

**Minute of the fortieth meeting of the Water Industry Commission for
Scotland**

Held on 2 September 2008 in Stirling

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)
Mrs Donna Very
Mr Richard Khaldi (Analyst) (item 6)
Mr Ian Tait (Director of Investment) (item 7)
Mr John Simpson (Director of Analysis) (items 8 and 9)

Chairman's opening remarks

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

1. Apologies for absence

Nil

2. Minute of previous meeting and review of action points

2.1 Minute of last meeting (06/08)

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

2.2 Review of action points (AP60/08)

The Commission noted it was in a satisfactory position.

3. Update on current issues

3.1 Working with stakeholders

3.2 Other current issues

The Chief Executive met with Ofwat to discuss its consultation on competition issues.

The Chief Executive attended the Cave Review Session at Warwick University. WICS also responded to the Cave review. The Chairman reported that he had met with Professor Martin Cave and his associate Alex Skinner.

The Chief Executive reported that Mr Tony Kelly, Managing Director of Yarra Valley Water, Australia had visited the WICS office.

The Chairman reported that he had met with Mr Ronnie Mercer from Scottish Water. He had also held discussions with Stewart Stevenson MSP, Minister for Transport, Infrastructure & Climate Change on schedule 3 issues.

3.3 Update on the Central Market Agency (CMA)

The Commission noted the written update provided by Dr Jeremy Atkinson, Chief Executive of the CMA, and thanked him for attending the Commission meeting.

The Commission noted that it looked forward to meeting with the CMA Board later that evening.

4. Corporate Affairs

4.1 Update on the office workplan and strategy for the price review (CP94/08)

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

4.2 Update on framework contracts (CP95/08)

The Commission welcomed the improvements made to the report in its management of framework contracts.

4.3 Update from Audit Committee (CP96/08)

The Chairman of the Audit Committee, Mr Coulthard, provided the Commission with an update from the Audit Committee meeting held in July. Mr Coulthard reported that whilst the Audit Committee is working effectively, some improvements were required to bring it in line with Scottish Government procedures.

The Commission agreed all recommendations set out in this paper.

4.4 Update on management accounts (CP97/08)

The Commission noted this paper.

5. Visit of Stewart Stevenson, MSP

Stewart Stevenson MSP, Minister for Transport, Infrastructure and Climate Change visited the Commission with Mr John Mason, Head of Climate Change and Water Industry and Environmental Quality Directorates and Bob Irvine, Scottish Government. The Commission welcomed Mr Stevenson and thanked him for his time. Mr Stevenson had lunch with all staff.

6. Competition

6.1 Update on licensees (CP98/08)

Mr Khaldi provided an oral update on licence providers.

Mr Khaldi had met with Mr David Cooke from Osprey on 2 September. Mr Cooke advised that Osprey intended to participate actively in the market and had won its first customer, Ladbrokes.

Mr Khaldi reported that Ondeo had completed the Central Market Agency assurance process.

Mr Khaldi confirmed that the revocation of Aquavitae's licence had taken effect on 2 September. No appeal was received from Aquavitae.

The Commission noted this paper and were pleased with progress being made by Osprey and Ondeo. The Commission also noted that the revocation process had worked effectively.

6.2 Update on communication strategy (CP99/08)

The Commission noted this paper and expressed its satisfaction with the progress being made.

6.3 Update to market framework (CP100/08)

Mr Khaldi reported that although the process to revoke Aquavitae's licences had worked effectively, the experience had brought to light some minor changes that could be made to improve the market framework further.

The Commission noted this paper and requested an update at the October meeting.

7. Investment

- 7.1 Oral update on investment delivery
- 7.2 Update on investment progress (CP101/08)

Mr Tait provided the Commission with an oral update on Scottish Water's investment delivery. Mr Tait reported that although there had been some improvement in the overall delivery position, sign-off of completed projects remains behind target.

The Commission noted these updates and were pleased to see that the quality of information being provided by Scottish Water has improved.

- 7.3 Financing Scottish Water's duty on sustainability (CP102/08)

The Chief Executive updated the Commission on its responsibilities in relation to Scottish Water's sustainable development. The Commission noted that Scottish Water has a statutory duty to have regard to issues of sustainable development, and in doing so, have regard to any guidance or objectives set by Ministers. The Commission has a statutory duty to ensure Scottish Water is financed to deliver any ministerial objectives, in this and in other areas at the lowest overall reasonable cost.

The Commission noted this paper.

- 7.4 Key messages – Investment Report (CP103/08)

The Commission considered the key messages outlined in this paper.

The Commission approved these key messages.

8. Strategy

- 8.1 Process on setting cost of capital (CP104/08)
- 8.2 Draft paper on assessing the cost of capital (CP105/08)

The Commission discussed the issues raised in setting the cost of capital for a public entity such as Scottish Water. The Commission agreed that their preferred option is to set prices based on Scottish Water's financial strength compared with the companies in England and Wales (after they had paid any dividends to their shareholders). The Commission agreed that it would be more appropriate for Scottish Water to work to cash-based financial ratios.

The Commission considered the evidence presented on how consistent this approach is with approaches taken by other regulators.

It agreed that Scottish Water and its customers were neither advantaged nor disadvantaged by the choice of approach to setting the cost of capital.

8.3 Strengthening regulatory framework and adapting to take account of 2005 Act (CP106/08)

The Chief Executive outlined a proposal to strengthen the current framework by introducing accounting separation for Scottish Water's wholesale business.

The Commission agreed that further work should be done in this area. A scoping document will be used to quantify the detailed work before seeking final approval from the Commission.

8.3.1 Section 25 Legal Advice (CP107/08)

The Commission noted this paper.

9 Customer Service Report

9.1 Key messages – Customer Service Report 2007-08 (CP108/08)

The Commission approved the key messages proposed.

9.2 Company Business Plans – Key numbers (CP109/08)

The Commission noted this paper with interest.