The Commission reiterated that customers would not pay twice for the same output, and that as such, Scottish Water

would be expected to accommodate these cost increases within its existing budget.

The Commission also noted that delays were arising in signing-off projects that had been delivered to beneficial use. The Commission requested that this issue be raised with the Outputs Monitoring Group (OMG) and the relevant quality regulators.

**Action:**

- II. Update on populating Output Monitoring Group (OMG) graphs (CP168-07)

The Commission noted and welcomed the work that was being undertaken to populate the OMG's graphs to monitor Scottish Water's investment delivery. The Commission remained concerned however, that as these graphs were being more accurately populated, further delays were becoming apparent with the delivery of the programme.

**8. Costs, performance and levels of service**

- I. Scottish Water's quarterly financial performance (CP169-07)

The Commission understood that should Scottish Water maintain its current performance on operating costs, it would be on target to outperform the regulatory contract. The Commission noted and welcomed this update.

- II. Scottish Water's charges scheme (CP170-07)

The Commission considered and approved Scottish Water's proposed household charges scheme for 2007-08. The Commission noted that Scottish Water's wholesale charges scheme would now be approved in final form (in line with the procedure agreed at the June meeting) and noted that default retail charges for non-household customers would also be approved.

- III. Update on the extent of non-household metering (CP171-07)

The Commission noted the update on the extent of non-household metering. The Commission recommended that some engineering resources should be dedicated to verifying the extent of Scottish Water's progress.