

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

**Held on 4 and 5 February 2008 in Stirling**

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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)  
Mrs Donna Very  
Dr Jeremy Atkinson (Chief Executive of the Central  
Market Agency Scotland Limited) for item 3.3.

**Chairman's opening remarks**

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

**1. Apologies for absence**

John Banyard

**2. Minute of previous meeting and review of action points**

2.1 Minute of last meeting (10/07)

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

2.2 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**

#### **3.1 Working with stakeholders**

The Commission noted that regular meetings with Scottish Water, the quality regulators and other stakeholders were continuing. It was noted that maintaining this dialogue was important.

#### **3.2 Other current issues**

Charles Coulthard reported that he had attended an Audit Committee Chairmen's meeting on 10 December 2007. He also advised that the December Audit Committee had had to be cancelled as Audit Scotland had not signed off the Commission's Annual Accounts in time for the meeting.

Dr Brooker updated the Commission on the development of competition initiatives within OFWAT. He stated that it is important to keep links with OFWAT while maintaining progress in Scotland. The secondment to OFWAT of Simon Less, a HM Treasury official, was noted.

Professor Simpson reported that a second paper on the research conducted by the David Hume Institute was due to be published shortly.

Professor Simpson also advised that he would be chairing the MEUC events on 7 and 13 February.

The Chief Executive reported on a meeting with Douglas Millican, the acting CEO of Scottish Water. One issue raised by SW was that they were likely to miss their leakage target for 2007-08. It was agreed that the Commission should consider a paper on leakage at its next meeting.

#### **Action:**

He reported the imminent publication of a paper on the Costs and Benefits of Competition and asked for any comments from Commission Members.

The Chairman advised that he had given a presentation to the Adam Smith Institute.

#### **3.3 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 CMA is prepared for market opening and that its administration was going well. The

Commission noted that CMA are on track for the GO-LIVE date of 1 April. Licence Providers will be issued with details of payments for wholesale charges on 11 March 2008.

Dr Atkinson reported that the Technical Panel had met for the first time and that the CMA's budget had been approved. Business Stream had raised some concerns over the level of budget for CMA at the meeting. CMA agreed to meet with Business Stream formally every 6 months to discuss progress with its budget.

Dr Atkinson advised Deloitte has been appointed as the auditor of the CMA.

#### **4. Corporate Affairs**

##### 4.1 Update on the office workplan (CP1-08)

The Commission agreed the update to the office's workplan.

##### 4.2 Update on framework contracts (CP2-08)

The Commission noted the update and expressed satisfaction that the office was managing framework contractors in a more pro-active manner.

##### 4.3 Update on the financial management of the office (CP3-08)

The Commission noted this paper.

It was agreed that a preliminary discussion should take place between the Chief Executive and Chairman of the Audit Committee to ensure that the splitting of management accounts and internal audit tenders comply with corporate governance and that they explore the budget implications of such a split.

#### **Action:**

##### 4.4 Update on the communication activities for the new competition framework (CP4-08)

The Commission noted this paper.

#### **5. Strategy**

##### 5.1 Update on process for working with Scottish Water on the price review (CP5-08)

The Commission noted this update.

##### 5.2 Setting Scottish Water's cost of capital (CP6-08)

The Chief Executive highlighted the areas for consideration outlined in the paper. The Commission confirmed its view that Scottish Water faced operational risks broadly similar to those of other water and sewerage companies operating in the UK. It further agreed that it may, however, be appropriate to adjust the allowed for rate of return to reflect differences in the governance framework in Scotland.

Ministers had indicated in their Principles of Charging Consultation, that they did not want to receive a dividend from Scottish Water.

The Commission resolved that Scottish Water should enjoy a similar level of financial strength to non-dividend paying companies, or companies after they had paid their annual dividend. It was provisionally further agreed that an appropriate target level for the financial strength of the company may be at the bottom of the top quartile.

