

**Minute of the fourth meeting of the Water Industry Commission for  
Scotland  
Held on 13/14 September 2005 in Edinburgh and Stirling**

In attendance

Commission: Sir Ian Byatt (Chairman)  
Professor David Simpson (Deputy Chairman)  
Professor John Banyard  
Mr Charles Coulthard  
Mr Alan Sutherland (Chief Executive)

Miss Harriet Towler

Apologies for absence: Dr Michael Brooker  
Mrs Katherine Russell (Secretary to the  
Commission)

**Chairman's opening remarks**

The Chairman welcomed everyone to the meeting, and on behalf of the Commission, expressed his sympathies to the Secretary of the Commission on her recent family bereavement.

**Agreement of minutes of 8/9 August 2005**

The Commission agreed the draft was an accurate account of the meeting of 8/9 August 2005.

**Update on current issues**

The Commission was updated on recent developments. It was noted that one of the sources that had been used in the Draft Determination, a report by Faber Maunsell, had been resubmitted to the Office. Following discussion of the changes made in this later iteration of the report, the Commission concluded that they were not likely to have a material effect on the conclusions reached in the Draft Determination.

Meetings had recently been held with SEPA and the DWQR to discuss the Strategic Review. The Commission welcomed the opportunity to work closely with the quality regulators to ensure the efficient delivery of Scottish Water's proposed investment programme.

The Commission was informed of meetings which had been held with members of Scottish Water's Executive team when the Commission had visited Scottish Water.

The Commission discussed recent meetings which members had attended with other regulatory bodies and relevant organisations. Meetings since the Commission last met had been held with Meryll Lynch, Department for Regional Development and the Water Service in Northern Ireland, Northern Ireland Authority for energy regulation, Postcomm and Dwr Cymru. It was noted that these meetings had been valuable and provided an opportunity to discuss issues which would be relevant to the economic regulation of the Scottish water industry such as the role of incentive mechanisms.

Future meetings were planned with ING Barings, AWG Ltd, Southern Water and the OFT. The Commission agreed that in addition to meeting the OFT in London, it would also be valuable to arrange a meeting with OFT representatives in Scotland.

### ***Action***

The Commission agreed the establishment of a Remuneration Committee. In addition to Sir Ian presiding as Chairman of the Committee, Professor Simpson and Professor Banyard agreed to join the Committee. It was agreed that the Remuneration Committee would decide the remuneration of senior members of staff, and consider the conclusions of the independently conducted pay review of the Office. The Committee would also work to establish general principles which could be applied to the remuneration policy of all staff. The Chairman invited the Chief Executive to present any matters he believed were of importance to the Committee for their consideration.

### ***Action***

The Water Customer Consultation Panels (WCCP) had recently held their annual conference. Professor Simpson had been invited to speak at the conference, accompanied by the Secretary to the Commission. The Commission noted that it was important that the Office and the WCCP should continue to work closely to promote the interests of the customers of the Scottish water industry.

The Chief Executive updated the Commission on the progress that had been made since the last Commission meeting on licensing. The Chief Executive noted a detailed project plan with clear deliverables and allocation of responsibilities had been produced.

### **Outstanding administrative issues**

The Commission approved a finalised Code of Conduct, this Code will be placed on the "Water Commission" website and made publicly available. The Commission were also updated on the progress that had been made on the draft Rules of Procedure. Comments and suggestions made by the Commission would be incorporated and a second draft issued to the Commission once it had been completed by Shepherd+ Wedderburn. Members would be advised of a deadline by which further comments should

be received. Commission members would also be asked to complete a Register of Interest. This would be issued to members shortly.

***Action***

**Corporate Plan 2006-10**

The Commission approved a draft of the plan, including the structure of the Office and proposed budget. The Commission asked that the Chief Executive ensure that there was sufficient funding to ensure that the Office could explain its role. The Commission also sought confirmation that budgets were consistent with all potential costs. It was agreed that the plan should accurately reflect the unique nature of the role of the Commission (including the Office as a whole) and their unprecedented responsibilities in the new regulatory framework - for instance, licensing the non-household retail market. It would be important that these relatively new concepts were clearly translated into actions in the plan.

Members of the Commission were informed that an independent review of the structure of the Office was being concluded. The final version of the corporate plan would reflect the conclusions of this Review.

It was agreed that additional resources would be required within the present administrative function of the Corporate Affairs team.

***Action***

**Strategic Review of Charges 2006-10: Final Determination**

The Commission reviewed and approved the proposed structure for the Final Determination and the timetable for its completion. It was agreed the Final Determination should accurately present representations on the Draft Determination and clearly address the issues they raised, before presenting the final conclusions of the Commission.

Key issues for the Final Determination would be discussed by the Commission at the following meetings:

- Today's meeting – financial ratios
- 28/29 September – customer revenue
- 3/4 October – operating expenditure
- 19/20 October – capital expenditure

It was also agreed that members would keep 24/25 October free as a contingency should Professor Banyard be unable to attend the planned meeting on 19/20 October (due to a prior commitment). Members of the Commission absent from today's meeting would be informed of this possible date change.

***Action***

By 4 November, the Commission will receive a comprehensive draft of the Final Determination. A meeting will be held with the Commission's QC to discuss the draft on 10 November.

### **Final Determination: the initial RCV and financial ratios.**

The Chief Executive explained the role of the initial RCV and financial ratios in the Draft Determination and the process that had been used to derive them. He noted that financial ratios had been an important cornerstone of the Draft Determination. The Draft Determination proposed that Scottish Water should be compliant with these ratios by the end of the 2006-10 regulatory period if Scottish Water met the capital expenditure and operating cost targets set out in the Strategic Review. It was noted that whilst ensuring compliance meant that charge limits would be marginally higher in the 2006-10 period than could otherwise have been achieved, non-compliance would require much larger increases in charge limits in future periods (no matter what level of investment was required – the higher that level of investment the greater the required increases in charges).

The Chief Executive noted that the next stage in the process had been to determine an appropriate rate of return on the RCV. The overall rate of return was justified based on real interest rates since Bank of England independence and the Scottish Executive commitment to make public borrowing available. The Draft Determination also made a full allowance for embedded debt. The draft allowed the pre-tax return on the unleveraged component of the RCV to be equal to the post-tax return on outstanding debt. This ensured that Scottish Water had no incentive to seek to change its capital structure.

Once compliance with financial ratios had been agreed, and a rate of return established, it was then possible to establish an initial RCV for Scottish Water which was consistent with delivering Ministers' objectives at the lowest overall reasonable cost.

The Commission agreed that, subject to representations, this was a prudent approach, and that compliance with financial ratios should also be a cornerstone of the Final Determination.

The Commission stated that it was determined to maintain a position of financial viability for Scottish Water, and that to do otherwise would be irresponsible. The Commission recognised that in future regulatory control periods, capital expenditure commitments could increase, and that future public expenditure limits could be uncertain.

### **Future agenda items**

The Commission agreed that future meetings should include discussion of the framework for retail competition and the role of concurrent powers. It was

agreed the latter should be discussed, if possible, before members met with the OFT.

***Action***