The Commission agreed that it would return to the issue of the cost of capital at its strategy day in May. At that time it would like to meet with Professor Julian Franks of London Business School, to discuss the work completed by the Office.

### 5.3 Scottish Government's consultation on the futures trust (CP7-08)

The Scottish Government's consultation was published prior to Christmas. The Chief Executive explained how the consultation envisaged that the Scottish Futures Trust would raise finance, own assets and lease these back to the public sector organisation; which would be responsible for service delivery.

In the discussion it was noted that:

- a. The Commission should look at the proposals in the light of its statutory duty to set water and sewerage charges on the basis of the lowest reasonable cost;
- b. The Commission's experience in regulating Scottish Water would suggest that the SFT would require a high level of expertise to deliver its remit efficiently. This would involve both procurement and financial expertise;
- c. While there could be some economies of scale in raising finance, different organisations would have different risk profiles and borrowing for the generality of projects may actually disadvantage the Scottish Water Industry. Lending to Scottish Water may be much less risky than lending to other public bodies.

The Commission agreed that the Scottish Futures Trust could potentially benefit the Commission in its work. It would respond to the

Consultation. The Chief Executive was asked to revise the draft paper in line with the discussion.

**Action:**

- 5.4 Scottish Government's consultation on the principles of charging (CP8-08)

The Commission was asked whether it wished to respond to the Scottish Government's Principles of Charging Consultation.

The Commission recognised the importance of the Scottish Government's role of policy on the unwinding of cross-subsidies. It concluded that it should reply to the Consultation.

The paper was approved by the Commission subject to some drafting points.

**Action:**

- 5.5 Letter to the Minister on the gilts buffer (CP9-08)

This letter was agreed.

**Action:**

**6. Competition**

- 6.1 Standard agreement for trade effluent services provided by SW to licensed providers (CP11-08)

The Commission approved this paper and its recommendations and delegated authority to the Chief Executive.

**Action:**

- 6.2.1 OFWAT's consultation on competition (CP11-08)

The Commission noted this paper.

- 6.2.2 Issues arising from OFWAT's consultation on competition (CP12-08)

The Commission agreed that common carriage could lead to de-averaging of charges. It noted that most of the benefits of common carriage could be avoided without requiring de-averaging if a buy/sell model was adopted. The buy/sell model ensures that environmental costs and social issues could remain within the network.

This paper was noted by the Commission.

6.3 Joint working with OFWAT on accounting separation and issues arising (CP13-08)

This paper was noted by the Commission.

6.4 Update on Schedule 3 (CP14-08)

The Commission approved the draft methodology for an appropriate wholesale charge to be set for each Schedule 3.

6.5 Revisions to the wholesale charges scheme (CP15-08)

Commission agreed to the three recommendations outlined in this paper.

6.6 CMA technical panel minute and actions (CP16-08)

The Commission noted the work of the Technical Panel and looked forward to regular updates from the Chief Executive of the CMA

The Chief Executive advised that Commission was due to resign as a member of the CMA as soon as practicable. This would occur once CMA had been able to recover the VAT on set-up costs that had been incurred by the Commission before the incorporation of the CMA.

## 7. Investment

7.1 Update on Scottish Water's investment performance (CP17-08)

The Commission had requested monthly information on Scottish Water's investment performance. This would comprise of an oral update at the Commission meeting of progress in the previous month. There would also be a written analysis of progress provided at the next meeting. This timetable was dictated by Scottish Water's internal collection of information on the delivery of its investment programme.

The Commission noted that close monitoring of the delivery of Scottish Water's investment programme should continue.

7.2 Update on the Outputs Monitoring Group (CP18-08)

The Commission noted this paper.

The Commission stressed the importance of quality regulators' sign-off that an output had been delivered.

The Commission also noted the establishment of Quality and Standards 3B Working Group.

**Action:**

7.3 Update on UIDs (CP19-08)

The Commission agreed Stage 4 approval for the five catchments as outlined in the paper.

It was noted that the average cost for each UID was below the original cost outlined in the SRC.

**Action:**